

Directorate of Distance Education

**UNIVERSITY OF JAMMU
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**Self Learning Material
M.A. POLITICAL SCIENCE**

SEMESTER III

COURSE NO.: POL-304

INTERNATIONAL POLITICAL ECONOMY

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M.A. POLITICAL SCIENCE

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Printed at : S. K. Printing Press / 2021 / Qty. 1000

M.A. POLITICAL SCIENCE, SEMESTER III

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M.A. Political Science, Semester III, Course No. 304, International Political Economy

UNIT – I: CONCEPT AND EVOLUTION

**1.1 INTRODUCTION TO INTERNATIONAL
POLITICAL ECONOMY: HISTORY,
CHARACTERISTICS AND RELEVANCE**

- V. Nagendra Rao

STRUCTURE

1.1.0 Objectives

1.1.1 Introduction

1.1.2 History of Political Economy

1.1.3 Political Economy: Definitions

1.1.4 Political Economy: Characteristics

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1.1.8 Let us Sum Up

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1.0 OBJECTIVES

After going through this lesson, you should be able to:

- understand the history of political economy;
- know the meaning of political economy and definitional diversity;
- understand the major characteristics of political economy;
- comprehend the nature and focus of international political economy (IPE);
- know the relevance of IPE for the students of international relations.

1.1 INTRODUCTION

How does politics affect economic outcomes? This question is serious concern for numerous people ever since they developed an interest towards understanding the role economic factors play in politics. From Adam Smith's *Wealth of Nations* in 1776 until at least John Stuart Mill's *Principles of Political Economy* in 1848, what we now call 'Political Science' was in fact generally referred to as 'political economy'. This terminology in large part reflects the belief that politics was not really separable from economics. This was more than an administrative classification of disciplines; it arose from the widespread view that political factors are crucial in determining economic outcomes or vice versa.

Political economy begins with the political nature of decision-making and is concerned with how politics will affect economic choices in a society. In the Political Science literature politics is defined as the study of power and authority. Power, in turn, means the ability of an individual or a group to

achieve outcomes which reflect his objectives. However, questions of power and authority are relevant only when there is heterogeneity of interests, that is, a conflict of interests between the economic actors in a society. How then does a society make collective policy decisions that affect it as a whole when individual members have conflicting interests? How do individuals, classes, or groups within a larger society gain power or authority attempt to have the societal choice reflect their preferred course of action? Politics may be thought of generally as the study of mechanisms for making collective choices. Asking how power or authority are attained and exercised can be thought of as a specific form of the general question of what mechanisms are used to make collective decisions. Hence, studying the exercise of power in making collective decisions in the backdrop of conflicting interests is the core of political economy studies. This can be carried out at local, regional and global level, by observing multiple dimensions of society, polity, history, economy, etc.

In short, Political Economy most commonly refers to interdisciplinary studies drawing upon Economics, Political Science, Law, History, Sociology and other disciplines in explaining the crucial role of political factors in determining economic outcomes. Further, political economy is an area of study that permits a variety of ideological perspectives and theoretical paradigms. The academic return to political economy is especially encouraged by the growing interest in interdisciplinary studies.

This lesson introduces political economy in general and International Political Economy (IPE) in particular 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 lesson 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 international economy.

1.2 HISTORY OF POLITICAL ECONOMY

Political economy took shape as a separate discipline during the formative period of capitalism. The term ‘political economy’ was first used in France in the early seventeenth century. Until that juncture, economy or economics were traditionally referred to the household management. However, with the growth of trade and commerce during the seventeenth century, new and important schools of economic thought began to emerge in Western Europe which attempted to understand the operation of the economy not of the single household but the entire nation-state. Monarchs and statesmen who were preoccupied with nation-building began to get concerned with the nature, reproduction and distribution of the wealth of nations and the effective management of the state of affairs so that the wants of the population could be addressed.

In his seminal enquiry into the nature and causes of the wealth of nations, Adam Smith defined political economy as a “branch of the science of statesman or legislature” whose twin and distinct objectives were “first, to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly, to supply the state or commonwealth with a revenue sufficient for the public services. It proposes to enrich both the people and the sovereign”. As a consequence, political economy became the term that was used to refer the management of the affairs of the state, as opposed to the economics of the household. Indeed, the ensuing debate over the appropriate role of state in the development of the market economy remained to be the central debate within the discipline of political economy ever since. In the mid-19th century Karl Marx proposed a class-based analysis of political economy that culminated in his massive treatise *Das Kapital*, the first volume of which was published in 1867.

However, the holistic study of political economy that characterizes the works of Smith, List, Marx, and others of their time was gradually eclipsed in the late 19th century by a group of more narrowly focused and

methodologically conventional disciplines, each of which sought to throw light on particular elements of society, inevitably at the expense of a broader view of social interactions. As result, political economy as a distinct academic field had been essentially replaced in universities by the separate disciplines of economics, sociology, political science, and international relations.

In the second half of the 20th century, as the social sciences (especially economics but also political science) became increasingly abstract, formal, and specialized in both focus and methodology, political economy was revived to provide a broader framework for understanding complex national and international problems and events. The field of political economy today encompasses several areas of study, including the politics of economic relations, domestic political and economic issues, the comparative study of political and economic systems, and international political economy. The emergence of international political economy, first within international relations and later as a distinct field of inquiry, marked the return of political economy to its roots as a holistic study of individuals, states, markets, and society.

Following the end of Cold War, international political economy became focused on issues raised by economic globalization, including the viability of the state in an increasingly globalized international economy, the role of multinational corporations in generating conflict as well as growth in the “new global economy,” and various problems related to equity, justice, and fairness (e.g., low wage rates in developing countries and the dependency of these countries on markets in wealthier countries).

1.3 POLITICAL ECONOMY: DEFINITIONS

A dictionary of economic terms tells us that “political economy is the science of wealth” and “deals with efforts made by man to supply wants and satisfy desires”. Before political economy became a science, before it served as the intellectual description for a system of production, distribution, and exchange, political economy meant the social custom, practice, and

knowledge about how to manage, first, the household, and later, the community. Specifically, the term 'economics' is rooted in the classical Greek *oikos* for house and *nomos* for law. Hence, economics is initially referred to household management. 'Political' derives from the Greek term (*polis*) for the city-state, the fundamental unit of political organization in the classical period. Political economy therefore originated in the management of family and political households. Stuart aptly made the connection by noting that "What economy is in a family, political economy is in a state".

It is also important to note that from the very beginning, political economy combined a sense of the descriptive and the prescriptive. This is in keeping with the *Dictionary of Economic Terms*, which defined the original intent of political economy as a "branch of statecraft", but which is now "regarded as a study in which moral judgments are made on particular issues".

Other definitions concentrate on how the development of economics narrowed what was originally an encompassing discipline. As early as in 1913, a standard economic dictionary noted that "although the name political economy is still preserved, the science, as now understood, is not strictly *political*: i.e., it is not confined to relations between the government and the governed, but deals primarily with the industrial activities of individual men". Similarly, in 1948, the *Dictionary of Modern Economics* defined political economy as "the theory and practice of economic affairs" and noted that: "Originally, the term applied to broad problems of real cost, surplus, and distribution. These questions were viewed as matters of social as well as individual concern. With the introduction of utility concepts in the late nineteenth century, the emphasis shifted to change in market values and questions of equilibrium of the individual firm. Such problems no longer required a broad social outlook and there was no need to stress the political".

However, most of the literature accepted the main focus of the political economy as that of organization of economic relations in a political state. Drawing upon the ways of seeing political economy, which emphasize that definitions are grounded in social practice and evolve over time in intellectual

and political debate, one can think about political economy as the study of *the social relations, particularly the power relations, that mutually constitute the production, distribution, and consumption of resources*. Political economy asks us to concentrate on a specific set of social relations organized around **power** or the ability to control other people, processes, and things, even in the face of resistance. This would lead the political economist to look at shifting forms of control along the circuit of production, distribution, and consumption.

A far more general and ambitious definition of political economy is *the study of control and survival in social life*. Control refers specifically to the internal organization of individual and groups members, while survival takes up the means by which they produce what is needed to reproduce itself. Control processes are broadly political in that they involve the social organization of relationships within a community. Survival processes are fundamentally economic because they concern the production of what a society needs to reproduce itself. The strength of this definition is that it gives political economy the breadth to encompass at least all of human activity and arguably all organic processes. This is in keeping with the pattern of analysis in environmental, ecological, and science studies which, among other things, aim to identify processes at work in all forms of life and to assess their differences and interrelationships.

1.4 POLITICAL ECONOMY: CHARACTERISTICS

Definitions are useful but they take us just so far. Another way to describe political economy is to focus on a set of central qualities that characterize an approach. These broaden the meaning of political economy beyond what is typically provided in definitions. Drawing on the major works of political economy, this section focuses on four characteristics or cornerstone of political economy: *social change* and *history, the social totality, moral philosophy, and praxis*.

1.1.4.1 Historical Transformation

Political economy has traditionally given priority to understanding social change and *historical transformation*. For classical theorists like Adam Smith, David Ricardo, and John Stuart Mill, this meant comprehending the great capitalist revolution, the upheaval that transformed societies primarily based on agriculture labour into commercial, manufacturing, and, ultimately, industrial societies. For political economists like Karl Marx, it meant the examination of dynamic force in capitalism that was primarily responsible for its growth and change. The objective was to identify both cyclical patterns of short-term expansion and contraction as well as long-term transformative patterns that signal fundamental change in the system.

The Canadian political economist Wallace Clement captures this theme in setting out a clear vision for history in political economy: “It is fundamentally historical and dynamic in the sense of seeking understanding of the social transformations, including the agents and forces of change”.

However, the triumph of history in the discipline is too much optimistic. History would remain central to political economy but the neoclassical synthesis, which became mainstream economics, set history aside or at least kept it in the background. This was chiefly because history made all the more difficult the drive to turn economics into a science.

1.4.2 Social Totality

Political economy, from the time of its origin has also maintained that the discipline should be firmly rooted in an analysis of the wider *social totality*. This means that political economy spans the range of problems that today tend to be situated in the compartments of several academic disciplines where those with an interest in social class go to sociology, those interested in government to political science, in the market to economics, and so on. From the time of Adam Smith, whose *Wealth of Nations* knew no disciplinary boundaries, political economy has been taken up with the mutual constitution and multiple determination of social life. Early in the development of political

economy Mill described the necessity of a broad approach to social life: “For practical purposes, Political Economy is inseparably intertwined with many other branches of Social Philosophy. Except on matters of mere detail, there are perhaps no practical questions which admit being decided on economical premises alone”. Like many political economists, Mill is interested in using political economy as one means of understanding the social whole, even while acknowledging that his own approach is interconnected with the other branches of what he calls Social Philosophy. From this perspective, political economy is not just another approach. It is also a guide to understanding the relationships that prevail among numerous approaches and to the relationships among many aspects of social life. As Heilbroner puts it, “the great economists were no mere intellectual fustians. They took the whole world as their subject and portrayed that world in a dozen bold attitudes – angry, desperate, hopeful.”

First and foremost, a commitment to the social totality means understanding the connections between the political and the economic. But making use of the social totality does not require essentialism or reductionism of thought. In fact, as Marx reminds us, dialectical thinking leads us to recognize that reality is comprised of both the parts and the whole, organized in the concrete totality of integration and contradiction that constitute social life.

1.4.3 Moral Philosophy

Moral philosophy provides the third characteristic to the political economy approach. Moral philosophy refers to social values and conceptions of appropriate social practices. The goal of this particular form of analysis is to clarify and make explicit the moral positions of economic and political economic perspectives, particularly because moral viewpoints are often masked in these perspectives.

In their overview of the political economy of communication, Golding and Murdock maintain that, what distinguishes critical political economy is that “perhaps most importantly of all, it goes beyond technical issues of

efficiency to engage with basic moral questions of justice, equity and the public good.” These are examples from across the spectrum of perspectives in economics and political economy that suggest some unease with what has become the customary practice of separating science from morality. Their interest in moral philosophy reflects a central concern of some of the founding figures in political economy.

1.4.4 Praxis

The fourth characteristic of a political economy approach is praxis, an idea with deep roots in the history of philosophy and one which has found several paths to many enquiries, including Marxian theory, the Frankfurt School of critical thought, and the “action-research” tradition best embodied in sociology. Most generally, praxis refers to human activity and specifically to the free and creative activity by which people produce and change the world, including changing themselves. The word originates in the ancient Greek where it typically referred to the political and business activities of free men.

Praxis came to occupy a central place in the work of the philosophers Kant, Hegel, and Marx. For Kant, praxis or practical reason takes primacy in the unity with theory that comprises full reason. Indeed, morality is defined as “absolutely practical.” Hegel also recognized the superiority of praxis to theory, but looked to a higher unity for truth to be found in freedom where the absolute spirit realizes itself in philosophy, the arts, and religion. Marx was concerned with praxis from his earliest work, a doctoral dissertation on Greek philosophy, which insisted that philosophy be made practical. His principal interest in the term was to create an alternative to alienated labour. In Marx’ view, capitalism freed labour from the alienation of necessity only to replace it with a new form of alienation – the reduction of labour power to a marketable commodity. The revolutionary goal was to transform alienated labour into praxis or free, universal, self-activity.

In brief, praxis guides a theory of knowledge to view knowing as the

ongoing product of theory and practice. It rejects as partial those epistemologies which conclude that truth can only result from contemplation. Knowledge requires more than a process of purifying conceptual thought. Rather it grows out of the mutual constitution of conception and execution. Praxis has also occupied an important place in the substantive development of political economy. After all, political economy began as the practical activity of household management and control of the polis. Aristotle placed it among the practical disciplines whose wisdom would guide the conduct of rulers.

1.5 INTERNATIONAL POLITICAL ECONOMY (IPE)

What is International political economy (IPE)? In simple terms, IPE can be defined as an analytical effort to break down the barriers that separate and isolate the disciplines of politics, economics, and sociology and their methods of analysis, seeking a comprehensive understanding of mainly international, if not global, issues and events.

The world is a complicated place characterized by tremendous amount of interdependence (interconnectedness) among individuals, social groups, nation-states, and a variety of other actors in the international system. As a reflection of this reality, in one sense IPE represents a return to the kind of analysis done by political theorists and social scientists before the study of human social behaviour became fragmented into the discrete fields of Economics, Political science, and Sociology, supported by History and a certain amount of Philosophy. In an academic world filled with analytical boundaries that enclose disciplines and limit interaction, Susan Strange, who helped establish the modern study of IPE at the London School of Economics and Politics, suggests that IPE represents a return to the idea that until the twentieth century was "... a vast, wide open range where anyone interested in the behaviour of men and women in society could roam just as freely as the deer and the antelope. There were no fences or boundary-posts to confine the historians to history, the economists to economics. Political scientists

had no exclusive right to write about politics, nor sociologists to write about social relations”.

From her attempts to create a new synthesis, Strange defined the new discipline of IPE as being concerned with “the social, political and economic arrangements affecting the global systems of production, exchange and distribution, and the mix of values reflected therein”. Perhaps Strange’s most important contribution was to remind IPE students that political economy is inextricably concerned with the nature and exercise of POWER, be it economic or political or both. Thus, not only should IPE identify where authority is located in a particular context and who has exercised power, but also ask why and whether that individual, public institution or private corporation should possess such power.

From this perspective, Strange was able to develop an approach to IPE which has asserted that while relationship to power has remained important to the study of political economy, it has been increasingly displaced by the exercise of structural power, where structural power is the “power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprise and (not least) their scientists and other professional people have to operate”.

For Strange, structural power emanates from those with the capacity to exercise “control over security; control over production; control over credit; and control over knowledge, beliefs and ideas”. As a consequence, the legitimate field of enquiry for IPE should include not only political economy’s traditional concern with the economics of production and finance, but also extend to a detailed analysis of the implications of security issues and intellectual property on the development of the market.

More recently, Geoffrey Underhill has defined IPE as an exploration of the interactive relationships “between domestic and international levels of analysis; between economic issues and political conflict; and between institutional patterns and economic structures, on the one hand, and the politics that takes place within them, on the other”.

The globalization of late twentieth century has also tremendously contributed to the growth of International Political Economy as an important discipline across the globe. Over the past several centuries, the interdependence of national economics has increased due to greatly enhanced flows of trade, finance, and technology.

It is suffice to say that, in today's complex world, the most important issues we all face have an international or multinational aspect to them that is best understood through an integrated study drawing on a variety of tools and analytical perspectives. Rowland Madoock puts it in a slightly different way: "... international political economy is not a tightly defined and exclusive discipline with a well-established methodology. It is more a set of issues, which need investigating and which tend to be ignored by the more established disciplines, using whatever tools are at hand".

1.6 RELEVANCE OF POLITICAL ECONOMY

One way to understand the nature of IPE is to pick apart its name. First, IPE is international in scope, meaning that it deals with issues that cross national boundaries and with relations between and among nation-states. Increasingly today, people talk about a global political economy because more and more problems and issues affect the whole world, not just a few nations, and require a universal perspective and understanding.

Most importantly, IPE is about the economy or economics, which means that it deals with how scarce resources are allocated for different users and distributed among individuals, groups, and nation-states through the market process, which is sometimes decentralized and other times quite centralized or controlled. Though economic, political, and social analyses often look at the same questions, but economic analysis focuses less on issues of state power and national interests and more on issues of income, wealth, and individual interests.

IPE also focuses on issues with a multidimensional outlook, related to the effects of society and culture on politics and economics. IPE does not

exist in social vacuum. The social forces associated with class, ethnic, religious, and other cultural groups, along with their different beliefs and values, must also be considered in the IPE analytical formula. Likewise, the state, economy, and society are also affected by the historical development of important events and issues that cannot be ignored. IPE, then, attempts to understand the complex interaction of real people in the real world, along with their attitudes, emotions, and beliefs.

1.6.1 Nature of IPE: Analytical, Normative and Prescriptive

When it comes to treatment of issues, International Political Economy is neither an objective, value-free science, nor a detached, ivory tower, purely academic debate about the relationship between states and markets. On the contrary, it is an inherently normative and practical discipline which “consists of prescription rather than description; although, since it is concerned with practice, its recommendations make use of what aspires to be a scientific examination of the results of action rather than wishful thinking regardless of consequences”.

Susan Strange states that IPE must be closely concerned with causes so as to be able to explain the consequences today for individuals, states and corporations of events in the past. Therefore, IPE must be sensitive both to the political and economic history of contemporary events, and also to the future possibilities for remedying today’s problems. IPE must therefore encompass not only a reflective, analytical approach to discover what has happened and why, but also a normative, prescriptive approach, thereby identifying what should happen.

The issue pervading the subject of international political economy is the relationship between economic change and political change. What are the effects on international political relations and what problems are associated with structural changes in the global focus of economic activities, leading economic sectors, and cyclical rates of economic growth? And, vice versa, how do political factors affect the nature and consequences of structural

changes in economic affairs? It is also necessary to ask whether or not economic instabilities are the cause of profound political upheavals such as imperialist expansion, political revolution, and the great wars of the past several centuries.

Political economy thus concerned with the effects of economic changes on international political relations. These economic changes undermine the international status quo and raise profound political problems. What will be the new basis of economic order and political leadership? Can or will adjustment to the changed economic realities, for example, new trading and monetary relations, take place? How will the inevitable clash between the desire of states for domestic autonomy and the need for international rules to govern change be reconciled? It is important to probe the relationship between these structural changes and the crisis of the international political economy.

Apart from this, the IPE also deals with the influence of world market economy on domestic economies, its consequences in the economic development, economic decline, and economic welfare of individual societies. Further, it deals with the questions like, how does the world market economy affects the economic development of the less developed countries and the economic decline of advanced economies? What is its effect on domestic welfare? How does it affect the distribution of wealth and power among national societies? Does the functioning of the world economy tend to concentrate wealth and power, or does it tend to diffuse it?

In short, international political economy (IPE) studies how politics shape developments in the global economy and how the global economy shapes politics. It focuses very 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 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.

1.6.2 Issues of Focus

One way scholars simplify the study of the international 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.

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? How does politics shape societal decisions about how to allocate available resources? For example, how does a society decide whether to use available labour 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. 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.

The second abstract question is that; 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.

1.7 WHY WE STUDY IPE?

Students should study international political economy for at least three reasons—because IPE is important, useful, and interesting.

IPE is Important. IPE makes the front pages every day because many events affect us all as citizens of the world, residents of particular nation-states, and daily participants in societies and systems of markets that are increasingly international, if not global, in nature. It is crucial in today's world, in which events and conditions in one part can strongly affect conditions in other parts, that we analyze these conditions so as to understand what caused them and how they might be managed.

IPE is Useful. Public and private employers increasingly seek out individuals who can think broadly and critically, and who can appreciate the effects of social conditions and alternative values. Real problems require solutions and policies that reflect a comprehensive analysis and understanding of complex and dynamic systems. In a global political economy and society in which so many things influence and affect one another, employers and government officials seek out those who can understand the international and global context of human activity. Indeed, a person needs to understand at least a little of IPE just to be able to make sense of the plethora of information available in the newscasts, in magazines, over the internet, and in other forms of communication. IPE is the social science that most directly addresses these needs.

IPE is inherently interesting. To paraphrase Samuel Johnson, a person who is bored with IPE is bored with life! IPE is all about life and the many actions and interactions that connect human beings around the globe. The study of IPE is an opportunity to study some of the most fascinating issues and questions of the past and present.

1.8 LET US SUM UP

This lesson set the stage for a detailed examination of the political

economy as a broad-based and variegated approach to social analysis. It started with a set of definitions that suggested how political economy developed out of practical questions of household and community management. Following this presentation and assessment of definitions, the lesson took up central characteristics which mutually constitute a political economy approach. These include social change and history, the social totality, moral philosophy, and praxis. Political economy has made use of these from its roots in the thinking of eighteenth-century Scottish Enlightenment philosophy. Their meaning has shifted as they have been tested against a changing world order and challenges from alternative intellectual currents.

In the context of international relations, the central concerns of political economy are the impact of the world market economy on the relations of states and the ways in which states seek to influence market forces for their own advantage. Embedded in this relationship of state and market are three closely related issues of importance to the students of politics. The first is the way in which market interdependence affect and is affected by international politics and in particular by the presence or absence of political leadership. The second is the interaction of economic and political change that gives rise to an intense competition among states over the global location of economic activities, especially the so-called commanding heights of modern industry. The third is the effect of the world market on economic development and the consequent effort of states to control or at least to be in a position to influence the rules or regimes governing trade, foreign investment, and the international monetary system as well as other aspects of the international political economy.

Although the state as the embodiment of politics and the market as the embodiment of economics are distinctive features of the modern world, they obviously cannot be totally separated. The state profoundly influences the outcomes of market activities by determining the nature and distribution of property rights as well as the rules governing economic behaviour. People's growing realization that the state can and does influence market forces and

thereby significantly determines their fate is a major factor in the emergence of international political economy. The market itself is a source of power that influences political outcomes. Economic dependence establishes a power relationship that is a fundamental feature of the contemporary world economy. In brief, although it is possible to regard politics and economics as distinct forces creating the modern era, they do not operate independently of one another.

Thus the future of IPE would appear to reside with a multidimensional approach privileging no single moment in the complex interplay of political, economic and cultural factors. This will regard the private, extra-governmental and social spheres as being equally legitimate arenas for exploration as the public, governmental and state spheres. Therefore, the challenge for those preoccupied with domestic political economy is to recognize the international conditions of domestic political and economic dynamics, whereas the challenge for those from an international relations background is to recognize the domestic conditions of international/global political and economic relations.

1.9 EXERCISE

1. Write a note on history of political economy?
2. “What economy is in a family, political economy is in a state”. Elaborate.
3. State the major characteristics of political economy.
4. IPE by its very nature is interdisciplinary. Critically analyse.
5. Write a note on nature and focus of IPE.
6. Why we study IPE?

UNIT – I: CONCEPT AND EVOLUTION

**1.2 TRADITIONAL SCHOOLS OF
INTERNATIONAL POLITICAL ECONOMY:
MERCANTILIST, LIBERAL AND MARXIST,
INCLUDING THEIR CONTEMPORARY TRENDS**

- V. Nagendra Rao

STRUCTURE

- 2.0 Objectives
- 2.1 Introduction
- 2.2 Mercantilism
- 2.3 Liberalism
- 2.4 Neo-liberalism
- 2.5 Marxism
- 2.6 Neo-Marxism
 - 2.6.1 The Frankfurt School
 - 2.6.2 Robert Cox and Neo-Gramscian Perspective
- 2.7 World-System Theory
- 2.8 Let us Sum Up
- 2.9 Exercise

2.0 OBJECTIVES

After going through this lesson, you should be able to know:

- What are the traditional Schools of International Political Economy;
- Mercantilism and its basic premises;
- The basic proposition of liberalism and neo-liberalism;
- The theoretical foundations of Marxism towards political economy;
- The contribution of neo-Marxist theories to understand the twentieth century developments to the global political economy;
- The significance of World-system theory to understand contemporary international political economy.

2.1 INTRODUCTION

Over the past century and half, the theories or ideologies of liberalism and Marxism have divided humanity. Theories based on ideology refer to “systems of thought and belief by which (individuals and groups) explain how their social system operates and what principles it exemplifies”. The conflict among these two moral and intellectual positions has revolved around the role and significance of the market in the organization of society and economic affairs. Through an evaluation of the strengths and weaknesses of these theories it is possible to illuminate the study of the field of international political economy.

These theories differ on broad range of questions such as: What is the significance of the market for economic growth and the distribution of wealth among groups and societies? What ought to be the role of markets in the organization of domestic and international society? What is the effect of the market system on issues of war or peace? These and other similar questions are central to discussion of international political economy.

These theories are fundamentally different in their conception of the relationships among society, state, and market, and it may not be an

exaggeration to say that every controversy in the field of international political economy is ultimately reducible to differing conceptions of these relationships. The intellectual clash is not merely of historical interest. Economic liberalism and Marxism are all very much alive at the end of the twentieth century; they define the conflicting perspectives that individuals have with regard to the implications of the market system for domestic and international society. Many of the issues that were controversial in the eighteenth and nineteenth centuries are once again being intensely debated.

2.2 MERCANTILISM

Mercantilism is the oldest and the most important perspective in IPE. The central focus of mercantilism is the problem of security and the role of the state and the market in providing and maintaining a nation's security. Mercantilism has changed over the years as the economy and the nature of the national security have changed and the tools that can be used to achieve security have also changed. This section traces the history of mercantilism from its origins, from the earlier form of classical mercantilism to its development as economic nationalism, to its contemporary forms as 'neomercantilism'.

Mercantilism is a perspective that accounts for one of the basic compulsions of all nation-states: to create and sustain wealth and power in order to preserve and protect their national security and independence. Wherever you find a concern about foreign threats to security—whether military, economic, or cultural—we will find evidence of mercantilist thought. Typically, mercantilism is defined somewhat narrowly in terms of state efforts to promote exports and limit imports, thereby generating trade surpluses to create wealth and power.

From a mercantilist perspective, the new nation-state had many needs that could be secured through either violent or peaceful means. The threat of war and violence was always real, as the history of European wars makes clear. Territorial security was always considered the first priority of the state,

because efforts to achieve prosperity, justice, or domestic peace were useless if the nation was not protected from foreign invaders or internal groups that might overthrow the state. Security was costly, however. Armies and navies were expensive to raise, equip, and maintain. Along with weapons and other instruments of power, wealth came to be regarded as one of the essential keys to achieve and preserving national security.

Because it bought weapons and financed armies, wealth was viewed as being intertwined with power and part of a *virtuous* cycle in which power generates wealth, which in turn increase power, which in turn leads to more wealth, which makes a nation more prosperous and thus more secure. At the same time, wealth and power were deemed to be part of a *vicious* cycles in which the policies adopted by a monarch or a group of officials to generate and protect their national wealth and security were often perceived to be at the expense of another state. Thus, most government officials viewed state power in terms of *absolute gains and losses*; more power could help protect the state, inadequate power could lead to disaster. The poorer the nation, the weaker and more vulnerable it might appear to be to others. Indeed, many officials felt that this vicious cycle of weakness and poverty, if left unaddressed by mercantilist action to protect the nation-state, would, and often did, lead to disastrous situations such as military defeat, economic bankruptcy, or the destruction of the society—its territory, culture, and language.

For mercantilists, then, gains in economic wealth by one state, which were often perceived as losses by competing states, conferred on mercantilism a **zero-sum** (nobody wins) worldview. Dependency on other states would supposedly weaken a nation-state if imported provisions were cut off. The dependent state might also be vulnerable to the influence and power of the providing state. Therefore, in an increasingly economically competitive and politically hostile environment, states were motivated to generate wealth aggressively, especially through international trade and specifically by generating surpluses, limiting imports, and acquiring gold and silver bullion, much of it from colonies in the new world.

2.3 LIBERALISM

Some scholars assert that there is no such thing as a liberal theory of political economy because liberalism separates economics and politics from one another and assumes that each sphere operates according to particular rules and a logic of its own. This view is itself, however, an ideological position and liberal theorists do in fact concern themselves with both political economic affairs.

There is a set of values from which liberal theories of economic and of politics arise; in the modern world these political and economic values have tended to appear together. Liberal economic theory is committed to free markets and minimal state intervention, although, as will be pointed out below, the relative emphasis on one or the other may differ. Liberal political theory is committed to individual equality and liberty, although again the emphasis may differ. We are primarily concerned here with the economic component of liberal theory.

The liberal perspective on political economy is embodied in the discipline of economics as it has developed in Great Britain, the United States, and Western Europe. From Adam Smith to its contemporary proponents, liberal thinkers have shared a coherent set of assumptions and beliefs about the nature of human beings, society and economic activities. There are many forms of liberalism and all these forms are committed to the market and the price mechanism as the most efficacious means for organizing domestic and international economic relations. Liberalism may, in fact, be defined as a doctrine and set of principles for organizing and managing a market economy in order to achieve maximum efficiency, economic growth, and individual welfare.

The basic notion behind liberalism is that government intervention should be kept to a minimum, emphasizing instead the role of the individual and the primacy of the mechanism of the free market. Three key ideas underlie liberal thought:

1. that there is great value to be derived from the free expression of the individual personality;
2. that such expression can be made valuable both to those who express it and to society, and
3. that institutions and policies that protect and foster both free expression and confidence in that freedom must be upheld.

In contrast to mercantilism, with its strong role for the state, the roots of liberalism lie in the notion that governments can often be too intrusive in a state's economic activity. As a reaction to the prevailing mercantilist thought of the day, liberals argued for the inherent value of the individual and that individuals should be able to take part in economic activity free from the repression of the state. By doing this, liberals believe, a harmony of self-interest between individuals will be achieved. The key mechanism for any liberal is the market. Taking part in market activities is seen as a positive-sum game in which every participant gains.

Economic liberalism assumes that a market arises spontaneously in order to satisfy human needs and that, once it is in operation, it functions in accordance with its own internal logic. Human beings are by nature economic animals, and therefore markets evolve naturally without central directions. As Adam Smith put it, it is inherent in mankind to "truck, barter and exchange". To facilitate exchange and improve their well-being, people create markets, money, and economic institutions.

The rationale for market system is that it increases economic efficiency, maximizes economic growth, and thereby improves human welfare. Although liberals believe that economic activity also enhances the power and security of the state, they argue that the primary objective of economic activity is to benefit individual consumers. Their ultimate defence of free trade and open markets is that they increase the range of goods and services available to the consumer.

The fundamental premise of liberalism is that the individual consumer,

firm, or household is the basis of society. Individuals behave rationally and attempt to maximize or satisfy certain values at the lowest possible cost to themselves. Rationality applies only to endeavour, not to outcome. Thus, failure to achieve an objective due to ignorance or some other cause does not, according to liberals, invalidate their premise that individuals act on the basis of a cost/benefit or means/ends calculus. Finally, liberalism argues that an individual will seek to acquire an objective until a market equilibrium is reached, that is until the costs associated with achieving the objective are equal to the benefits. Liberal economists attempt to explain economic and, in some cases, all human behaviour on the basis of these individualistic and rationalistic assumptions.

Liberalism assumes that a market exists in which individuals have complete information and are thus enabled to select the most beneficial course of action. Individual producers and consumers will be highly responsive to price signals, and this will create a flexible economy in which any change in relative prices will elicit a corresponding change in patterns of production, consumption, and economic institutions; the latter are conceived ultimately to be the product rather than the cause of economic behaviour. Further, in a truly competitive market, the terms of exchange are determined solely by considerations of supply and demand rather than by the exercise of power and coercion. If exchange is voluntary, both parties benefit.

Liberals argue that today the conditions necessary for the operation of a market economy exist, and the normative commitment to the market has spread from its birthplace in Western civilization to embrace an increasingly large portion of the globe. Despite setbacks, the modern world has moved in the direction of the market economy and of increasing global economic interdependence precisely because markets *are* more efficient than other forms of economic organization.

In essence, liberals believe that trade and economic intercourse are a source of peaceful relations among nations because the mutual benefits or trade and expanding interdependence among national economies will tend to

foster cooperative relations. Whereas politics tends to divide, economics tends to unite peoples. A liberal international economy will have a moderating influence on international politics as it creates bonds of mutual interests and a commitment to the status quo.

2.4 NEO-LIBERALISM

As it has evolved over time, the term ‘neo-liberalism’ is usually used by economists to refer to the economic policies pioneered by Chile in the 1970s. Subsequently these reforms spread through most of Latin America in the 1980s and to other parts of the developing world in the late 1980s and early 1990s. In this sense, neo-liberalism emphasizes a policy mix stressing a greater role for the market in the allocation of resources, a much reduced role for the state and increasing integration in the world economy.

The intellectual foundations of modern neo-liberalism stem largely from the writings during the 1950s and 1960s of Friedrich von Hayek and Milton Friedman. In large part, Hayek and Friedman were responding to the emergence of Keynesianism in Western capitalist societies and to the socialism that evolved in the former Soviet Union, China and many other nations following World War II. David Harvey, in his *A Brief History of Neoliberalism*, gives the concept a wide-ranging definition:

Neoliberalism is in the first instance a theory of political economic practices that proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets and free trade. The role of the state is to create and preserve an institutional framework appropriate to such practices. The state has to guarantee, for example, the quality and integrity of money. It must also set up those military, defence, police and legal structures and functions required to secure private property rights and to guarantee, by force if need be, the proper functioning of markets. Furthermore, if markets do not exist (in

areas such as land, water, education, health care, social security, or environmental pollution) then they must be created, by state action if necessary. But beyond these tasks the state should not venture. State interventions in markets (once created) must be kept to a bare minimum because, according to the theory, the state cannot possibly possess enough information to second-guess market signals (prices) and because powerful interest groups will inevitably distort and bias state interventions (particularly in democracies) for their own benefit.

Harvey's suggested definition of neo-liberalism is well suited to accommodate his overall analysis, which includes the firmly held belief that the world has experienced "an emphatic turn towards neo-liberalism in political-economic practices and thinking since the 1970s". Harvey proposes with his definition to view neo-liberalism, not as the rejuvenation of classical liberalism in general, but as a distinctive economic theory which in practice replaced welfare-liberalism.

In the eyes of the neo-liberals, the triumph of democracy and markets over authoritarianism and statist economies was combined with efforts to promote open economies and open policies stressing the necessity of thoroughgoing economic reforms supporting export-led industrialization policies.

The neo-liberal core is based on three important concepts: (1) imperfect information, (2) individual freedom, and (3) the market.

Imperfect Information: Neo-liberals contend that because individuals, in general, and society as a whole have imperfect information about past and present developments and events, any strategy attempting to plan or make policies is irrational and doomed to fail. However, neo-liberals goes further, pointing out that any attempt to plan or construct a society that attempts to go beyond these natural restrictions is dangerous for the existing social order.

Individual Freedom: Neo-liberalism is based on the freedom of

individuals to seek to maximize their preferences and on the primacy of private ownership of property. This apparently natural behaviour is particularly important from an economic viewpoint because it leads to political freedom. Thus, individual economic freedom is the basis for any civilized society and is a direct response to totalitarianism or to any form of economic planning.

The Market: The market is the principal economic and social institution within which individuals adjust their preferences according to price signals, in spite of restrictions on the available information. Hayek and Friedman are aware of the market's limitations, since perfect competition, individual freedom and private ownership, as well as instantaneous price adjustments, depend on perfect information. The concept of 'market' thus becomes utopic and yet is dogmatically defended by the neo-liberal against any form of planning or state intervention.

While numerous economic policies have been encompassed under the rubric of neo-liberalism, in actual practice it is often difficult to separate macro-economic adjustment policies from liberalization measures. The main components of neo-liberalism, in this sense, comprise the following: 1) fiscal adjustment, 2) privatization, 3) decontrolling and/or adjusting prices, 4) decontrol of the financial sector, 5) trade liberalization, 6) incentives to foreign investments, 7) social security reform, and 8) labour market reforms.

To critics, the neo-liberal reforms have simply resulted in one of the following: 1) the rationalization of economic production and distribution on a global scale along the lines of comparative advantage and vast corporate economies of scale; 2) the maximization of the rate of return (that is, profit) on invested capital for transnational banks and corporations and tier stockholders.

2.5 MARXISM

Like liberalism, Marxism has evolved in significant ways since its basic ideas were set forth by Karl Marx and Friedrich Engels in the middle of the nineteenth century. Although Marx viewed capitalism as a global economy,

he did not develop a systematic set of ideas on international relations; this responsibility fell upon the succeeding generations of Marxist writers.

Marx's starting point was human work. However, labour has a deeper significance for Marx than it did for classical liberal political economy. Marx and Engels wrote that "men can be distinguished from animals by consciousness, by religion or anything else you like. They begin to distinguish themselves from animals as soon as they begin to produce their means of subsistence". Social labour is the essence of humankind and the key presupposition of a materialist conception of history. This underpins Marxism's preoccupation with class. Hence, the questions of exploitation, production and distribution have become critical in Marxist theories. To understand any society it is useful first to understand what is produced, how, and by and for whom.

Historical materialism thus begins by attempting to understand the development of relations between what Marx called the 'forces of production', people's capacity to produce, and the 'relations of production'. These last include relations between exploiters and exploited. Marx's critique of political economy, then, understands capitalism as a historically specific mode of production. Exploitation becomes masked by the apparent equity of market relationships. Labour power, the ability to work, is itself reduced to a commodity, which can be bought and sold. Its value, like that of other commodities, is determined by the work needed (to produce the commodities needed) for its reproduction. So in a sense workers do receive a 'fair wage'. Of course, even market relationships between capital and labour are iniquitous; workers have no choice but to work for capital, while capital's ability to draw on a reserve army of unemployed workers leads to low wages. However, the fundamental inequity and exploitation comes in production, as workers can be made to work longer or more intensely than is needed to produce goods equivalent to the value of their labour power. Exploitation in production creates surplus value, which can become profit for capitalists.

Exploitation, in capitalism as in any other class society, is the necessary

basis for the production of surplus. The immediate goal of each producer is simply to make profit and it contains within it the ever present possibility of crisis. Competition between capitals drives an imperative to accumulate, to produce more and more cheaply than competitors. This impels exploitation, but also innovation. The productive powers expand relentlessly, but equally continually disrupt any equilibrium between supply and demand. Competition also produces a concentration and centralisation of capital; the scale of production increases as the unfortunate and inefficient go to the wall or are taken over. Ever larger firms tend to dominate. The continual imperatives to innovate mean a constantly changing weight of human labour and machinery and raw materials in the production process. Capitalism involves displacing workers (the living labour) with machines (the dead labour). Marx describes a rising organic composition of capital and a concomitant tendency of the rate of profit to fall, itself countered by various features, including the cheapening of labour and other means of production. Perhaps most fundamentally, there is no 'invisible hand': what is good and rational for each individual capital may be irrational for collective capital. With surplus ultimately directed to accumulating more surplus, not to satisfying human wants, what works at one time may at another be the cause of instability, of over- or of underproduction.

Thus, although Marx is developing much of what had been said by earlier classical political economists, he transforms and radicalises it. He sees capitalism as only one, historically specific, form of production. There is nothing 'natural' in the individualist propensities it generates. What may seem fair and inevitable actually represents a transitory form of exploitation. Capitalism, a recent phenomenon, also contains within itself the seed of its own potential downfall. Marx also notoriously described how the hand mill produces feudalism, the steam mill capitalism. He wrote of people's social relations, established in conformity with material productivity, producing "also principles, ideas and categories, in conformity with their social relations".

Marx's critique of political economy saw capitalism as a complex and contradictory social system. It created enormous material advances, yet because it did so for private profit, it did not necessarily produce any general social improvements. As witnessed in the twentieth century, technological advance is compatible with social catastrophe, wars and mass murder. However, in also creating enormous numbers of exploited proletarians, capitalism was creating its own potential gravediggers. Knowledge of the circumstances, not of their own choosing, provided the basis for effective social action in which people could then make their own history. Marx and Engels envisaged the realisation of working-class potential only as a protracted long process of struggles necessary to change both the world and the workers themselves.

After Marx, many contributed to strengthen Marxist thought. Four essential elements can be found in the overall corpus of these Marxist writings:

The *first* element is the dialectical approach to knowledge and society that defines the nature of reality as dynamic and conflictual; social disequilibria and consequent change are due to the class struggle and the working out of contradictions inherent in social and political phenomena. There is, according to Marxists, no inherent social harmony or return to equilibrium as liberals believe.

The *second* element is a materialistic approach to history; the development of productive forces and economic activities is central to historical change and operates through the class struggle over distribution of the social product.

The *third* is a general view of capitalist development; the capitalist mode of production and its destiny are governed by a set of "economic laws of motion of modern society".

The *fourth* is a normative commitment to socialism; all Marxists believe that a socialist society is both the necessary and desirable end of historical development.

The early twentieth century saw a remarkable flowering of revolutionary Marxism. This coincided most obviously with the movements at the end of the First World War. In political economy, particularly in relation to imperialism, Marxists produced analyses that continue to provide at least a useful point of departure. It also saw innovation in philosophy.

Marx believed that in the mid-nineteenth century, the maturing of capitalism in Europe and the drawing of the global periphery into the market economy had set the stage for the proletarian revolution and the end of the capitalist economy. When this did not happen, Marx's followers, such as Rudolf Hilferding, Rosa Luxemburg and Gramsci, became concerned over the continuing vitality of capitalism and its refusal to disappear. The strength of nationalism, the economic success of capitalism, and the advent of imperialism led to a metamorphosis of Marxist thought that culminated in Lenin's *Imperialism*. Through his theory of imperialism, Lenin in effect converted Marxism from essentially a theory of domestic economy to a theory of international political relations among capitalist states. By Lenin times, the massive export of capital by Great Britain and subsequently by other developed economies had significantly changed the world economy; foreign investment and international finance had profoundly altered the economic and political relations among societies. Furthermore, Marx's capitalism had been composed mainly of small, competitive, industrial firms. By the time of Lenin, however, capitalist economies were dominated by immense industrial combines that in turn, according to Lenin, were controlled by the great banking houses. For Lenin, the control of capital by capital, that is, of industrial capital by finance capital, represented the pristine and highest stage of capitalist development.

Lenin argued that capitalism had escaped its crisis and collapse through overseas *imperialism*. The acquisition of colonies had enabled the capitalist economies to dispose of their unconsumed goods, to acquire cheap resources, and to vent their surplus capital. The exploitation of these colonies further provided an economic surplus with which the capitalists could buy off the

leadership of their own proletariat. The essence of Lenin's argument is that a capitalist international economy does develop the world, but does not develop it evenly. Individual capitalist economies grow at different rates and this differential growth of national power is ultimately responsible for imperialism, war, and international political change.

2.6 NEO-MARXISM

The term 'neo-Marxism' refers to a body of theory that has in common with the use of parts of the conceptual apparatus of theories drawn from the work of Karl Marx. 'Neo-Marxism' is, however, both a very broad term and a contentious one. It is broad because it can be used to categorize a range of theorists: from those who wish to adopt explicitly some of the theoretical apparatus provided by Marx, through to those whose main connection with Marx might be a normative or moral concern for those excluded from the benefits of global capitalism. It is a contentious term because it is sometimes used in a pejorative (derogative) sense to exclude from serious consideration theories with which those claiming to have some special insight into Marxism might disagree.

Neo-Marxists borrow a conceptual and theoretical framework from Marx to explain the 'modern' world as, first and foremost, a capitalist global economy. The idea of capitalism is sometimes used by neo-Marxists in a very broad sense to describe a historically specific era characterised by increasingly globalized market relationships of exchange. In addition to the concept of capitalism, neo-Marxism utilizes other notions familiar to the Marxian lexicon, including 'exploitation', 'proletariat' and 'class'. Some variants of neo-Marxism use the language of Marx to the international arena by arguing that states can be understood as analogous to classes, in that 'core' states should be understood as a ruling class of states that exploit the small and poor states of the 'periphery'.

Neo-Marxist theory unravels the processes at work in the capitalist global political economy through the utilization of a framework of analysis

that considers class as a major factor in international relations; economic relationships as key dynamics, and international justice and equality as key normative concerns. Most of the neo-Marxist writings express commitment towards a more equal global community coupled with some idea that theorization of inequality could contribute to emancipator outcomes.

Neo-Marxist writing, however, either ignores or rejects the labour theory of value as a basis for understanding modern societies. In order to account for the change in social conditions since Marx's times, these neo-Marxists chose the parts of Marx's thought that might clarify social conditions that were not present when Marx was alive. They filled in what they perceived to be omissions in Marxism with ideas from other schools of thought.

2.6.1 The Frankfurt School

Initially, like Marxism, neo-Marxism too began as a European phenomenon with a strong presence in Germany through the Frankfurt School. However, it was the rise of the Nazi regime under Adolf Hitler that caused the spread of this ideology to the United States, albeit unintentionally. The Nazi authorities suppressed all forms of political ideologies and their advocates were hunted down. As a result, during the Nazi regime, the members of the (Frankfurt) school fled first to Geneva, Switzerland and then to the United States. After the end of the war, in 1949, some of them (members of the Frankfurt school) namely Max Horkheimer, Theodor Adorno, and Friedrich Pollock returned to Germany and 2 years later helped re-establish the Institute for Social Research. This institute was to become the focal point for all research in the neo-Marxist school of thought in the years to come.

During the 1930s, the Frankfurt school developed a critical and interdisciplinary approach to cultural and communications studies, combining political economy, textual analysis, and analysis of social and ideological effects of capitalism. They coined the term "culture industry" to signify the process of the industrialization of mass-produced culture and the commercial imperatives that drove the system. The critical theorists analyzed all mass-

mediated cultural artefacts within the context of industrial production, in which the commodities of the culture industries exhibited the same features as other products of mass production: commodification, standardization, and massification. The culture industries had the specific function, however, of providing ideological legitimation of the existing capitalist societies and of integrating individuals into its way of life.

Furthermore, the critical theorists investigated the cultural industries in a political context as a form of the integration of the working class into capitalist societies. The Frankfurt school theorists were among the first neo-Marxian groups to examine the effects of mass culture and the rise of the consumer society on the working classes which were to be the instrument of revolution in the classical Marxian scenario. They also analyzed the ways that the culture industries and consumer society were stabilizing contemporary capitalism and accordingly sought new strategies for political change, agencies of political transformation, and models for political emancipation that could serve as norms of social critique and goals for political struggle.

The Frankfurt school focused intently on technology and culture, indicating how technology was becoming both a major force of production and formative mode of social organization and control. In a 1941 article, “Some Social Implications of Modern Technology”, Herbert Marcuse argued that technology in the contemporary era constitutes an entire “mode of organizing and perpetuating (or changing) social relationships, a manifestation of prevalent thought and behaviour patterns, an instrument for control and domination”. In the realm of culture, technology produced mass culture that habituated individuals to conform to the dominant patterns of thought and behaviour, and thus provided powerful instruments of social control and domination.

In retrospect, one can see the Frankfurt school work as articulation of a theory of the stage of state and monopoly capitalism that became dominant during the 1930s. This was an era of large organizations, theorized earlier by Austro-Marxist Rudolf Hilferding as “organized capitalism”, in which the

state and giant corporations managed the economy and in which individuals submitted to state and corporate control. This period is often described as “Fordism” to designate the system of mass production and the homogenizing regime of capital which wanted to produce mass desires, tastes, and behaviour. It was thus an era of mass production and consumption characterized by uniformity and homogeneity of needs, thought, and behaviour producing a mass society and what the Frankfurt school described as “the end of the individual”. No longer was individual thought and action the motor of social and cultural progress; instead giant organizations and institutions overpowered individuals. The era corresponds to the staid, conformist, and conservative world of corporate capitalism that was dominant in the 1950s with its organization men and women, its mass consumption, and its mass culture.

2.6.2 Robert Cox and Neo-Gramscian Perspective

Among numerous analysts that have been striving to develop novel paradigmatic constructs, analytical perspectives and approaches to the study of the global political economy, Robert Cox occupies a distinguished position thanks to his pioneering work aimed at adopting a rejuvenated neo-Gramscian perspective focusing on the role of power structures and social blocs formed around them.

Cox’s method of understanding global change represents a powerful challenge to mainstream theorizing about international relations. Rather than discussing states as the predominant actors operating in the international realm whose interaction ought to be understood, explained and predicted, the work of Cox has focused on the transformation of main *forms of state* and how these forms change under pressure from forces from above (*world order*) and from below (*civil society*). Cox considers states as the “focal terrains of domestic and international conflict” and foremost “institutional means of coordinated action”. In his worldview, the future represents an opportunity to break with the political structures of the past and thus the potential to escape the strictures that bind human potential.

Cox does not believe the existence of a theory divorced from a standpoint in time and space, and contends that “Theory is always for someone and for some purpose”. He differentiates between two broad purposes for formulating theories: The first is problem-solving theory which takes the world as it finds it with prevailing social and power relationships, and institutions into which they are organized as the given framework for action. The general aim of problem-solving is to make these institutions and relationships work smoothly by dealing with particular sources of trouble. Critical theory, on the other hand, does not take the institutions and social power relations for granted. It questions the very origins and improvement potential of the existing patterns of interaction, focusing on the social and political complex as a whole, rather than its separate and fragmented aspects. Critical theory allows for a normative choice in favour of an alternative social and political order.

Building upon the Gramscian notion of hegemony, Cox contends that in order to become truly hegemonic, a state would have to establish and protect a world order which is universal in conception. In other words, this would not be an order in which a dominant state exploits others, but an order which will be perceived by subordinate states as compatible with their interests. A *world-hegemony entails a social structure, an economic structure and a political structure*, and it emerges as a result of a widely appreciated sense of supremacy in the inter-state system, global political economy, as well as social and ecological systems. International organizations are the primary mechanisms in this framework through which universal norms of a world-hegemony are clearly expressed.

Cox cites five major characteristics of international institutions expressing their hegemonic role of stabilizing and perpetuating a particular global order. *First*, international institutions embody the rules which facilitate the expansion of dominant economic and social forces, but at the same time permit adjustments to be made by subordinate interests with minimum pain. *Second*, international institutions and rules are generally initiated by the

particular state (for example, the United States) which establishes the hegemony. At the very least, they must have that states' support that will try to secure the international hierarchy of powers through influencing the decision-making processes directly or indirectly. *Third*, international institutions ideologically legitimate the norms of the existing world order. They reflect orientations favourable to the dominant social forces, thereby defining policy guidelines and supporting certain practices at the national level. *Fourth*, international institutions recruit and co-opt elite talent from peripheral countries in a manner called "*transformismo*" by Cox. Outstanding personalities from the periphery are recruited to the central organizational hierarchies in order to allow them to internalize and transfer elements of modernization into their local settings. Finally, *transformismo* simultaneously serves to absorb potentially counter-hegemonic ideas and recapitulate them to be consistent with the hegemonic doctrine.

2.7 WORLD-SYSTEM THEORY

World-systems theory draws on the intellectual tradition of Marxism-Leninism in focusing on the structures of dominance and dependence in the international system. For world-systems theorists, the key actors in the international arena are not states, but the classes that are involved in the prevailing capitalist structure – the exploiters and the exploited. The foundations of the world-systems theory was laid down by Immanuel Wallerstein.

Wallerstein was an Africanist who, in studying Africa, realized that underdevelopment there could not be explained or cured by the liberal capitalist theories coming from the West. He sought to explain the division of the world between a relatively small wealthy core, and an impoverished and underdeveloped periphery. A small semi-periphery held states that moved beyond poverty and instability, but could not become as wealthy and dominant as core states.

It is here, in its explanations of semi-periphery that the world-system

theory moves beyond dependency theories core-periphery dichotomy. This 'middle-class' of states called as 'semi-periphery' was seen as necessary for the economic growth and political stability of the system as a whole, situated as it was between the core and periphery in terms of economic power. Semi-peripheral states have societies that are in the process of industrializing and diversifying their economies. Wallerstein argued that there were limited opportunities for upward movement within the capitalist world system and, under such circumstances, industrialization was the only way for states to move to the core. World-system theory, then, provides an explanation for the industrialization that has taken place in some of the developing countries. In addition, semi-peripheral states play a critical role in the world system because their existence means that the core states are not constantly pitted against the periphery states. Indeed, Wallerstein attributes the survival of the system to the existence of these semi-peripheral states, arguing that they have acted as a cushion between the exploiting core states and the exploited periphery. The semi-peripheral states do this because by playing the role of both exploited and exploiter, they diffuse both the anger and revolutionary activity of the peripheries. Indeed, Wallerstein sees the semi-periphery as a structural prerequisite for stability in the international system. When and if this ceases to be the case, then the international system will disintegrate. Thus, all countries are fundamentally and inescapably constrained, Wallerstein argues, by the international system as a whole. Moreover, the semi-periphery provides secure investment locations for core capital whenever core wages become inflated by well-organized labour movements.

In essence, Wallerstein posits capitalism as a world system with relations between the core and periphery structured so that the core exploits the periphery for cheap resources and labour, turning those goods into valuable finished products for consumption in the core. Some finished goods are sold back to the periphery, but consumed by governmental elites whose interests are more in line with those of the core than those within their own country. The elites in third world states thus find it in their interest to perpetuate structures that benefit the core (one reason corruption is prevalent throughout

third world governments). Because post-colonial states are often fictions with no strong sense of national identity, people go into government more to get rich than out of any idealistic notion of helping their state develop.

For Wallerstein and the numerous world systems theorists who followed in his wake, this world system functions in part through the control of a *hegemon* who can dominate the system and enforce its rules. First it was the Netherlands, then Great Britain, and finally the US. The world-system is always characterised by a single division of labour that is producing for a world market. Wallerstein further concluded that a world division of labour based on trade relations has historically given rise to regional economic specialization and to an international structure of unequally powerful nations. Particular states have become increasingly used to securing favourable 'terms of trade', through measures that include military threats and interventions. The tendency of politics to serve economic ends has thus accelerated the unequal distribution of wealth within the global system. For this reason, the capitalist system became increasingly polarized into a core of wealthy, technologically advanced countries and a periphery of poor countries from which key primary goods and capital were extracted on unfavourable terms. Thus, core countries enjoyed a position of global dominance as the result of their structural relations within the world economy, a position that helped to sustain a constant accumulation of new advantages by the core nations. Likewise, peripheral countries encountered structural constraints on their political economies that prevented there being any fundamental change in their disadvantaged positions. For this reason, uneven development was endemic within the capitalist world system.

The world-systems theory has been effective in predicting the ongoing division between rich and poor states and the limitations of the semi-periphery (Taiwan, South Korea, Brazil, India, etc.), but seemed overly pessimistic about the health of global capitalism. Like all Marxian theories, it claims that capitalism as it operates in the real world contains contradictions which lead to intermittent crises. The most dangerous is the problem of

over-production which can lead to a credit crisis that can cause systemic failure.

2.8 LET US SUM UP

It is important to understand the nature and content of some of the most influential theories of political economy to comprehend the world around us. This is due to the fact that these theories allege to provide scientific descriptions of how the world *does* work while they also constitute normative positions regarding how the world *should* work.

This lesson has illustrated two important theories of political economy along with their sub-theories, viz. Liberalism and its more contemporary offshoot neo-liberalism, and Marxism its most recent interpretations neo-Marxism and World Systems Theory. Although scholars have produced number of ‘theories’ to explain the relationship of economics and politics, these two theories stand out and have had a profound influence on scholarship and political affairs. Liberalism which emerged from Enlightenment in the writings of Adam Smith and others, was a reaction to mercantilism and has become embodied in orthodox economics. It assumes that politics and economics exist, at least ideally, in separate spheres; it argues that markets—in the interest of efficiency, growth and consumer choice—should be free from political interference. Neo-liberalism has emerged in the second half of the twentieth century in reaction against Keynesian Welfare Economics, reflecting twentieth century developments in capitalist world strongly making case for free market. Marxism, which appeared in the mid-nineteenth century as a reaction against liberalism and classical economics, holds that economics drives politics. Political conflict arises from struggles among classes over the distribution of wealth. Hence, political conflict will cease to with the elimination of the market and of a society of classes. Neo-Marxist and World-system theories incorporated the twentieth century developments highlighting the importance of superstructure along with the structure and how ideology and hegemony of the ruling classes are serving the interests of the dominant classes over the masses.

2.9 EXERCISE

1. Explain Mercantilism.
2. What are the basic propositions of liberal thought?
3. How neo-liberalism is advanced the liberal thought in twentieth century?
4. What are the primary theoretical postulates of Marxism?
5. How Neo-Marxism contributed to the Marxist thought in understanding contemporary political economy?
6. Critically analyse World-system theory.

UNIT – I: CONCEPT AND EVOLUTION

**1.3 CONTEMPORARY PERSPECTIVES ON
INTERNATIONAL POLITICAL ECONOMY:
CONSTRUCTIVIST, FEMINIST AND
ENVIRONMENTALIST**

- V. Nagendra Rao

STRUCTURE

3.0 Objectives

3.1 Introduction

3.2 Constructivism

3.2.1 Material Facts of the World

3.2.2 Constructed Interests

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3.2.4 Socialization

3.3 Feminism: International Political Economy

3.3.1 A Feminist Twist to Understanding Political Economy

3.3.2 Neoliberal Policies: Feminist Political Economy

3.3.3 Gendered Economy of Investments

3.3.4 Trafficking

3.3.5 Social Reproduction and Work

3.3.6 The Questions Feminist Political Economy Asks

3.4 Environmentalists and International Political Economy

3.4.1 Economic Globalization and Environmentalism

3.5 Let us Sum Up

3.0 OBJECTIVES

After going through this lesson, you should be able to know:

- What are the critical perspectives to understand contemporary international political economy;
- How constructivism interprets International Political Economy;
- What is the contribution of Feminist discourse on political economy;
- Why environmentalism become an important aspect in the analyses of International Political Economy.

3.1 INTRODUCTION

Dear Student, you are already familiar with three perspectives that the lesson is intended to delve upon. These are: Constructivism, Feminism and Environmentalism. All these theories or perspectives we have discussed in your previous semester courses, particularly in International Relations. The major difference from what you have studied earlier and what you are going to study in this lesson is ‘treatment’. Whereas you have these perspective in political dimension in your previous semester, in this lesson you will study from political economy perspective.

3.2 CONSTRUCTIVISM

As you studied in your International Relations course in the first semester, Constructivism’s arrival in IR is often associated with the end of the Cold War, an event that the traditional theories such as realism and

liberalism failed to account for. Constructivism argues that the social world is of our making. Actors (usually powerful ones, like leaders and influential citizens) continually shape – and sometimes reshape – the very nature of international relations through their actions and interactions. Constructivism sees the world as socially constructed. Constructivists go beyond the material reality by including the effect of ideas and beliefs on world politics. This also entails that reality is always under construction, which opens the prospect for change. In other words, meanings are not fixed but can change over time depending on the ideas and beliefs that actors hold.

Although what we think of as “the world economy” is composed of both material and social facts, the field of international political economy (IPE) within political science has tended until recently to focus almost exclusively on the material facts of the economy. Materialist scholars have attempted to map individual, firm, and government preferences over outcomes onto these material facts, thereby privileging the rational, goal-oriented pursuit of policies as the central causal mechanism in accounts of economic policy making. In IPE, the combination of materialism and rationalism has become the dominant, even orthodox, view of the world economy.

Political Science scholars who have employed the analytical frameworks of social constructivism have created a coherent set of arguments and an innovative collection of empirical methods for exploring the influence of ideas, norms, identities, and ideologies on the economic practices of governments, firms, and societies. Constructivist political economy within political science imported ideas from sociology and economics to explain the operation of International Political Economy.

3.2.1 Material facts of the world

Constructivists argue that economy includes an inescapably ideational/social element, all the way down through such ‘hard facts’ as GDP. Although there is a sense in which GDP is fundamentally material in that one produces wheat and weapons or one does not, how societies account for national product

and national income is a construction. The usefulness of the construction helps to explain its widespread use among societies, but it is clear that choices have been made about what to count (e.g., goods and services with market values, rather than the “gray,” informal economy or activities within households), what not to count (e.g., environmental degradation and ecological sustainability), and how to count it (e.g., with surveys and various methods of estimating changes in economic activity). National income accounting is a social construction that the entire world now takes for granted, and governments alter their economic policies on the basis of a few basis points of change of GDP from one quarter to the next.

Second, despite materialist theorists’ pronouncements, many of the material processes of the world do not seem to result in unambiguous outcomes. Causes and effects often seem to be opaque and linked non-linearly. Take financial globalization as an example. Regardless of the particular nuances, the materialist theories of the 1990s were clear. Big spending welfare states would be punished with capital flight in a taxation and wage race to the bottom. Either such states would converge on the Anglo-American equilibrium of labour market flexibility, low taxes, and low welfare transfers, or they would be seriously hurt. What we saw instead was that those states slated most likely to falter were in fact among the most productive. Materialist theories of such processes, by ignoring how agents interpret the environment around them and then take actions, make erroneous predictions. How globalization impacts a state depends upon how it is seen by agents within that state. Thus, while the British seek to ‘embrace’ globalization as an opportunity, the French resist ‘Mondialisation’ as an alien import. Material facts, it seems, can be very underdetermining indeed.

3.2.2 Constructed Interests

Beyond the interpretation/outcome problems noted above concerning interests, the notion of acting on one’s interests implicitly assumes that agents act in their “true” interests.

Yet “true” interests can only be assessed and acted upon under optimal conditions with perfect information. Only under such conditions are the full range of alternatives and their relative costs apparent to the agent. Such conditions are rather implausible and are perhaps never found in situations of political interest. If information is processed differently by different agents, or if information is asymmetrically distributed, then interests cannot be “given” by structural location or revealed ex-post in behavior. Yet, it is precisely these situations that are of interest to political economists. Otherwise, we are, simply re-describing the obvious in a somewhat circular manner.

Seen in this way, specifying agents’ interests becomes less about structural determination and more about the construction of “wants” as mediated by beliefs, desires, and the wider social context of action. Interests are social constructs, not material givens, and should be analyzed as such. Before they can be something that “does the explaining,” they themselves need to be explained.

As Alexander Wendt has argued, in order to specify interests one must first specify the beliefs an agent has about what is desirable in the first place, which is an irreducibly inter-subjective process. We need to consider “what is desired” as a construction rather than a material given since “we want what we want because of how we think about it” and not because of any innate properties of the object desired. When seen in this way, the constructed and inter-subjective nature of desires and beliefs collapses and a richer constructivist understanding of interests becomes possible.

In contrast to rationalist and materialist theories, a constructivist version of IPE argues that agents’ expectations and intersubjective beliefs constitute causal relationships in the economy by altering the agents’ own beliefs about the interests of others, upon which the realization of their own inter-subjectively constructed interests depend. This is why, in part, whether a given convention is deemed to be “true” or not depends on how widely it is held.

The economic policies of governments are social in both their causes and their effects. Economic policies may be pursued because they are in accord with international norms that define both legitimate and illegitimate policy practices (for sociologists) or behaviours (for economists), as well as being materially “in the interest” of states to do so. State and national identities also influence economic policies by endowing them with purpose and meaning, as well as by connecting material facts cognitively. The international economy is therefore composed of norms of regular behaviour, as well as norms of appropriate policy practices. The fact that the legitimacy and illegitimacy of macroeconomic policy practices has changed over time points to the centrality of such constructions as objects in the political economy that analysts need to take more seriously.

3.2.3 Persuasion

Some constructivist work argues that social construction takes place due to the entrepreneurial action of innovative people. These “carriers” bring new interpretations into an arena and then persuade others to take them up. In general, the actual creation of particular new ideas or norms is not something such arguments (or any constructivist arguments) attempt to explain. Instead they suggest that pre-existing ideas or norms were somehow at least partly delegitimated, making an opening for innovation, but the specific invention of new rules, practices, or symbols is an underdetermined act of agency. Persuasion arguments do then try to explain how other actors were persuaded to accept these ideas or norms, however—the actual steps of social construction. They tend to point either to the sheer force of the new concepts, to some qualities of the carrier, or to the indirect “fit” between the new concepts with existing ideas or norms.

3.2.4 Socialization

The mechanism that stands behind most of the current constructivist literature—sometimes explicitly, usually implicitly—suggests that norms or ideas spread in a relatively incremental, evolutionary way generated by

repeated interaction within groups, as argued in the above regarding the notion of conventionally based behaviour. A group of people come together in interaction. They could interact in a wide variety of ways, but either through accident, deliberation, or initial innovative leadership they orient themselves around certain norms or beliefs. Action becomes increasingly robustly embedded in the norms or beliefs over time. The social constructs are not entirely static, however, since norms and beliefs may be constantly reshaped on the margins as they are reproduced.

Constructivism's theoretical contributions have focused heavily on emphasising the fact of constructedness. Clearly there is a worthwhile political impulse here: a key concern of constructivist IPE has been to assert the contingency of what in the wake of neoliberalism and the collapse of communism had come to appear as the hard facts of capitalist life, and so to identify opportunities for politics and agency in a world increasingly governed by the dismal logic of markets. Constructivists tend to stress the constructed nature of things precisely when they want to emphasise their contingent and changeable nature. The constructedness of something is seen to reduce its degree of reality, to make it less than a natural or material fact.

3.3 FEMINISM: INTERNATIONAL POLITICAL ECONOMY

By this time you must have understood that political economy perspective makes explicit linkages between political, economic and social factors. It is concerned with how politics can influence the economy. It looks at the access to, and distribution of wealth and power in order to understand why, by whom, and for whom certain decisions are taken, and how they affect societies – politically, economically and socially.

Feminist international political economy is an interdisciplinary intellectual project that has focused both on theoretical and empirical analysis of women and gender within the field. Feminist IPE emerged from the confluence of an eclectic body of work over the last several years encompassing fields as disparate as international relations, IPE, feminist

economics, the literature on gender and development, and feminist literature on globalization. They have engaged with the three major categories of analysis—ideas, material capabilities, and institutions—in order to understand hegemonic processes that function to (re)construct and (re)produce both gendered categories of analysis and practice. Feminist revisions of IPE have focused on international institutions, rules and norms, while simultaneously shedding light on contemporary states and how they are being transformed in this current phase of globalization.

The feminist movement in IPE is gathered momentum in the post-Soviet neoliberal world order. Noting the gendered impact of frequent economic crises and global recessions in the world since 1990s onwards, the feminist economists started working how lives of women are effected severely with more job losses and falling living standards. The observation that the capitalist crisis – albeit deep and shocking – is neither the first nor will it be the last. Women and men have survived crises through everyday struggles, and feminists have analysed and campaigned on economic crises, for decades: the gendered impacts of the 1980s debt crisis, the East Asian crisis, and the Argentine crisis, among others. Consumption in the North (fuelled by accumulating debt) has transformed the economies of the developing world, where a new international division of labour occurred alongside an increasing mobilization of female workers and the consolidation of a gendered division of labour. Care chains grow longer as migrant laborers provide the domestic and market-based care work necessary to sustain Northern economies. Simultaneously, these modes of exchange deepen class divisions while creating new metropolises in the South that are migration magnets of historic proportions. Taking such historical links and power relations on board, the feminist economists attempted to provide an alternative perspective from which to view the current crisis, and related systems of production, exchange, consumption, and social reproduction in a distinctive, feminist light.

The contribution of feminist political economists is significant in recent

period. Apart from the issues and context mentioned above, the Feminists economic literature primarily follows the following areas:

- In the national context, feminist economists attempted to understand the political and economic context and power divisions in the country; the nexus between political elite and economic interests; investment focuses and priorities; legal context for access to human rights, in particular economic and social rights, and so forth.
- Identification and understanding of regional and geopolitical actors and their interests is an important part of understanding the political economy in a given country. Many times, both political and economic decision-making by the national governments is highly influenced by the interest of neighbouring and other countries, and that interest can be expressed through both politics and economy. Feminists attempted to capture the impact of these developments in their analysis.
- Feminists consider collaboration with the international stakeholders is an essential part of their work. They use the findings and analysis of the national context to strengthen advocacy towards UN, regional mechanisms and international finance institutions. They also use it to argue for states' extraterritorial obligations with respect to human rights impacts of their actions – be it the arms trade or the decisions made by the World Bank or International Monetary Fund on conditionalities they impose on countries.

3.3.1 A feminist twist to understanding political economy

Classical approach to political economy studies the relationship between production, labour, trade, different laws and government policies, and distribution of national income and wealth, but it does so from a gender-blind point of view. It focuses on macroeconomic indicators such as balance of payments, financial data (interest rates, exchange rates), international trade (export/import), consumer price index and so forth. This is a very limited, conflict and gender-blind approach. Treating all members of the society as if

they have the same needs, problems, capacities, access, and power tells nothing about political and economic mechanisms that lead to (gender) inequalities in the society, nor how to deal with them in conflict affected communities.

A feminist political economy on the other hand looks at the broader picture. It looks at social policies, such as health policies or labour rights; it looks at intra-household labour division; access to and distribution of economic resources; indicators of human well-being; gender pattern in wages; the decency of wages; unpaid care work. Feminist political economy takes into consideration environment and environmental sustainability; it looks at access and control over natural resources and the role the natural resources can play in sustainable development. It also allows for an intersectional analysis that looks at not just gender, but also how different systems of power, and access to power interact and impact on different groups in the society.

When put in a ‘conflict context’ feminist political economy looks at the ratio between resources allocated to security institutions (such as police and military) and those allocated for peacebuilding; the ratio between militarization and effective demilitarization and how it plays out. Feminists also look at war-related violations and harms women and men suffer during conflict, and the needs, as well as gender and power dynamics, that stem from those violations. We can then use feminist political economy to plan and propose needed levels of investment into different services that enable victims to access gender sensitive services necessary for their rehabilitation and unimpeded and equal participation in society.

3.3.2 Neoliberal Policies: Feminist political economy

Pursuing neoliberal economic policies, countries, including those recovering from conflicts and wars, are sometimes faced with imposition of “structural adjustment” or “fiscal consolidation” reforms – also called austerity measures. Economic policies that are not based on solidarity and equality can be harmful for societies as growing inequalities are one of the

root causes of war. In addition, in countries recovering from conflicts such policies can put them at risk of regression to violence.

Austerity measures typically consist of public expenditure cuts: less money for health, education, pensions, social welfare, and everything else that is typically funded through public budgets, and more so, what is typically needed in a society recovering from conflict. Within the “package” of these measures economic growth is often understood to take place through freeing the economy from “state-imposed restriction”. This often translates into flexibilization of labour laws, deregulations and privatization that directly influences public ownership and control over resources, and subsequently also the distribution of those resources. Feminist political economy challenges the assumption of economic growth happening through minimal state and minimal public intervention. It recognizes the unequal and gendered social context and power-relations that are in place, and the inability of neoliberal policies to challenge such environment and create gender just growth for everybody, and not just the political and economic elite.

3.3.3 Gendered economy of investments

What is invested in and what the societies “save” money on is highly gendered. Most of economic policies, be it from the local government or from international finance institutions, lack proper gender impact assessment that can help understand how economic policies will affect gender equality in the country. On top of it, most economic interventions, in conflict or post-conflict countries lack critical conflict analysis. Instead, “conflict” and “economic policies” are often seen as not interrelated. The “reform packages” are often represented as ideologically neutral and economically (and politically) necessary. However, without the additional information and baselines collected through conflict analysis it is not possible to foresee and track the impact of economic interventions on the society. For a society coming out of a conflict economic policies must also be part of dealing with the remnants of war or otherwise they risk feeding into new aggravations.

3.3.4 Trafficking

Jan Jindy Pettman observes that an ‘international political economy of sex’ now traffics exclusively in female bodies through migrant labour, mail-order brides, sex tourism, and militarised prostitution. Typically the first sector to ‘internationalise’, it services the manly state and its equally masculinised partner, global capital, in the form of politicians, soldiers, businessmen, tourists, police, tribal chiefs, and so on. Prostitution booms especially in postsocialist or transitional economies like China, Vietnam, and Kampuchea as they ‘reintegrate’ into the global capitalist economy.

3.3.5 Social Reproduction and Work

Despite some differences of emphasis in feminist analyses, social reproduction has three key components: first, biological reproduction or the production of future labour, and the provision of sexual, emotional, and affective services (such as are required to maintain family and intimate relationships); second, unpaid production of both goods and services in the home, particularly of care, as well as social provisioning (by which we mean voluntary work directed at meeting needs in the community); and third, the reproduction of culture and ideology, which stabilizes dominant social relations. These components are institutionalized through gendered labour, discourses, and the organization of everyday life.

Despite its everyday importance, social reproduction is rarely included in analytical work done by political economists, nor is it usually accounted for in national statistics. However, the significance of what one set of observers term the “glorious tangle of production and reproduction” that characterizes people’s lives has long been recognized by feminists. In particular, they established a powerful critique of 1980s-style neoliberalism on the grounds that it pushed women into the paid labour force while increasing their caring responsibilities. There has been, however, a less unified response from feminists to subsequent formulations of capitalism. As states and international financial institutions temporarily turned away from the

savage varieties of neoliberalism imposed via conditionalities and toward a post–Washington Consensus about institutional strengthening, good governance, inclusion of the marginalized, and social safety nets, feminist political economists responded divergently. While some welcomed the shift, working within the development apparatus on the grounds that gender is being taken far more seriously now, others argued that the anti-indigence projects associated with this new phase of policy have further increased social reproduction burdens on women by institutionalizing their roles – forged under crisis conditions – in securing community and family survival. This raises crucial questions about the extent to which the new poverty programs that characterize “inclusive neoliberalism” are reliant on “female altruism at the service of the state” and how these may evolve in a crisis context. Issues of work – paid and unpaid, formal and informal – remain central to feminist IPE debates and the promise of paid labour and market inclusion as routes to women’s empowerment continues to be critically interrogated.

3.3.6 The Questions Feminist Political Economists Ask

We further our analysis by asking specific feminist questions, some of which are listed below. But this is not an exhaustive list and different context and different problems might require a different or adapted set of questions. For that reason, it is important that we use what professor Cynthia Enloe refers to as “our feminist curiosity” in order to identify the most relevant questions for a given context.

- What does the overall context for women’s rights, equality and participation look like in the society?
- Who are the main political and economic actors? Who sets the agenda? Whose priorities and needs are catered for? Whose are not?
- How do social and economic realities look like for women and men? What role(s) do they play in that reality, and how do economic and political decisions/reforms affect them? Can they participate in the

decision-making (both political and economic) process? Can they influence planned (whether economic and/or political) reforms?

- What are the constraints (both in private and public sphere) for women and men to engage in formal economy? What circumstances (family relations, laws, regulations, mechanisms etc.) would be conducive for their equal and just participation in the economy and overall realization of their right?
- How does the division between the formal/informal and productive/reproductive economy look like? We need to look at the division between women and men but also dig deeper do an intersectional analysis in terms of social stratification, urban/rural etc., asking “which women”?
- What is being produced? How? By and for whom?
- What is being invested in? How? By and for whom? Is there a preference for certain types of investments? How do those investments play into gender (in)equalities?
- Where are women primarily employed? How does the investment in those sectors look like?
- How does the access to resources look like? Who owns them and who controls them? (This has to be intersectional analysis).
- How does the access to social, economic and cultural rights look like for women and men? Is the access gendered? In what way? Is there a strategy for further development of socio-economic rights? Is it gendered?
- What is the ratio between resources allocated to security (such as police and military) and public services such as health care, education, day-care (human security)? How does this play with regards to power and gender relations?
- How does the local community understand security? Is it through

militarized responses of various security forces (i.e. physical security) or is there a broader understanding of what security is? Is there a difference between individual and collective security? What does security for women in the given context mean? How can that security be achieved?

To sum up, feminist work in international political economy is exceptionally varied, but we can identify three important themes. First, feminist work often addresses the gendered regimes of capitalist production and consumption, which illuminates the changing relations between nation-states and the global economy; processes of globalized capital accumulation and investment; the nature of social reproduction; the relationship between material and discursive production and the circulation of goods, services, and knowledges; gendered patterns of consumption; and changing relations between local communities, states, and globalized markets. The second theme is gendered systems of exchange, which allows analyses of the gendered international division of labor; the nature of exchange, whether involving care or cash within private and public spheres of the economy; and the effects of monetary exchange in fashioning, challenging, and transforming gendered relations. Finally, the third theme takes up gendered struggles for emancipation and equality, which leads to examinations of challenges to capitalism in the post–Cold War era; analyses of the class, race, and gender relations underlying particular strategies of empowerment or theoretical critiques of concepts such as emancipation, equality, and transformation; and the place of gender in current critiques of IPE.

3.4 ENVIRONMENTALISTS AND INTERNATIONAL POLITICAL ECONOMY

One of the most contentious issues in current debates on the economy–environment nexus concerns the environmental impact of international economic liberalization (i.e., free trade and free capital movement). This controversy began with the formation of the World Trade Organization (WTO)

and negotiations on the North American Free Trade Agreement (NAFTA), and gained further momentum in the context of the 1997 Kyoto Protocol and other international environmental agreements.

So, how does liberalization of trade and investment (i.e., economic globalization) affect the natural environment? Under which circumstances does economic globalization lead to a deterioration or amelioration of a country's natural environment? And what about other forms of globalization, such as memberships in international organizations? Do these forms of globalization also have profound impacts on countries' natural environment? These are the questions before the environmentalist to confront with.

Starting with globalization-induced adverse environmental effects, increased competition between economic actors (usually firms) due to increased market openness (globalization) cause a regulatory race to the bottom in formal and informal environmental standards. And it might induce some jurisdictions to serve as pollution havens attracting dirty foreign direct investment. The reason is that countries might weaken their environmental policies in an attempt to protect their industries from international competition or attract foreign firms and FDI motivated by the expectation of lower environmental protection costs. The most common expectation here is that developed (industrialized) countries will refrain from adopting more stringent environmental regulations and might even reduce existing standards due to competition with countries that have laxer environmental regulation. And less-developed countries presumably adopt lax environmental standards to attract FDI flowing into pollution-intensive sectors and export the respective goods to jurisdictions with higher environmental standards.

More recently, IPE scholars have also started to study the political dimensions of globalization and their effects on environmental protection efforts. Memberships in international organizations are at the centre of this research. Recent studies analyse, for example, how these organizations may affect the quality of the environment across countries. Other studies focus more on specific organizations, such as the WTO and for instance, evaluate

whether in trade disputes over environmental standards economic or environmental concerns prevail. Finally, a new strand of the “IPE and environment” literature deals with the micro level and studies how citizens evaluate economic openness in light of potential environmental concerns.

3.4.1 Economic Globalization (Trade/FDI) and Environmental Degradation

The existing literature on the effect of international economic liberalization on the environment is extensive and highly elaborated; nevertheless, it does not allow (neither theoretically nor empirically) for a clear-cut overall assessment of this relationship. As stated above the main reason for this stems from the fact that some effects of economic liberalization on the environment are indirect, as they run via economic growth, and some are direct; that is, they hold for a given level of income. In both cases, the effects can be either beneficial or detrimental for the environment. In the following, we elaborate on these effects.

Indirect Effect via Income

Economic globalization can have an effect on countries’ natural environment via its impact on welfare. In particular, it is argued that international economic integration (openness) allows countries to specialize in those industries in which they have a comparative advantage and hence allows for a more efficient allocation of resources. Due to the resulting welfare-enhancing gains, a country’s national income tends to increase. In the long run, it can be argued that these increases in general welfare lead to a rise in demand for public goods provision as the demand for most public goods such as better environmental quality, education, or health care usually increases with growing income. In the short run, however, the effect of an increase in income depends on the current income level of the respective country. Many studies have pointed out that environmental quality is deteriorated at low levels of income and then improve at higher income levels after a tipping point is reached.

3.5 LET US SUM UP

In this era of economic globalization, there has been remarkable growth in the volume and value of global trade, investment, and finance. These international economic relationships have important implications for the natural environment, as all have been identified as having some linkage to environmental quality. The extent to which these international economic relationships contribute to environmental problems or to solutions for environmental problems is the subject of extensive debate. Some see the relationship as largely positive, with environmental benefits being attached to the economic growth that global economic transactions seek to facilitate. For these thinkers, environmental policies should be able to address any negative outcomes that may arise in ways that do not impede global economic activity. Others, however, see mainly negative environmental implications arising from global economic relationships and the economic growth that is associated with it. For them, it is important that environmental policies do restrict global economic transactions. A third view which seeks to bridge the divide is also gaining prominence, arguing that while there are some potential negative aspects of global economic relations for the environment, a balanced management of the global economy can bring both economic and environmental benefits.

UNIT – I: CONCEPT AND EVOLUTION

**1.4 EVOLUTION OF MODERN GLOBAL ECONOMY:
MERCANTILISM TO GLOBALISM**

- V. Nagendra Rao

STRUCTURE

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4.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The evolution of the post-feudal internal political economy;
- The mercantilism's influence in European economies from 15th century onwards;
- The origin and growth of capitalism and various interpretation in analysing capitalism;
- The development of colonialism and imperialism from capitalist economic productions systems;
- The rise of 20th century Welfare economies in Europe, particularly in western Europe;
- The contemporary globalism its basic features.

4.1 INTRODUCTION

This lesson deals schematically with the phases in the economic development of the world in general and evolution of contemporary international political economy (IPE) in particular. The systematic order of modern economy from mercantilism to contemporary capitalism illustrates the journey of international political economy. Any exploration of the contemporary political economy whose foundation is based on capitalism is forced to probe a series of questions about the nature of the society that preceded it and the processes that led to its genesis. Modern capitalism built upon elements of almost everything that went before. Contemporary capitalism emerged out of various imperfectly understood processes. Considering these nevertheless helps to contextualize the contemporary global political economy and to understand general processes of social transformation. These processes or phases can be broadly divided into five: Mercantilism, Capitalism, Imperialism, Welfare Economics, and Globalism. The proceeding sections of the lesson explain each of these phases.

- Various viewpoints about capitalism;
- Imperialism its links with colonialism and various theories of imperialism;
- Welfare economics with reference to Keynesianism;
- Globalism or Globalisation that prevailed in contemporary international relations.

4.2 MERCANTILISM

We have already studied mercantilism theoretically in the previous lessons. You must have understood in those lessons that mercantilism is a stage of economy that has tremendously contributed to the modern economic evolution in general and capitalist growth in later period. The classical mercantilist period of history is inextricably linked to the rise of the modern nation-state in Europe during the fifteenth through eighteenth centuries. This was a period when the idea of state building and intervention in the economy to secure the nation-state dominated political and economic thought.

Mercantilism is economic nationalism for the purpose of building a wealthy and powerful state. Adam Smith coined the term “mercantile system” to describe the system of political economy that sought to enrich the country by restraining imports and encouraging exports. This system dominated Western European economic thought and policies from the sixteenth to the late eighteenth centuries. The goal of these policies was, supposedly, to achieve a “favourable” balance of trade that would bring gold and silver into the country and also to maintain domestic employment. The mercantile system served the interests of merchants and producers such as the British East India Company, whose activities were protected or encouraged by the state.

Most of the mercantilist policies were the outgrowth of the relationship between the governments of the nation-states and their mercantile classes. In exchange for paying levies and taxes to support the armies of the nation-

states, the mercantile classes induced governments to enact policies that would protect their business interests against foreign competition.

The mercantilist period was one of generally rapid growth, particularly in England. This is partly because the governments were not very effective at enforcing the policies they espoused. While the government could prohibit imports, for example, it lacked the resources to stop the smuggling that the prohibition would create. In addition, the variety of new products that were created during the industrial revolution made it difficult to enforce the industrial policies that were associated with mercantilist doctrine.

By 1860 England had removed the last vestiges of the mercantile era. Industrial regulations, monopolies, and tariffs were abolished, and emigration and machinery exports were freed. In large part because of its free trade policies, England became the dominant economic power in Europe. England's success as a manufacturing and financial power, coupled with the United States as an emerging agricultural powerhouse, led to the resumption of protectionist pressures in Europe and the arms race between Germany, France, and England that ultimately resulted in World War I.

4.2.1 Mercantilism and Colonialism

Colonialism supplemented by state military power, was viewed as another important instrument in mercantilist efforts to control trade. Mercantilism has often been cited as one of the main driving forces behind colonialism and imperialism in developing regions of the world. Mercantilists established colonies to be exclusive markets for the goods of the mother country, a source of raw materials or goods bought from a competitive country, or a source of cheap labour. Thomas Mun, a successful trader and director of the East India Company argued for “the overriding need for England to pursue a positive balance of trade”. In so doing the growing merchant class supported a strong state that would protect its interests, and in return the state sanctioned monopolistic merchant control over certain industries that profited merchants and the state via commercial trade.

Classical mercantilism then refers to a period of history when newly emerging nation-states faced the problem of using their economies as a means to achieve wealth and power for the sake of national security. The political philosophy of mercantilism suggested how national leaders could create a virtuous cycle of power and wealth that would allow them to prosper while making them more powerful. Mercantilist policies included the use of subsidies to generate exports and restrictions on imports, along with the development of colonial empires. These policies appeared to be very rational given the relatively insecure nature of newly established states to one another. States could look only to themselves, and mercantilist policies to help protect and sustain themselves.

4.2.2 The Entrenchment of Neomercantilism – Protectionism

Despite the formal commitment to the international goals of opening up international trade and reducing trade barriers, many states remain concerned and quite protective of their own economic security and national independence. Simultaneously, they have continued to pursue ways to protect their particular industries and the whole domestic economy within an international political and economic environment that discourages classical mercantilist policies, especially tariffs and quotas. **Neomercantilism** is a more subtle form of *protection* that accounts for what are essentially mercantilist-defensive-oriented policies many individual nations feel compelled to adopt as a result of domestic pressure to protect certain industries from overseas competition and international economic integration.

Finally, many neomercantilists today argue that, to accumulate and maintain their wealth and power, states are tempted more than ever to intervene in and influence developments not only in their domestic economies but also in the economies of other nations. In support of their own industries, many states try to restructure the international economy in their favour by one means or another. One way to do so is to influence or even control the political and economic rules of the game governed by the WTO and IMF, for instance, in such a way that efforts to open up certain international markets

mask protectionist motives to support certain domestic producers. For many neomercantilists, as it was for classical mercantilists, economic liberalism is simply another tool that state officials can employ to protect their industries along with their wealth and power.

4.3 CAPITALISM

‘Capitalism’ is one of the most hotly contested terms in social science. It may be broadly defined as a distinct, historically specific form of social organization, based on generalized commodity production, in which there is private ownership and/or control of means of production. Initially popularized by Marxist writers, it is a term which has increasingly gained credence across the political spectrum, although it has inevitably produced inconsistency in its employment. At least three present day usages are discernible.

4.3.1 Werner Sombart and Max Weber Perspective

The first, and most popular, is the meaning derived from the work of Werner Sombart and Max Weber. Sombart describes capitalism in terms of a synthesis of the spirit of enterprise with the ‘bourgeois spirit’ of calculation and rationality. This spirit is deemed to be an aspect of human nature and is seen to have finally taken a suitable form for itself in the shape of the economic organization of modern society. On this basis, Weber charts how the ‘spirit of capitalism’ transformed other ‘older’ modes of economic activity designated by the term ‘traditionalism’. The capitalist enterprise is based on a rational reorganization of production and is directed solely toward maximizing productive efficiency. In this system, ‘Man is dominated by the making of money, by acquisition as the ultimate purpose of his life. Economic acquisition is no longer subordinated to man as the means for the satisfaction of his material needs’. Capitalism is therefore less the result of the introduction of a new technology than the consequence of a new entrepreneurial spirit. Weber henceforth develops an account of the rise of modern capitalism in post-feudal Europe, emphasizing characteristics broadly similar to those discussed by Marx. The spirit of rational calculation fosters a capitalist

economic system in which wage-labourers are legally 'free' to sell their labour power; restrictions on economic exchange in the marketplace are removed; technology is constructed and organized on the basis of rational principles, and there is a clear separation of home and workplace. Furthermore, capitalism enables the consolidation of the legal form of business corporation, the expansion of public credit, organized exchanges for trading in all commodities and the organization enterprises for the production of commodities rather than simply for trade. Above all, capitalism is characterized by the increased rationalization of social life and the further advance of bureaucratic mechanization is seen as inevitable in the modern world.

4.3.2 Marxian Perspective

Karl Marx sought the essence of capitalism neither in rational calculation nor in production for markets with the desire for gain. For Marx, capitalism is a historically specific **MODE OF PRODUCTION**, in which capital is the principal means of production. A mode of production is not defined by Technology, but refers to the way in which the conditions of production are owned and controlled, and to the social relations between individuals which result from their connection with the process of production. Each mode of production is distinguished by how the dominant class controlling the conditions of production, ensures the extraction of the surplus from the dominated classes. As Marx clarifies in a famous passage, the really distinctive feature of each society is not how the bulk of labour is done, but how the extraction of the surplus from the immediate producer is secured.

Capitalism is perceived as a transient form of class society in which the production of capital predominates, and dominates all other forms of production. Capital is not a thing, not simply money or machinery, but money or machinery inserted within a specific set of social relations, based on private property, whose aim is the expansion of value (the accumulation of capital). Capitalism is therefore built on a social relations of struggle between the bourgeoisie and the working class. Its historical prerequisite was the concentration of ownership in the hands of the ruling class and the

consequential and ‘bloody’ emergence of a property-less class for whom the sale of labour power is their only source of livelihood. Capitalism therefore combines formal and legal equality in exchange with subordination and ‘exploitation’ in production. Like Weber, Marx portrayed capitalist society as the most developed historical organization of production. Unlike Weber, Marx thought that Class Struggle and competition between capitals would intensify, producing ever deeper bouts of crisis, and that at some point capitalism would either degenerate into barbarism or progress to ‘socialism’.

4.3.3 Historical Development of Capitalism

Marx claims that in Western Europe capitalist society began to evolve in the sixteenth century and was making giant strides towards maturity in the eighteenth century. Industrial capitalism, which Marx dates from the last third of the eighteenth century, finally establishes the domination of the capitalist mode of production: “At first trade is the precondition for the transformation of guild and rural domestic crafts into capitalist businesses. As soon as manufacture becomes somewhat stronger, and still more so large-scale industry, it creates a market for itself and uses its commodities to conquer it. Trade now becomes the servant of industrial production, for which the constant expansion of the market is a condition of existence”.

For many analysts, Britain’s dominance of the world economy in the mid- to late nineteenth century is seen as constituting the high point of the laissez-faire phase of capitalism. This phase took off in Britain in the 1840s with the repeal of the Corn Laws, the Navigation Acts and the passing of the Banking Act. The state adopted a liberal form which encouraged competition and fostered the development of a ‘self-regulating’ market society. Liberal and conservative thinkers have been keen to identify this particular phase of capitalism with the essence of capitalism itself.

World War I marked a turning point in the development of capitalism. After the war, international markets shrank, the gold standard was abandoned in favour of managed national currencies, banking hegemony passed from

Europe to the United States, and trade barriers multiplied. The Great Depression of the 1930s brought the policy of laissez-faire (non-interference by the state in economic matters) to an end in most countries and for a time cast doubt on the capitalist system as a whole. The performance of capitalism since World War II in the United States, the United Kingdom, West Germany, and Japan, however, has given evidence of its continued vitality.

From its inception, capitalism has developed in the context of the world market. However, a number of recent changes associated with the Globalization and the demise of former ‘socialist’ states have strengthened the claim that capitalism should now be viewed as an integrated, if nevertheless uneven, world system.

4.4. IMPERIALISM

In popular political discussion, the term ‘imperialism’ has long been used to refer to a wide range of unequal power relations, especially those involving the domination of powerful states over weak ones, whether by economic, cultural or coercive means. In addition, theories of imperialism dating from the early twentieth century have had a special and enduring relevance for students of international relations, because they made bold though conflicting claims about causal links between the economic and political spheres and aspired to offer systemic explanation of war between great powers.

4.4.1 Imperialism and Colonialism

Anglo-American liberal historians simply assumed the ‘imperialism’ of the social theorists to be close synonyms for ‘colonialism’ – referring to the acquisition by European powers of formal domination over non-European territories and peoples. So colonialism can be defined as the conquest and control of other people’s land and goods. But colonialism in this sense is not merely the expansion of various European powers into Asia, Africa or the Americas from the sixteenth century onwards; it has been a recurrent and

widespread feature of human history. At its height in the second century AD, the Roman Empire stretched from Armenia to the Atlantic. However, there is crucial distinction between these two: whereas earlier colonialisms were pre-capitalist, modern colonialism was established alongside capitalism in Western Europe.

Modern colonialism did more than extract tribute, goods and wealth from the countries that it conquered—it restructured the economies of the latter, drawing them into a complex relationship with their own, so that there was a flow of human and natural resources between colonised and colonial countries. This flow worked in both directions—slaves and indentured labour as well as raw materials were transported to manufacture goods in the metropolis, or in other locations for metropolitan consumption, but the colonies also provided captive markets for European goods. Thus slaves were moved from Africa to the Americas, and in the West Indian plantations they produced sugar for consumption in Europe, and raw cotton was moved from India to be manufactured into cloth in England and then sold back to India whose own cloth production suffered as a result. In whichever direction human beings and materials travelled, the profits always flowed back into the so-called ‘mother country’.

4.4.2 Theories of Imperialism

Many different explanations have been advanced to help us understand the imperialism of the late nineteenth century. Some of the theories stress developments in European countries while others focus on developments outside Europe; some see the imperial drives as motivated by economic factors while others stress the role of military completion.

Hobson’s Theory of Imperialism

Hobson’s pioneering and influential explanation identified an ‘economic tap root of imperialism’. Hobson argued that imperialism was caused by underconsumption in Western states. The mass of the population were kept poor and could not buy the goods being produced. Economic

interests such as the finance industry, arms exporters and shipping pushed government into expanding overseas so that they could continue to make a profit. Hobson's solution to this situation was a redistribution of income within Western states. This would allow people to buy the goods being produced and would end the need for imperialism in other parts of the world. For Hobson, the design of the Western economic system promoted imperialism, but this could be reversed by changing public policy.

Lenin's views on Imperialism

Lenin's pamphlet, *Imperialism: The Highest Stage of Capitalism*, tried to account for the outbreak of war between the leading capitalist states due to imperial rivalry. Lenin had not set out to account for European colonization of the tropics. On the contrary, he specified that imperialism commented only when colonization ended. Moreover, the virtually complete territorial division of the world by the great powers was, for Lenin, only one of a number of facets of imperialism. Concurrent anti-competitive division of raw materials and world markets between large corporations were not causes but analogues of concurrent territorial division. Lenin regarded monopoly and finance capitalism as the causes of territorial rivalry. The crucial feature of imperialism was that spatially extensive development of the capitalist system was no longer possible, and the great powers and their capitalists alike were therefore caught up in a zero-sum game consisting in highly conflictual re-division of territory and markets alike.

4.4.3 Beyond Imperialism

Following the national liberation struggles and the process of decolonization after World War II, imperialism was redefined to refer to forms of world capitalist domination under the hegemony of the United States. For example, Baran and Sweezy sought to revise the Marxist theory of imperialism to take account of the latest phase of monopoly capitalism under the hegemony of the United States and rise of Multinational Corporations. Terms like neo-

imperialism and neo-colonialism were more frequently used than hitherto, indicating a shift in the analysis of imperialism.

Since the 1960s and 1970s, the theory of imperialism has largely been subsumed under dependency, unequal exchange and world-systems theory. The neo-Marxist dependency theory, in particular sought to overcome the European centrism of classical Marxist theories of imperialism, as these had centred their analysis on the imperial countries paying little attention to the internal structures and processes of the the dominated countries.

4.5 WELFARE ECONOMICS

It is very difficult to precisely define what constitutes the welfare state is. The main reasons are that welfare derives from other sources besides state activity, and there are various modes of delivery of the services made available to citizens. Some are funded but not produced by the State, some publicly produced and delivered free of charge, some bought by the private sector, and some acquired by individuals with the money handed on to them by the State. Although its boundaries are not well defined, the Welfare State is used as shorthand for the state's activities in four broad areas: cash benefits; health care; education; and food, housing, and other welfare services.

The objectives of the Welfare State can be grouped under four general headings. It should support living standards and reduce inequality, and in so doing it should avoid costs explosion and deter behaviour conducive to moral hazard and adverse selection. All these objectives should be achieved minimizing administrative costs and the abuse of power by those in charge of running it.

The road leading to endorsement of the above goals in Britain started with the liberal reforms of 1906-1914, but full commitment to them was only sealed with the legislation of 1944-48, favourable conditions for which derived from the experience of World War II and the aftermath.

Since the publication of the *General Theory of Employment, Interest*

and Money in 1936 Keynes had been arguing in favour of control over total investment – the bulk of it ought to be carried out or influenced by public or semi-public bodies – as the viable solution to maintain a steady level of employment. He saw the “curse of unemployment” as the root of the evil of market economies, driving the risk of being overwhelmed by totalitarian solutions (Nazism, Fascism) to alarmingly high levels in the 1930s.

Keynesian welfare economics emerged when the popularity of classical liberalism considerably eroded due to the Great Depression and, then, World War II. It was the belief that governments needed to play a role in regulating their economies and that the laissez faire paradigm could not operate with only an ‘invisible hand’ is the key foundation notion for Welfare Economics. A real hand needed to serve as a countervailing element to control its cycles and any speculative abuses.

This new philosophy focused not only on the need for each nation to regulate its economy individually, but also on the need to implement a structure that would establish an international financial regulatory framework and a bank that would support the reconstruction and development of the belligerent nations, as well as of the nations of the underdeveloped world.

Overall, for almost thirty years, the welfare of all ranks of society substantially improved in much of the capitalist world. Both developed and developing nations applied Keynesian economics. The First World consolidated its welfare system, and the Third World began its own. The most important event: that the responsibility of government, by using a very visible hand and intervening in the economy whenever necessary, was to provide for the general welfare of all ranks of society, became the general assumption. That is, that the first responsibility of democratic governments is to provide and maintain the conditions necessary for the common good. The need for government to directly intervene at all times in the economy and manage it, acting as an agent to compensate for the negative effect of the free forces of the market, became clearly established.

1.4.6 GLOBALISM

Over the last three decades the sheer scale and scope of global interconnectedness has become increasingly evident in every sphere, from the economic to the cultural. Worldwide economic integration has intensified as the expansion of global commerce, finance, and production binds together the economic fortunes of nations, communities, and households across the world's major trading regions and beyond within an emerging global economy. The integration of world economy is such that no national economy can insulate itself entirely from the contagion effect of turmoil in global markets. Economic instability in one region takes its toll on jobs, production, savings, and investment many thousands of miles away.

Multinational corporations now account for between 25 and 33 per cent of world trade, and 80 per cent of international investment, while overseas production by these firms considerably exceeds the level of world exports, making them key players in the global economy, controlling the location and distribution of economic and technological power.

New modes and infrastructure for global communication have made it possible to organize and mobilize like-minded people across the globe in virtual real time—as demonstrated by the Arab spring in 2011 as democratic movements spread across the West Asia and the more than 45,000 international Non Government Organisations (NGOs), from Greenpeace to the Climate Action Network, not to mention the activities of transnational criminal and terrorist networks, from drugs cartels to Al Qaeda.

With a global communication and infrastructure has also come the transnational spread of ideas, ethnic cultures, and information, both among like-minded peoples and between different cultural groups, reinforcing simultaneous tendencies towards both an expanded sense of global solidarity among the like-minded and difference between different societies, nations and ethnic groupings.

People—with their cultures—are also on the move in their tens of

millions—wither legally or illegally—with global migration on a scale of the great nineteenth century movements but now transcending all continents, from South to North and East to West, while each year over 600 million tourists traverse the globe.

As globalization has intensified, so has the recognition of transnational problems requiring global regulation, from climate change to the proliferation of weapons of mass destruction. Dealing with these transnational issues led to an explosive growth in transnational and global forms of rule-making and regulations, from annual G20 summits to climate change conferences. This is evident in both the expanding jurisdiction of formal international organizations, such as the International Monetary Fund or the International Civil Aviation Organization, and the literally thousands of informal networks of cooperation between parallel government agencies in different countries.

With the recognition of global problems and global interconnectedness has also come a developing awareness of the multiple ways in which the security and prosperity of communities in different regions of the world has repercussions for public perception of security in Europe and the USA, while agricultural subsidies in the USA and the EU have significant consequences for the livelihoods of farmers in Africa, Latin America, and Asia.

4.6.1 Conceptualizing Globalism

Initially, it might be helpful to think of globalism as a process characterized by:

- Stretching of social, political and economic activities across political frontiers so that events, decisions, and activities in one region of the world come to have significance for individuals and communities in distant regions of the globe; civil wars and conflict in the world's poorest regions, for instance, increase the flow of asylum seekers and illegal migration into the world's affluent countries.
- The intensification, or growing magnitude, of interconnectedness in almost every sphere of social existence, from the economic to the

ecological, from the activities of Microsoft to the spread of harmful microbes such as the SARS virus, from the intensification of world trade to the spread of weapons of mass destruction.

- The accelerating pace of global interactions and processes as the evolution of worldwide systems of transport and communication increases the velocity with which ideas, news, goods, information, capital, and technology move around the world—routine telephone banking transactions in the UK are dealt with by call centres in India in real time, while at the outset of the recent financial crisis stock markets across the globe displayed a synchronized collapse within minutes rather than in weeks as in the Great Crash of 1929.
- The growing extensity, intensity, and velocity of global interactions, which is associated with a deepening enmeshment of the local and global in so far as local events may come to have global consequences and global events can have serious local consequences, creating a growing collective awareness or consciousness of the world as a shared social space that is globality or globalism; this is expressed, among other ways, in the worldwide diffusion of the very idea of globalization itself as it becomes incorporated into the world's many languages.

As above paragraphs suggested, the cumulative scale, scope, velocity, and depth of contemporary interconnectedness is dissolving the significance of the borders and boundaries that separate the world into its many constituent states or national economic and political spaces. The concept of globalism seeks to capture the dramatic shift that is under way in the organization of human affairs: from a world of discrete but interdependent national states to the world as a shared social space. The concept of globalization therefore carries with it the implication of an unfolding process of structural change in the scale of human social and economic organization. Rather than social, economic, and political activities being organized solely on a local or national territorial scale today, they are also increasingly organized on a transnational or global scale. Globalization therefore denotes a significant shift in the scale

of social organization, in every sphere from economic to security, transcending the world's major regions and continents.

If patterns of contemporary globalization are highly complex, they are also highly uneven. It is a common misconception that globalization implies universality: that the 'global' in globalization implies that all regions or countries must be uniformly enmeshed in worldwide processes. This is plainly not the case, for it very markedly involves differentiated patterns of enmeshment. The rich OECD countries are much more globalized than many of the poorest sub-Saharan African states. Globalization is not uniformly experienced across all regions, countries, or even communities since it is inevitably a highly differentiated process. Among both OECD and sub-Saharan African states, elites are in the vanguard of globalization while the poorest in these countries find themselves largely excluded. Globalization exhibits a distinctive geography of inclusion and exclusion, resulting in clear winners and losers not just between countries but within and across them. For the most affluent it may very well entail a shrinking world but for the largest slice of humanity it tends to be associated with a profound sense of disempowerment. Inequality is deeply inscribed in the very processes of contemporary globalization such that it is more accurately described as uneven globalization.

Given such asymmetries, it should not be surprising to learn that globalization does not prefigure the emergence of a harmonious global community or an ethic of global cooperation. On the contrary, as 9/11 tragically demonstrated, the more the world becomes a shared social space, potentially the greater the sense of division, difference, and enmity it may engender. Historically, violence has always been central to globalization, whether in the form of the 'New Imperialism' of the 1890s or the current 'war on global terror'.

Beyond the OECD, globalization is frequently perceived as Western globalization, stoking fears of a new imperialism and significant counter-tendencies, from the protest of the anti-globalization movement to forms of

economic or cultural protectionism as different ethnic or national communities seek to protect their indigenous cultures and ways of life. Rather than a more cooperative world order, contemporary globalization, in many respects, has exacerbated existing tensions and conflicts, generating new divisions and insecurities, creating a potentially more unruly world.

Hence, many sceptics argue that globalization has been highly exaggerated and that it is a myth or ‘conceptual folly’ that distracts us from the reality of a world which is much less interdependent than it was in the nineteenth century, and which remain dominated by states, geopolitics, and Western capitalism.

4.7 LET US SUM UP

This lesson deals schematically with an enormous time-span and controversial debates. Any exploration of the origins of capitalism is forced to investigate a series of questions about the nature of the society that preceded it and the processes that contributed to its genesis. Capitalism emerged out of various, still imperfectly understood processes. Considering these nevertheless helps to contextualise the contemporary global political economy and perhaps to understand general processes of social change. There had been many shades of capitalism during the previous centuries. However, only with the unique conjuncture of political transformations, which broke absolutism on a national basis and established national capitalist economies, was the industrial revolution consolidated. This heralded economic expansion on a scale unprecedented in world history. Its dynamism was also contradictory. Domestic problems and crises could be solved temporarily and in part by pushing beyond national boundaries. This tended to offset and delay the contradictions, which were then played out in the form of national imperialist projects and competition between the imperialist powers. It led to two world wars which caused massive destruction, but left the United States as the world’s most powerful economy. The Keynesian welfare economics policies pursued in the post-World War II significantly contributed

to the reconstruction of entire Europe. However, the recession experienced by the Europe and North-American capitalism pushed these economies towards neo-liberal policies. The destruction of the Soviet Union and socialist world further consolidated capitalism in entire world as globalization brought all the markets and societies into a single entity.

4.8 EXERCISE

1. How do you understand Mercantilism and its relation to colonialism and economic nationalism?
2. Briefly state various perspectives on Capitalism.
3. Write a note on imperialism and major theories on imperialism.
4. How do you understand Welfare Economics and contribution of Keynes to it?
5. Critically analyse contemporary globalism or globalization.

M.A. Political Science, Semester III, Course No. 304, International Political Economy

**UNIT – II: POST SECOND WORLD WA R INTERNATIONAL
ECONOMIC ORDER**

**2.1 BRETTON WOODS SYSTEM: CONTEXT AND
EMERGENCE**

- V. Nagendra Rao

STRUCTURE

2.1.0 Objectives

2.1.1 Introduction

2.1.2 Political-Economic Context

2.1.3 Bretton Woods: Multiple Discourses of Economy

2.1.3.1 The Context and Conditions

2.1.4 Bretton Woods Conference

2.1.5 The Bretton Woods Model

2.1.6 The Status of Developing Countries

2.1.7 Let us Sum Up

2.1.8 Exercise

2.1.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The political and economic context for the initiation of Bretton Woods Conference in the post-Second World War period;
- The dominant economic and ideological discourses that guided the proceeding of Bretton Woods Conference and the institutions emerged out of it;
- The core economic order emerged out of Bretton Woods Conference that has become a regulatory role in contemporary international political economy;
- The status and role of developing countries in the Bretton Woods conference and the institutions emerged out of it.

2.1.1 INTRODUCTION

Toward the end of the Second World War it was realized that more than just a gentlemen's agreement would be needed to achieve meaningful economic coordination between states. An international system administered by an international organization was required if states were to renew their economies and live in peace. With this in mind, delegates from forty-four countries met in July 1944 at a place called Bretton Woods, New Hampshire. In this tiny place plans were laid for three big global institutions – the international Monetary Fund (IMF), the World Bank and the International Trade Organization (ITO). As a result, for the first time there was a codified form of rules and principles that imposed some obligations on states in the conduct of their economic affairs. Given that money and trade had always been a symbol of political power, the incursion of Bretton Woods into state sovereignty was considerable. The institutions of Bretton Woods were part of a planned global regulatory system for trade and finance. Financial regulatory cooperation among states in the past had been bilateral. It had been based on the need to deal with a crisis, as in the case of cooperation

between the central banks of England and France during the nineteenth century, or it had been cooperation based on following the Bank of England's lead. Bretton Woods represented a different kind of cooperation. It was a shift away from the tacit, convention-based cooperation of central bankers to a sweeping, rule-based, multilateral cooperation of states. Such cooperation would be based on a world market, in which capital and goods might move freely, regulated by global institutions operating in the general interests of greater stability and predictability.

This lesson looks at three aspects of the emergence of the new global economic accord. Firstly, it looks at the political and economic conditions prevailing in the West between the late nineteenth century and the middle of the twentieth, the idea being to contextualize expressions of collective concern about the capitalist economy that led to Bretton Woods. Secondly, it outlines the economic perspectives dominant at the time, from the intersection of which Bretton Woods policies emerged as a governance system for a world in crisis. Thirdly, it explains the political economy of the conference itself, and the Bretton Woods model that resulted. Needless to say, these three lines are intertwined.

2.1.2 POLITICAL-ECONOMIC CONTEXT

What we now call modern 'globalization' – an intense interchange of people, ideas, capital and technology across international space – came into existence during the Pax Britannica, roughly between 1875 and 1914. This was a period of relative peace in which liberal consciousness, with its faith in the natural progress of reason, rationality and the rule of law, combined with an assumption of racial superiority to justify European economic and political domination of large parts of the non-industrialized world. This world was tied together politically by imperialism and economically by trade, investment and flows of technology. Most trade remained inter-European, with the colonies serving mainly as sources of raw materials.

International monetary exchanges at this time were based on the gold

standard. The rules were simple: each national currency (the amount of money in circulation) was backed by a quantity of gold held by the country's central bank. Currencies were, at least theoretically, freely convertible into gold, which was allowed to cross borders without restrictions. As the major actor, Britain provided other countries with a means of earning sterling (pounds – originally of silver) that served as the global currency for its imports.

In the years immediately following the First World War, the capitalist world economy entered a really difficult time. State treasuries were burdened by the cost of the war, which had far exceeded expectations. Moreover, Britain could no longer maintain a position at the centre of the international economy. At times of crisis, countries sought to protect domestic production regardless of the effect on other countries. Furthermore, during the war, the gold standard and currency convertibility, which regulated the price structures of independent markets, had been suspended. To mobilize domestic economies, governments printed inconvertible paper money, depreciating the values of national currencies. This resulted sporadically in massive inflation and unemployment. All this led to the onset of 'Great Depression' in the developed world in 1929 which led to the ruining of their economies.

At the same time, and in contrast to the failing economic liberalism of the Western countries, the USSR was rapidly industrializing. Its state-planned economy seemed immune to the crises plaguing capitalist nations. Communism was seen by many working-class people as a viable alternative. Soon, fascism would present another alternative. Capitalist governments were therefore confronted with two difficult tasks. Something had to be done to lessen the effects of economic catastrophe. And the hegemony of the capitalist system had to be protected from the external threats presented by communism and fascism. Efforts to resolve crisis were not successful. The usual explanation for the failure to establish a new global economic regime is that there was no world hegemonic power capable of occupying Britain's pre-war position – saddled by war debts, Britain was incapable, and the USA as yet unwilling. Apart from this, the utter inadequacy of classical approaches

to economic issues, the continuing divorce between economics and politics in the (nineteenth-century) liberal imagination, and the inherent tendency for international rivalry in (competitive) capitalist systems also factors for increasing the crisis in western world.

What ended the inter-war economic crisis was neither conference nor global economic management, but the Second World War. Mass modern warfare requires mass modern production, carefully planned by the state, which was also the primary consumer of the machinery of warfare produced. Moreover, production was for readily apparent, immediate, political objectives, rather than market-oriented consumption. The war thus brought back together economics and politics which classical liberalism had long separated. The stage was set for Bretton Woods.

2.1.3 BRETTON WOODS: MULTIPLE DISCOURSES OF ECONOMY

Even catastrophic events do not produce discourse directly. Discussions of policy need a language and a set of concepts, a discourse founded on economic theories. Bretton Woods was a reaction to the (state) protectionism of the 1930s, just as classical political economy was formulated in reaction to the protectionist economy of mercantile capitalism. The classical notion that trade prevents war and brings about peace was present in the Bretton Woods project. Bretton Woods was conceived during a planetary war of unprecedented proportions. The fighting countries longed for peace. Practically, Bretton Woods, and the resulting institutions, were supposed to prevent further wars.

However, Bretton Woods system conceptualized in a world of division and diversity. Dependence already characterized relations between North and South, whereas the communist East was becoming completely independent from the West. Under these circumstances, the equality of the classical liberal perspective could have applied only to the countries of Western Europe and North America. Hence, Bretton Woods was conceived in a world already

characterized by relations of severe inequality, especially in terms of economic development. Nevertheless, in the Bretton Woods discourse, the world was publicly described in terms of the free market with sovereign autonomous states enjoying equal opportunity in an ‘open international system’ – that is, a politically neutral market. Yet Bretton Woods also represents the aggressive desire of the capitalist market to expand globally beyond the boundaries of the developed industrial world. Owing to the influence of Keynes, however, such an expansion had to be regulated and controlled – the market should not be left to its own whims, and all nations should participate in regulating its forces.

This brings us to the second side of the issue – state intervention in the economy. Interest in Keynesian policy, understood as the political management of domestic economies, developed as faith in the self-regulating market faded during the Depression of the 1930s. As you have already studied in the earlier lesson, Keynesianism lays greater emphasis on state or government intervention in the economic policy in terms of changing the interest rates, by deficit spending and other fiscal policies, shifting the economy from one equilibrium level to another, generally to higher employment levels to avoid economic depression and crisis. Additionally Keynes was for the redistribution of wealth through taxation, mainly with the purpose of increasing the propensity to consume, and the augmentation of private investment by government spending and deficit budgets. Keynes proved theoretically what depression had long shown in practice, that free markets did not spontaneously maximize human well-being. While Roosevelt first dismissed Keynes as a mathematician, rather than a political economist, Keynesian policy became the foundation for the New Deal programme in the USA in the late 1930s.

The question was how to expand Keynesianism to the world scale. The belief grew that governments had to assume collective responsibility for managing the international economic system, and that one country, the USA as it turned out, had to assume the responsibility of global leadership. With

the post-war objectives of hegemony through economic growth and full employment on a national scale, governments had to commit to intervening in national economies and establishing welfare states. Yet also, in contrast to the inter-war period, governments were responsible for creating a stable international economic order and preventing a return to the destructive economic nationalism of the 1930s. As a result, the new international economic regime would differ from the laissez-faire regime of the nineteenth century and the protectionist regime of the 1930s. In contrast to the prevailing situation under the liberalism of the nineteenth century, the governments of nation-states would have a greater role in the economy, subject to international rules, in a compromise between domestic autonomy and international norms. Contrary to what happened in the 1930s, the new regime would appeal to the consent and cooperation of member nations, but would also commit them legally. And it would also recognize the mutual obligations of countries with balance of payment deficits and surpluses. In summary, there would be balance between national and international stability without subordinating one to the other, with institutions devised to manage and resolve international economic conflicts, and hence assume regulatory force in the international market. These institutions would assume the role of the state in a global market economy.

2.1.3.1 The Context and Conditions

Thus, the conference held at Bretton Woods was made possible, as pointed out by Spero, by three conditions. First, power was concentrated, with a small number of states, in North America and western Europe, making decisions for an entire world system. The communist eastern Europe states, with their centrally planned economies, maintained deliberate policies of isolation from the world economy, and eventually had their own 'international' regime. The dominant Euro-American states were also not challenged by countries in what came to be called the Third World, a great number of which were still emerging as independent states. Instead these countries were fully integrated into a world economy they neither managed nor controlled. And weakened by the war, Japan remained subordinate and external to management

and decision-making. Concentration and exclusion facilitated the management of the system by confining the number of actors. Hence, the success of Bretton Woods in creating the IMF and the IBRD was due to the fact that countries other than the USA and Britain did not have a chance to include their 'different points of view' about the set-up of the resulting institutions.

The second condition making Bretton Woods possible resided in the common interests shared by the powerful states, mainly their beliefs in capitalism and, specifically, by the end of the Second World War, classical liberalism tempered by Keynesianism. States differed in their degree of preference for state intervention, with France advocating more governmental planning, and the USA preferring limited planning, once the war was over. Nevertheless, the economies of all states relied fundamentally on market mechanisms, with private ownership and minimal barriers to the flow of private capital. They all agreed on a conception of the 'common good': the bringing of international peace through maximization of economic welfare, with political and military security being of primary importance.

The third condition was the new willingness, and ability, of the USA to assume leadership. After the Second World War, the American economy enjoyed a huge, growing market, particularly in consumer goods, great productive capabilities, and a strong currency. Combined with American military might, especially atomic weapons, this provided the advanced capitalist economies, and the world system they were planning, with a leading power. American hegemony and internationalist (capitalist) ideals became, for the USA, inseparable. After all, at the end of the war, the USA owned three-quarters of the world's existing monetary gold, still the bedrock of currency stabilization. According to Eric Hobsbawm (1994), the institutions emerging from Bretton Woods were de facto subordinated to American foreign policy.

2.1.4 BRETTON WOODS CONFERENCE

The United Nations Monetary and Financial Conference hosted by the US Treasury Department at Bretton Woods in 1944 brought together delegates from 44 allied and associated nations and a neutral country, Argentina. Lord Keynes chaired the British delegation. Alongside the leading economists of the time, however, were government delegates with few of the qualifications necessary for a conference of that significance. Most of the delegates learned of the issues to be discussed only during the conference. Moreover, many did not speak English, the official language of the conference, and the sophisticated issues discussed remained unintelligible to many. That is the reason Van Dormael said that “At Bretton Woods, representatives of forty-four delegations signed the agreements without having the time or opportunity to read them”.

The Bretton Woods conference merely formalized previous agreements between the British and the Americans. The conference followed two and a half years of negotiations between the treasuries of the USA and the UK. Through a succession of bilateral agreements, the USA and the UK worked together toward forming a ‘world with expanding trade and easily convertible currencies’, a world that matched their own economic interests as industrially dominant powers.

The quota system that was followed to determine the status and power of members in both IMF and IBRD (WB) had become very critical to the institutional structure of Bretton Woods. The system of subscriptions and quotas as proposed by the USA would be a fixed pool of national currencies and gold subscribed by each member country. Members were assigned quotas roughly reflecting their relative economic importance. Quotas were deemed of great importance because voting power at what eventually became the IMF would be based on them, as the American delegation proposed. From the beginning it was tacitly agreed that votes on decisions made at the IMF, and later the IBRD, would be proportional to members’ quotas, and not on the more democratic one-country-one-vote system. Clearly, this system did

not meet all countries' expectations, and it remained problematic even for many who accepted it. With one-third of all the quotas at the outset, the USA assured itself an effective veto power over future decision-making.

Both the US and the UK agreed for a kind of 'international agency' that would control exchange rates. The international agency was conceived in this way so as to have 'supervisory power' concerning national actions threatening international equilibrium. The policing function of the agency was greeted by Soviet hostility, and eventual refusal to ratify the agreements made at the conference – accepting the IMF would mean 'exacting investigations' of Soviet gold production, gold and foreign exchange holdings.

2.1.5 THE BRETTON WOODS MODEL

The Bretton Woods institutions were supposed to govern agreed upon principles for the conduct of economic affairs decided at the conference – as stated in Article I of the Agreement, the IMF's purpose was 'to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy'. These principles were as follows:

- 1) Each member country's currency has been assigned a par value (based on gold reserves) with the dollar to facilitate exchange between various currencies in economic interactions.
- 2) A pool of gold and currencies to be drawn on in case of balance of payments difficulties was subscribed by member countries to the IMF according to a quota system adjusted every five years. The quota determined the country's drawing rights and also its vote in the institution. Countries could exchange specified amounts of their currencies for those of other countries under conditions supervised by the IMF.
- 3) To enable multilateral trade, after a five-year transition period, all

member countries were to eliminate controls making currencies convertible into one another at the official rates without restrictions or discrimination unless approved by the IMF.

- 4) The Bretton Woods Agreement established a permanent institution to promote international monetary cooperation and provide the machinery through which countries could consult and collaborate. The institution, called the IMF, a specialized agency of the UN, was part of an envisaged system that also included a bank dealing with long-term investments (IBRD), a trade organization (ITO), and actions to promote full employment under the UN Economic and Social Council.

2.1.6 THE STATUS OF DEVELOPING COUNTRIES

Post-war decolonization involved, in part, a movement for the redistribution of global economic power away from its exclusively Western, capitalist bases. However, Bretton Woods was an occasion for the formalization of US and UK dominance into an international monetary agreement, complete with enforcing institutions. Through the institutions established through Bretton Woods Conference, the Developed Western countries formally gained control over global economic matters, which include the economic development of poor developing countries. The involvement of the developing countries in the proceedings of the Bretton Woods Conference was almost negligible.

According to Richard Gardner, one of the leading scholars of the origins of the 1944, the Bretton Woods negotiations were dominated by a ‘sterling-dollar diplomacy’ between US and British officials in which the question of how to assist the development of poorer countries was not recognized as a major issue in the postwar planning. His more specific discussion of the creation of the IMF reinforces this point: “the delegates at Bretton Woods gave little thought to the Fund’s potential impact on the less-developed countries”. Gardner even downplays the significance of the creation of the International Bank for Reconstruction and Development at the

conference: “There was simply no conception of the vast needs of the less developed countries and of the role the Bank should play in meeting them. Indeed, the Bank was conceived mainly as an institution for reconstruction”.

Gardner’s view of the Bank’s original purpose is shared by others. For example, in a prominent book analyzing the Bretton Woods institutions, geographer Richard Peet argues:

“The IBRD was a mere afterthought. What little exchange there was concerning the IBRD centred on its possible role in the post-war reconstruction of Europe. On the few occasions that poor countries were – briefly – mentioned, issues such as poverty never came up. Indeed, such were the preoccupations of the Europeans and Americans at the time that labels such as ‘poor countries’, or the more critical term ‘underdeveloped countries’, did not exist as functional geographical categories - countries outside Europe and North America were referred to as ‘the colonies’.”

Similarly, Gerald Meier, a leading authority in the history of development thinking, describes the Bretton Woods conference: “Most of the developing countries were still colonies, and only a relatively few, mainly independent nations of Latin America, were invited. The political power lay with the United States and Britain, and from the outset it was apparent that issues of development were not to be on the Bretton Woods agenda”. Like many other scholars, he also cites a comment from Keynes before the conference in which he dismissed the potential significance of many poorer countries invited to the conference, arguing that they “clearly have nothing to contribute and will merely encumber the ground... The most monstrous monkey-house assembled for years.”

Meier also argues that poorer countries themselves did not press for development issues to be included on the Bretton Woods plans: “At Bretton Woods, the developing countries tended to view themselves more as new, raw-material-producing nations and less as countries with general

development problems. Comprehensive strategies of development and policies to accelerate national development were yet to be identified". In Meier's view, it was thus not only American and British officials who "were not directly interested" in development during the negotiations. As he puts it, "even most of the representatives of LDCs seemed unconcerned".

The role and significance of poorer countries is also minimized by John and Richard Toyne in their important contribution to the UN Intellectual History project. They argue that "close cooperation between the British and American delegations" at the conference "helped ensure that the voices of developing countries were drowned out". When discussing the US and British plans, Toyne and Toyne also argue that "there was no apparent recognition that the interests of countries participating in the proposed multilateral regime might differ – there were no special concessions to countries with less-developed economies". This latter argument is echoed by Edward Mason and Robert Asher in their detailed history of the World Bank:

"insofar as the Bretton Woods delegates considered the question specifically, they saw no reason to distinguish between those policies relating to trade, payments, and capital flows that were considered to be favourable to the growth and prosperity of the developed countries of the world from those favourable to less developed countries. In fact, the distinction between developed and less developed and between North and South – the special problems of the 'third world' – had scarcely swum into the ken of postwar planners."

As a result, most of the developing countries constituted United Nations Commission on Trade and Development (UNCTAD) as alternative to Bretton Woods institutions. They attempted to achieve reforms global economic order and called for a New International Economic Order (NIEO). However, with the dissolution of the socialist world in the late 1980s and 90s, the UNCTAD was effectively replaced by the WTO, founded in 1994. As a result, the USA

that emerged from Bretton Woods as an unchallenged power, continuing its hegemony in contemporary international economic order.

2.1.7 LET US SUM UP

The 1944 Bretton Woods conference is justly famous for creating the foundation of the postwar international financial system. The Bretton Woods negotiators established a new multilateral legal framework for financial relations as well as two institutions - the International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD) – that remain, albeit in altered forms, at the centre of global financial governance today. These arrangements were underpinned by an innovative “embedded liberal” vision that sought to reconcile a commitment to liberal multilateralism with new interventionist economic practices that had become influential across the world during the 1930s.

The Bretton Woods conference has also attracted many critics over the years. One of the most consistent criticisms concerns its treatment of international development issues. The Bretton Woods agreements are commonly portrayed as a product of Anglo-American negotiations between 1942 and 1944 in which little attention was paid to the concerns of poorer – or “Southern” – countries. This historical narrative has reinforced arguments that the Bretton Woods system has long privileged the narrow interests and perspectives of Northern countries over those of the Southern countries.

2.1.8 EXERCISE

1. Explain the historical context for the emergence of Bretton Woods’s institutions.
2. What is the political and economic context that led to the initiation of Bretton Woods Conference?
3. How do you understand the dominant economic discourse of Bretton Woods Conference?

4. What is the core economic model that emerged out of Bretton Woods Conference?
5. Critically evaluate the status of developing countries in the Bretton Woods Conference.

**2.2 INTERNATIONAL MONETARY SYSTEM:
GOLD EXCHANGE STANDARD, IMF AND ITS
EVOLVING ROLE**

- V. Nagendra Rao

STRUCTURE

2.2.0 Objectives

2.2.1 Introduction

2.2.2 Historical Outline

2.2.3 The Post-war Monetary System: The IMF

2.2.3.1 Structure of the IMF

2.2.4 IMF Policy 1945-71: Gold Exchange Standard

2.2.5 Crisis and Transition 1971-79

2.2.6 The Financial Revolution and Monetary Affairs

2.2.7 Third World Debt Crisis: The Changing Role of IMF

2.2.7.1 IMF and the Debt Crisis of the 1980s

2.2.7.2 Capital Account Liberalization: Financial Crisis

2.2.7.3 New Debt Crisis in Latin America

2.2.8 Protesting the IMF

2.2.9 Let us Sum Up

2.2.10 Exercise

2.2.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The reasons for creating IMF and its structure;
- The exchange rate policies pursued by IMF in its early years;
- The transformation of IMF into from stabilizing international economy to institution of lending institution;
- IMF role in East Asian and Latin American financial crisis
- The major criticism offered by various scholars to the policies pursued by IMF;

2.2.1 INTRODUCTION

The intricate workings of the international monetary and financial structure matter to us as individual consumers we buy imported goods. The currency exchange rates and transnational financial flows not only affect the success of many businesses and industries but also affect us as citizens because the particular rules, regulations, and conventions governing international monetary and financial relationships affect our ability to attain a variety of political, social, and economic objectives. These relationships matter to states as they affect their wealth and power. Finally, this structure matters to us as citizens of the world because issues such as development, international peace, and prosperity are also influenced by how well this system works. This lesson explains a number of fundamental elements of the international monetary and financial structure, including its basic institutions and who manages them, who determine its rules, why and how these rules change, and finally who benefits from its framework.

2.2.2 HISTORICAL OUTLINE

In the decades immediately following World War II, monetary and financial affairs were in general isolated from one another. The international

monetary system based on fixed but adjustable exchange rates was generally isolated from international finance, with little interaction between the two. In fact, there was really no international financial system as we now conceive it, because almost every country maintained capital controls. This relatively simple situation began to unravel in the 1960s with the emergence of the Eurodollar market. The first oil crisis in 1973 and the subsequent huge financial surplus of the Organization of Petroleum Exporting Countries (OPEC) changed this situation and led to creation of an international financial system. This then led to the integration of international money and international finance. For the first time in the postwar era, the international monetary system and international finance interacted and influenced one another.

2.2.3 THE POST-WAR MONETARY SYSTEM – THE INTERNATIONAL MONITARY FUND (IMF)

The post–World War II international monetary system was designed in 1944, and its fundamental principle was that exchange rates should be fixed in order to avoid the “competitive currency devaluation” policies of the 1930s and the ensuing economic anarchy. The International Monetary Fund (IMF) created at that time was intended to achieve this goal and to provide monetary reserves sufficient to enable member governments to maintain the exchange rates for their currencies at predetermined values.

The IMF was created essentially to do two things: it would regulate the rates at which currencies were exchanged among member countries; and it would help ensure international stability by making loans at times of crisis in member countries’ balances of payments. While its mission statement remains essentially the same, the IMF has subsequently undergone major changes, including several apparent reversals of fortune, that nevertheless resulted in an overall accumulation of power and influence – although recently that accumulative trend seems finally to have reversed. Today IMF policies directly affect the economies of 185 countries and influence, sometimes

drastically and often disastrously, the lives of the vast majority of the world's people. Until recently the IMF was probably the single most powerful non-state (governance) institution in the world. Publicly, governments had to praise the IMF, while complaining privately about the policies imposed on them.

2.2.3.1 Structure of the IMF

Established in 1945, when twenty-nine governments signed articles of agreement resulting from the 1944 Bretton Woods conference, the IMF actually began operations in 1947. The IMF was supposed to be the primary supranational institution that regulated the financial conditions deemed appropriate for the successful functioning of the world economy – especially, in its early days, conditions relating to currencies and exchange rates. As stated in Article I of the original Articles of Agreement, the objectives of the IMF were:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
5. To give confidence to member governments by making the general resources of the Fund temporarily available to them under adequate

safeguards, thus providing them with opportunity to correct maladjustment in their balance of payments without resorting to measures destructive of national or international prosperity.

6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

Theoretically the IMF is situated within the United Nations system. It is the central institution of the international monetary system, the system of international payments and exchange rates among national currencies, which prevents crises in the payments system. It does so by monitoring the economic policies of member countries and acting as a reserve fund that can be used by members needing temporary financing to address balance of payments problems. The IMF focuses mainly on the macroeconomic policies of governments, including: policies relating to the state budget, the management of money and credit, and the exchange rate; and the financial policies of governments, including the regulation and supervision of banks and other financial institutions. In addition, the IMF looks at the structural policies that affect macroeconomic performance (that is, the performance of economic aggregates such as national income, total national consumption, investment and the money supply). Under Article IV of the Articles of Agreement each member country commits itself to: directing its economic and financial policies toward orderly economic growth with reasonable price stability; promoting stability by fostering orderly underlying economic and financial conditions and a monetary system that does not produce erratic disruptions; avoiding manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and following exchange policies compatible with these undertakings.

The Board of Governors, with representatives appointed by all member countries (usually a country's minister of finance or the governor of its central bank), is the highest authority governing the IMF. The Board of Governors

meets twice a year at the joint annual meetings of the IMF and the World Bank to make decisions on major policy issues.

The Board delegates immediate, day-to-day decision-making to an Executive Board of twenty-four executive directors, with a managing director as chairman. The IMF staff and management are accountable to the IMF's managing director, who is appointed by and accountable to the Executive Board. By 'gentleman's agreement,' the managing director is chosen by the IMF's European member governments, while the first deputy managing director is chosen by the US government. The IMF's five major shareholders – the USA, Japan, Germany, France and the UK – along with China, Russia and Saudi Arabia, have their own seats on the Board. The other sixteen executive directors are elected for two-year terms by groups of countries called constituencies. Member votes and representation are skewed in favour of creditor nations. Ten of the available 24 Board seats are currently occupied by developing countries, collectively holding 26 per cent of the voting share. For developing countries to carry a decision in their favour they must build alliances with creditor members. There are currently forty-five sub-Saharan African member countries in the IMF, which hold a combined voting share of 4.4 per cent.

The IMF's financial resources come mainly from the capital subscriptions that countries pay when they join the organization. Countries pay 25 per cent of their quotas in 'hard' or readily convertible currencies, such as US dollars or Japanese yen (originally these payments were in gold), and the rest in their national currencies. Quotas determine a country's subscriptions, its voting power, and the amount of financing it can receive from the Fund. Quotas reflect the size of a country's economy and its volume of trade. The USA contributes most to the IMF and has 17 per cent of the total votes; Japan and Germany both have about 6 per cent of the votes; France and the United Kingdom each have 5 per cent; Saudi Arabia, China and Russia have approximately 3 per cent each. Since January 1999, IMF quotas have totaled \$290 billion.

Countries usually approach the IMF for financing when they are experiencing balance of payments problems – that is, not taking in enough foreign exchange (especially hard currency) from exports, or foreign investments, to pay for imports. This emergency situation, important because some imports are vital for economies or social services to function, is usually accompanied by other signs of economic crisis, as when the national currency is under attack in foreign exchange markets, the country's reserves of gold or hard currencies are heavily depleted, or the economy is suddenly depressed. The IMF imposes certain conditions when countries approach it for loan. These conditions (or 'conditionalities') consist of policies that a government has to put into effect to convince the IMF that it will be able to repay the loan within a time span of one to five years. There has been a significant increase in the number of conditionalities set for low-income countries eligible for its Poverty Reduction Growth Facility (PRGF) programme. This increase in prescriptions has greatly expanded the IMF's remit to include public sector employment, privatization, public enterprise reforms, trade policy, pricing, social security systems and 'systemic' reforms, among others.

The IMF currently provides loans under a variety of 'arrangements' and 'facilities':

- ***Stand-by Arrangements*** assure member countries that they can draw up to a specified amount, usually over twelve to eighteen months, to deal with short-term balance of payments problems.
- ***The Extended Fund Facility*** provides assurance that member countries can draw up to a specified amount, usually over three to four years, to make structural economic changes that the IMF thinks will improve balance of payments.
- ***The Poverty Reduction and Growth Facility*** (replacing the Enhanced Structural Adjustment Facility in 1999) provides low-interest loans to the lowest-income member countries facing protracted balance of payments problems, with the cost to borrowers subsidized by funds

raised through past sales of IMF-owned gold, together with loans and grants from richer member countries.

- ***The Supplemental Reserve Facility*** provides additional short-term loans at higher interest rates to member countries experiencing exceptional balance of payments difficulties because of sudden loss of market confidence reflected in capital outflows.
- ***Contingent Credit Lines*** provide precautionary IMF financing on a short-term basis when countries are faced by a sudden loss of market confidence because of contagion from difficulties in other countries.
- ***Emergency Assistance*** helps countries coping with balance of payments problems arising from sudden and unforeseeable natural disasters or, since 1995, emergency conditions stemming from military conflicts.

At present, all IMF borrowers are developing countries, transitional post-communist countries or ‘emerging market’ (middle-income) countries recovering from financial crises – although the middle-income countries have recently become extremely reluctant to borrow from the Fund.

2.2.4 IMF POLICY 1945–71: THE GOLD EXCHANGE STANDARD

The IMF was formed mainly to address the economic needs of the European and North American nation-states in the immediate post-war period. These problems were thought to centre on exchange rates and balances of payments. To clarify: the term ‘exchange rate’ refers to the price of one currency in terms of others. In market systems, exchange rates vary with fluctuations in the demand for and supply of a country’s currency. These, in turn, depend basically on demand for and supply of the country’s goods and services – although currency speculation also plays an increasingly important role. The term ‘balance of payments’ refers to the total financial transactions between the residents of one country and residents of the countries of the rest of the

world. Balance of payments accounts are kept by governments and are divided into a current account – recording payments for goods and services – and a capital account – recording flows of capital assets such as cash, stock market securities and government and corporate bonds. Countries have to maintain reserves of gold and hard currencies acceptable in global trading relations to cover a sudden shortfall in export earnings or dramatic changes in the market value of their currency, otherwise they would not be able to pay for necessary imports. Such reserves normally cover at least several months' worth of imports. Reserves covering only a few weeks' worth of imports signal a balance of payments crisis. In such cases, to prevent disruptions in trade, or to forestall drastic measures such as debt repudiation, deficits in a country's balance of payments can be temporarily filled by international credits, such as drawing from previous deposits with the IMF, or short-term loans from foreign banks.

In the longer term, a country's exports, and thus its foreign exchange earnings, can be increased by devaluing the national currency in terms of other currencies. Devaluation immediately makes exports cheaper and more internationally competitive. But it also makes imports more expensive, and as these higher-priced goods feed through the national economy, inflation eventually results. A further round of devaluations may then be necessary. This is exactly the kind of devaluation cycle that the IMF is supposed to prevent.

Through the IMF, member countries originally agreed to fix their exchange rates in a system of 'par values.' Each member country determined a value for its currency, measured in relation to gold, a commodity used to represent value in general, which was permanently valued at \$35 an ounce.

The arrangement of fixed value of currencies worked fairly well from 1947 until the late 1960s because a political bargain was struck between the United States and the nations of Western Europe. Once the Cold War began in 1947, the United States consciously accepted its hegemonic role of providing the collective good of security for its allies. Many point out that in

the bipolar world of the Cold War, this arrangement boosted Western European and Japanese recovery from the war and preserved an environment for trade and U.S. and other foreign investment in Western Europe. These policies also helped tie together the allies into a liberal-capitalist U.S.-dominated monetary and finance system.

As a hegemonic currency, the US dollar played the role of top currency, one in great demand that was often used in international trade and finance transactions. The dollar was also the reserve currency because of its fixed value to gold.

2.2.5 CRISIS AND TRANSITION 1971–79

The hegemony the US maintained due to dollars supremacy provided distinct advantages to it as the United States could spend freely for a variety of domestic programmes as well to fund the Vietnam War by merely printing more money, without the cost of those programmes weakening the dollar. The dollar could not depreciated in value against gold, because that would undermine one of the primary features of the fixed exchange system. As President Charles de Gaulle of France bitterly complained in the 1960s, the “hegemony of the dollar” conferred “extravagant privileges” on the United States, because it alone could simply print dollars to fight foreign wars, could buy up French and other businesses, and could go deeply into debt without fearing negative consequences.

Nevertheless, there was a fundamental contradiction at the heart of this dollar-based system. While the huge outflow of American dollars to finance the rebuilding of Western Europe and Japan and the American military build-up during both the Korean and Vietnam Wars helped solve certain problems, this outflow of dollars meant that the United States would one day be unable to redeem in gold, and at the agreed price of \$35 per ounce, those dollars held by private investors and foreign governments. This eroded the confidence in the dollar as the American balance of payments shifted from a surplus to a deficit. This problem did become acute late in the 1960s when

escalation of the Vietnam War and its inflationary consequences caused deterioration in international confidence in the value of the dollar. As that confidence declined, the foundations of the Bretton Woods System of fixed rates began to erode.

The success of the fixed exchange-rate system eventually undermined the value of the dollar, the monetary structure's institutions and rules, and the US leadership of the Bretton Woods monetary structure. By the early 1970s that structure had become too rigid, making it difficult for states to grow at their own pace and to promote their own interests and values. To prevent recession (a slowdown in the domestic economy) at home, in August 1971 President Richard Nixon *unilaterally* decided to make dollars nonconvertible to gold. The United States devalued the dollar, and, to help make up its deficit in the balance of payments, imposed a 10 per cent surcharge on all Japanese imports coming into the US. The US abandoned its role of benevolent hegemon for the sake of its own interests. Both the US and Western Europe accused one another of not sacrificing enough to preserve the fixed exchange-rate system.

Subsequent efforts of an international committee to develop a new system of stable exchange rates failed. The overwhelming problems posed by increased capital mobility, along with fundamental differences between the United States and Western Europe over any new system, made agreement impossible. As a consequence of this impasse, the major industrial powers accepted economic reality at the Jamaica Conference (1976) and instituted flexible rates.

2.2.6 THE FINANCIAL REVOLUTION AND MONETARY AFFAIRS

The end of the fixed rate system led to the growth of the Eurodollar market and overseas expansion of American banks in the 1960s had resulted in the emergence of an international financial market. Then, in the 1970s, development of the new international financial system accelerated following

deregulation of domestic financial systems, removal of capital controls in a number of countries, and the greatly increased size and velocity of global financial flows, an increase made possible by modern communications and new financial techniques and instruments.

Freeing financial markets facilitated reorganization and transformation of international business. Increased integration of national financial markets encouraged creation of a single, globally integrated market for corporation ownership and such corporate takeover activities as the late-1990s merger of Chrysler and Daimler-Benz.

The substantial increase in international interdependence has also had a profound impact on domestic economic policy. Economic interdependence considerably reduced the capacity of many countries to pursue full-employment policies, and this in turn undermined the domestic consensus supporting an open world economy. Increased interdependence also has integrated such once-isolated policy issues as trade flows and exchange rate determination, thus immensely complicating the task of managing the world economy and raising important questions about the adequacy of the rules governing international economic affairs.

With these several developments, the Bretton Woods rule-based international monetary system was replaced by a shaky political agreement among the dominant economic powers (G-7); this change made the central bankers of the major economic powers de facto managers of the international monetary system.

2.2.7 THIRD WORLD DEBT CRISIS: THE CHANGING ROLE OF IMF

The end of fixed exchange system drastically altered the role of the IMF, it transformed into a lending agency for Third World countries as they experienced huge balance of payment crisis due to increase in oil prices. In 1973, the Organization of Petroleum Exporting Countries (OPEC) raised the price of oil from \$3.01 to \$5.12 a barrel. Two months later it increased the

price again, to four times the original. First World and Third World (non-oil-producing) countries suddenly incurred greatly increased energy costs. Oil-producing states accumulated huge surpluses in their balances of payments, while most non-oil-producing countries, especially in the Third World, went into equally serious deficits. Time, it seemed, for the IMF to ride to the rescue.

The deficits faced by Third World countries became an opportunity for private financial institutions, especially commercial and investment banks, to step in. Led by Citicorp, a US commercial bank based in New York, banks began extensive lending to the Third World in the late 1960s. The scale of this lending greatly increased in the mid-1970s, when the commercial banks began recycling 'petro-dollars,' deposited in New York and London banks, as loans to Third World governments. These private institutions were less concerned with the social and political responsibilities attending the loans, and were more concerned with the interest earned – on the whole, commercial bank lending was to middle-income, industrializing Third World countries, where it was thought that money could be made. The whole process of inflated lending on easy or non-existent terms resulted in even more debt, without much economic growth to service the loans, and with excess, unnecessary imports contributing even further to national deficits. Increasingly, Third World countries accrued new debt merely to repay interest on the old. Then financial institutions in the West suddenly realized that many debtors were not repaying their loans. The major banks panicked and refused to lend more. Third World countries could no longer borrow to cover their balance of payments deficits. So while the accumulating of indebtedness at first signalled a further potential decrease in the power of the IMF, and an increase in the direct powers of private banks, eventually the reverse happened, and the institution rose to new prominence, with new functions and greater powers of control over even more dependent countries.

In early 1974 the IMF set up a special temporary oil facility, financed by borrowing from member countries, mainly for Third World countries to draw from to pay the higher oil prices. Also in 1974 the IMF introduced an

extended fund facility to give medium-term assistance to Third World countries. Essentially the IMF survived and prospered by lending the funds for overcoming the world oil crisis and the multiple debt problems associated with it, especially the accumulating commercial bank debt.

Under the guise of stabilizing the balance of payments situation in a country, the IMF engaged in the ‘financial programming’ of an applicant country’s monetary, fiscal and other economic policies under the general term ‘conditionality’ and employing its powers of Article IV surveillance. Surveillance of exchange practices increased, while ‘technical assistance’ and training of officials in economic and financial management were expanded. To summarize, in the late 1970s the IMF assumed greater powers of control over longer-term economic policies (structural adjustment rather than short-term stabilization) while still supposedly paying ‘due regard for the priorities, and circumstances of members.’

2.2.7.1 IMF and The Debt Crisis of the 1980s

After rising at a rate of 12 per cent per year in the 1970s, commodity prices dropped sharply in the early 1980s, creating catastrophic circumstances for countries dependent on exporting raw materials. Countries partly compensated for the declining terms of trade with increased foreign borrowing. By 1982 the aggregate debt of non-oil producing Third World countries had risen to \$600 billion. The crisis was acute in Latin American countries, particularly in Mexico and Brazil, as they defaulted in paying back the loans they have taken earlier as interest rates raised sharply and exports fallen.

The main players in the debt business were: the IMF, the Western commercial banks, and the First World governments on one corner of a triangular system; the governments of impoverished, oil-importing countries on another; and the people of the affected countries on the third. Concerned mainly with ensuring that loans were repaid, the IMF and the commercial banks developed an uneasy relationship of mutual support. The commercial

banks needed the IMF to ensure loan repayment, and the IMF could do this with stabilization and structural adjustment measures imposed as conditions for loans ensured by the state. In return for playing this essential role, denied to private banking institutions, the IMF demanded that the commercial banks contribute even more money for international lending. This made the IMF a more powerful institution again, while increasing the profits of the commercial banks (\$500 million profit in Mexico, \$1 billion in Brazil), but left Third World countries even more heavily indebted. In the end, however, the people of the debtor countries paid the price in terms of unemployment, cuts in services and higher prices for basic necessities.

The formula used by financial institutions to handle the debt crisis was called 'rescheduling.' During the first phase of the debt crisis, from 1982 to 1985, possible default by Third World countries was met by new loans organized by commercial banks, the IMF and other lenders. New lending under rescheduling was supposed to provide a respite enabling indebted countries to put their finances back in order, and resume repayment of their debts. The indebted countries had to follow IMF-sponsored structural adjustment measures that included raising taxes, raising tariffs, devaluing the currency and usually reducing government expenditure. Debt relief took the form of payment rescheduling, sometimes on concessional (low-interest) terms, sometimes coupled with new loans. Creditor governments formed a committee to deal with debt relief, in consultation with the IMF, which was hosted by the French Treasury and known as the 'Paris Club.' Repeated Paris Club rescheduling of debts led official lenders eventually to recognize that a new approach was needed for these countries.

2.2.7.2 Capital Account Liberalization – Financial Crisis

As per one of the original mandate, payments for current transactions, dealing with trade and other current business, including services and short-term banking and credit services, lie within the IMF's jurisdiction, while capital transactions, which are payments for the purpose of transferring capital, do not. In other words, the IMF was to regulate financial issues arising

from trade in goods and services that appear in the current accounts of countries' balances of payments. Private capital movements to 'emerging markets' that were not directly related to trade, however, increased rapidly in the early 1990s. To facilitate these movements, the international banks and the US Treasury pushed governments into rapidly opening all parts of their financial markets to foreign entry. In April 1997, the IMF appointed Interim Committee said that the original Articles might be amended to enable the IMF to promote the 'orderly liberalization of capital movements.' By this the Committee meant removing national (state) regulations on financial markets in member countries and removing all restraints on the free international movement of capital and all kinds of financial instruments and transactions – what the Fund called 'an open and liberal system of capital movements'.

On 2 July 1997, a speculative attack on the *baht*, the Thai currency, caused an overnight decline in value of 25 per cent, followed by further waves of speculation aimed at the currencies of Korea, the Philippines and Indonesia, in what built into the East Asian crisis – failing banks, plummeting GDP, rising unemployment – which left the 'miracle economies' floundering for years. Even worse for the IMF's case, the 'financial liberalization' that had already occurred was widely seen as contributing to the massive flows of speculative capital into, and out of, many of the East Asian economies – Joseph Stiglitz, for example, calls capital account liberalization the single most important cause of the East Asian crisis, and the crisis itself the worst since the Great Depression. The IMF had been active in Thailand, urging the government to devalue the *baht*, cut it loose from its peg to the dollar and float it. The same day (2 July) that the government complied, the IMF praised its 'comprehensive strategy to ensure macroeconomic adjustment and financial stability' (the stock phrase for all such circumstances) while the *baht* was nose-diving, followed by the currencies of most other East Asian countries after similar advice from the IMF.

IMF states that the financial crisis in East Asian economies due to

flawed and corrupt policies of respective governments. The IMF claims to have then restored international confidence by ‘helping’ the three countries most affected by crisis – Indonesia, Korea and Thailand – to adopt programmes of economic stabilization and reform in return for lending US\$35 billion and arranging US\$77 billion of additional loans from other sources. The IMF subsequently forced ‘comprehensive reforms’ that included increased foreign participation in domestic financial systems, increasing the power of free markets and breaking traditionally close links between business and governments. Exactly these links between government and business have, however, been main causal factors lying behind East Asian industrialization, while integration with international financial markets was thought by many to be the basic cause of the crisis. In this case, the IMF’s policies in East Asia were criticized by many economists including Joseph Stiglitz, the former economic adviser of World Bank, and, as a result, the institution’s reputation has never recovered, even in circles that the Fund values. Now the ‘middle income’ Third World countries of South-East Asia and Latin America follow the west European countries in also not going to the Fund in times of crises.

2.2.7.3 New debt crisis in Latin America

Latin American countries following free market policies have grown at a fraction of the rate they grew at in the 1970s and 1980s, when governments followed more interventionist and protectionist policies. In the late 1990s, and continuing in the early 2000s, many Latin American countries, following IMF-approved stabilization and restructuring programmes, became economically depressed. The country’s accumulating debt burden (\$128 billion), though not enormous relative to the size of its overall economy became unsustainable, as exports decreased. Fears of financial collapse led to the movement of assets out of the country. When Argentina approached the IMF in August 2001 for a further loan, the Bush administration tried to use Argentina’s financial crisis to demonstrate its new, sceptical approach to financial bailouts, breaking ‘an overly accommodating stance’ by the Clinton administration.

After nearly two weeks of negotiations, the IMF announced \$8 billion in emergency aid to Argentina to stabilize its economy, of which \$5 billion would be lent immediately, and the other \$3 billion delayed, awaiting a rescheduling of debt payments, a new and more forceful (even positive) approach. Other elements of the aid package included the usual IMF prescription of fiscal discipline and reduction of central and provincial government spending. The Argentine government then froze bank accounts and began raiding pension funds to find hard currency to make debt payments. In 2002 the economy minister announced that Argentina would no longer use its diminishing foreign reserves to pay back IMF loans. Widespread riots, the collapse of the government and continuing economic chaos had led to even more questions about the effectiveness of the IMF and the international financial policies of the USA, as with virtually all major financial agreements, including those in Mexico, Thailand, Indonesia, South Korea, Russia and Brazil.

Brazil also experienced same type of economic crisis. When economic growth declined and the country no longer repay the debt, it approached IMF for loan. The conditionalities imposed by IMF when it has loaned \$30 billion to Brazil were severe, and it led to widespread political resentment in the country. Many criticised IMF involvement as the subversion of democracy by an autocratic institution convinced that it knows best. Many pointed out how the financial markets are started ruling over political democracy rather than constituting it. In brief, the Argentina and Brazilian cases, together with imminent debt repudiation in Uruguay, and problems in Paraguay, Ecuador and Colombia, suggest systemic crisis in Latin America caused by a level of market failure that may well transcend the recuperative abilities of global governance.

2.2.8 PROTESTING THE IMF

IMF policies have long drawn massive and violent protest from the millions of people adversely affected. Until the mid-1970s, when IMF

conditionality took a turn for the austere, controversy over the Fund had taken the form mainly of intergovernmental arguments, between the USA and Britain, for instance, or between First and Third World members, and squabbles between governments and the institution – that is, between treasuries and ministries of finance on the one side, and the Executive Board, managing director and staff of the IMF on the other. But as conditionality came to be more drastically imposed on Third World countries, popular discontent quickly escalated. Protest often began as ‘food riots’ – people opposing sudden increases in the price of food – within overall ‘austerity protests’ – people objecting to broader aspects of a deteriorating situation, such as wage cuts and the elimination of government subsidies – all these being conditions imposed on national governments by the IMF in return for the granting of desperately needed loans.

For example, on 8 March 1976, workers in Cordoba went on strike to protest about the Argentine government’s freezing of wages for 180 days. In January 1977, riots broke out in Egypt after the government decided to lift subsidies on staple foods. On 1 July 1981, a general strike was called by the Democratic Workers’ Confederation in Casablanca to protest against the Moroccan government’s decision to lift subsidies on staple foods at the IMF’s insistence as a condition for a \$1.2 billion loan for a balance of payments deficit and foreign debt restructuring. On 24 April 1984, cities in the Dominican Republic erupted as business, labour, leftist organizations and youth struck and protested against government-imposed austerity measures. The protest and clashes with the security forces turned out so violent that fifty people were killed and four thousand arrested. Nigerian protests began in April 1988 as a reaction to the lifting of subsidies on petroleum products, and continued over two decades. In spring 1998 massive unrest and violent riots in Indonesia directly resulted from IMF-mandated reductions in government subsidies. Collapse of the national currency, the resulting international bailout, mass rioting and the eventual resignation of the president were all intricately connected with IMF intervention.

In general, popular protests against the IMF and national governments tend to follow a similar path. Using the cases of 146 ‘austerity protests’ in 39 countries in the period 1976–92, John Walton and David Seddon reach the following conclusions. They define ‘austerity protests’ as ‘large-scale collective actions, including political demonstrations, general strikes, and riots, which are animated by grievances over state policies of economic liberalization implemented in response to the debt crisis and market reforms devised and implemented by the International Monetary Fund’. The groups most drastically affected include the working poor, parts of the middle class, students and other urban dwellers.

Due to this criticism, the IMF moderated its policies of liberalization and loan-conditionalities. Moral outrage in the developed countries tended to focus on the issue of debt relief for poor countries. As a result, in the 1990s the main emphasis of IMF debt management shifted toward the lowest-income Third World countries. Loans to these very poor countries had been made mainly from official sources, as with government-to-government loans, export credits, official development assistance and loans from the IMF, the World Bank and regional development banks. Responding to widespread concern expressed by developed countries, and in concert with the World Bank, the IMF began its Heavily Indebted Poor Countries (HIPC) facility in 1996. The HIPC initiative was intended to manage, and even ‘resolve’ in the IMF’s optimistic language, the debt problems of the most heavily indebted poor countries (originally forty-one countries, mostly in Africa) with a total debt of about \$200 billion.

As a result of mounting criticism, the IMF also engaged in a series of internal evaluations of its operations and policies, and in 2001 set up a permanent Independent Evaluation Office (IEO) with the purpose of ‘improving the IMF’s effectiveness by enhancing the learning culture of the IMF and enabling it to better absorb lessons for improvements in its future work.’

2.2.9 LET US SUM UP

As this lesson has shown, the IMF has been subjected to high and increasing levels of well-founded criticism. Third World countries have long said that they resent being told what to do with their economies by the IMF. From a position of dominance in the pre-Asian-crisis global economy, the power of the IMF has been reduced by failed crisis management, the rejection of major policy initiatives, countries paying up as quickly as possible and distancing themselves, its credibility and legitimacy being questioned, and other symptoms of decline. The financial crisis of 2007/08 might seem like the perfect time for the IMF to ‘rise like a Phoenix,’ but the Fund played a minor role. This was due to widespread criticism of its earlier performance during the East Asian crisis. This resulted in the structural reforms to the very organization that so far has forced many Third World countries for reforms. At the 2006 Annual Meetings in Singapore, ad hoc increases in quotas were agreed for China, Korea, Mexico and Turkey. The IMF says that further reforms will eventually increase the voting shares of two-thirds of the 185 member countries, and enhance the voice and participation of low-income countries through a tripling of basic votes. Thus far, however, beyond ‘monitoring’ and ‘advising,’ the IMF has not been able to reassert itself. The question is, will it survive as a main actor in a changing global governance structure?

2.2.10 EXERCISE

1. The IMF was established to regulate the exchange rates at which currencies were exchanged among member countries. How do you understand this?
2. During the initial years of its establishment IMF primarily served the European countries. Comment.
3. The end of the fixed rate system completely altered the focus of the IMF. Explain.

4. The IMF policies precipitated the financial crisis rather than resolving the problems. Do you agree with this?
5. What are the major criticisms against IMF? Explain with reference to its structural adjustment policies.

M.A. Political Science, Semester III, Course No. 304, International Political Economy
UNIT – II: POST SECOND WORLD WA R INTERNATIONAL
ECONOMIC ORDER

2.3 INTERNATIONAL TRADE SYSTEM: SHIFT FROM GATT TO WTO

- V. Nagendra Rao

STRUCTURE

2.3.0 Objectives

2.3.1 Introduction

2.3.2 International Trade: Historical Background

2.3.3 The GATT

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2.3.5.1 The GATS

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2.3.7.1 Dispute between Developed and Developing Countries

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2.3.7.4 Contention on Agriculture

2.3.7.5 Food Security Issue and Deadlock in WTO

2.3.8 Let us Sum Up

2.3.9 Exercise

2.3.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The historical background for international trade;
- The GATT as a general guiding principle advanced trade liberalisation;
- The significance of Uruguay round in advancing international trade;
- The WTO and the new trade areas incorporated in its jurisdiction;
- The contentious issues in Doha round and how these issues have become critical in contemporary international trade regime.

2.3.1 INTRODUCTION

This lesson analyzes the international trading system that evolved in the post-Second World War period. The lesson primarily explains the shift over the past century, from an informal, non-institutionalized trading system to a ‘multilateral’ trading system characterized by rules and formal institutions. The shift towards multilateral institutionalization reflects a combination of ideational and material factors: a process of social learning and the rise of American hegemony in the mid-twentieth century. Most governments accepted that international trade was important to the achievement of national economic and political goals, but the bitter experience of the 1930s demonstrated that the international trading system was fragile and needed to be supported by a set of multilateral rules and institutions. The United States,

by then the world's major economic and trading power, adopted a new trade policy after the Great Depression and took the lead in promoting the new system. Today, this multilateral system is subject to various challenges and it is an open question as to whether it can be sustained indefinitely.

2.3.2 INTERNATIONAL TRADE: HISTORICAL BACKGROUND

The idea that trade between countries should be freed from governmental intervention is actually quite new. For most of its 500-year history, capitalism was directed by mercantilist policies involving state restrictions on imports, and incentives for exports, as a way of increasing national power, concentrated in the political might of the state.

After the Second World War, the tendency was to establish international organizations in the search for a new kind of global economic stability. Initially, the idea was to establish three main international institutions, the IMF and IBRD, and an International Trade Organization (ITO) that would regulate trade, as a necessary complement to the other two organizations. The USA wanted an organization that would free up trade in the specific interests of large, exporting corporations, but with a market-oriented, deregulated international economy more generally in mind.

After a series of Conferences, in 1948, the United States and its principal economic partners created the General Agreement on Tariffs and Trade (GATT) to promote "freer and fairer" trade, primarily through negotiated reductions of formal tariffs. However, when US State Department proposal for the International Trade Organization (ITO) was heavily amended in the UN, the US Congress refused to ratify the ITO as it considered that is nothing but undermining its own sovereignty. The USA was specifically opposed to an international organization controlled by UN-type international democracy, with each nation-state having one vote, at a time when the USA considered itself to be far more than one country in terms of economic power and political might.

2.3.3 THE GATT

With the failure of the ITO to get off the ground, governments reverted to the provisional agreement on trade and tariffs agreed to at Geneva in 1947 and signed on 15 November 1947 at the Havana Conference. The GATT is a fixed-rule trading system, and such a rule based system is quite different from managed or “results-oriented” trade that sets quantitative targets or outcomes. The GATT was also based on the principle of multilateralism; trade rules were extended without discrimination to all members of the GATT; unilateralism, bilateralism, and trading blocs were prohibited except in unusual cases. Another feature of the system was the principle of overall or general reciprocity, that is, trade liberalization and rules were to be determined by mutual balanced concessions. A system of specific reciprocity, on the other hand, requires that quite specific rather than general concessions must be made. The GATT also incorporated provisions for the impartial adjudication of disputes. Although the principles of the GATT trade regime were significantly qualified by escape clauses and exceptions, its creation was a major accomplishment, and it has facilitated extremely important reductions in trade barriers.

The GATT proved remarkably successful in fostering trade liberalization and providing a framework for trade discussions. However, in contrast to the abandoned ITO, its authority and the scope of its responsibilities were severely limited; it was essentially a negotiating forum rather than a true international organization, and it had no rule-making authority. Moreover, it lacked an adequate dispute settlement mechanism, and its jurisdiction applied primarily to manufactured goods. The GATT did not have authority to deal with agriculture, services, intellectual property rights, or foreign direct investment; nor did the GATT have sufficient authority to deal with customs unions and other preferential trading arrangements. Its power to resolve trade disputes was also highly circumscribed.

The GATT, despite the limitations of its mandate and its cumbersome organizational structure, was important for many years in reducing barriers

to international trade and in helping to establish rules to reduce trade conflict. The GATT provided a rule-based regime of trade liberalization founded on the principles of nondiscrimination, unconditional reciprocity, and transparency (for example, use of formal tariffs and publication of trade regulations); as trade relations constitute a Prisoner's Dilemma situation, unambiguous rules are required to forestall conflict. Trade rules were determined and trade barriers were reduced through multilateral negotiations among GATT members. In effect, GATT members agreed to establish regulations lowering trade barriers and then let markets determine trade patterns; member states pledged not to resort to managed or results-oriented trade that set import quotas for particular products. Under GATT, markets were opened and new rules established by international negotiations; agreements were based on compromise or unconditional reciprocity rather than on unilateral actions by the strong or by specific reciprocity. GATT's goal was an open multilateralism; that is, the agreement provided for extension of negotiated trade rules to all members of the GATT without discrimination. However, candidates for membership did have to meet certain criteria and agree to obey its rules.

The post-war period witnessed a number of agreements to lower tariff barriers. A significant shift in negotiations took place during the Kennedy Round (1964–1967). GATT members agreed to reduce tariffs on particular products by certain per centages and made trade-offs across economic sectors. While regulating “dumping” practices, preferential treatment was given to exports from less developed countries (LDCs). The next major initiative to liberalize trade was the Tokyo Round (1973–1979), which, after years of bitter fighting, proved far more comprehensive than earlier efforts. It included significant tariff cuts on most industrial products, liberalization of agricultural trade, and reduction of nontariff barriers.

2.3.4 THE URUGUAY ROUND

By the mid-1980s, the Bretton Woods trade regime was no longer adequate to deal with a highly integrated world economy characterized by

oligopolistic competition, scale economies, and dynamic comparative advantage. Moreover, the character of trade itself was changing and outgrowing the rules and trading regime of the early post-war era. Trade became closely intertwined with the global activities of multinational firms, and trade in both services and manufactures expanded rapidly; trade among industrialized countries became the most prominent feature of the trading system. In the 1980s, the “new regionalism,” especially acceleration of the movement toward European integration, was recognized as a threat to the multilateral trading system. And at least from the early 1980s, the United States pressured its West European and other trading partners for a new round of trade negotiations to strengthen the multilateral trading system. Eventually, this American pressure overcame European and other resistance, and the Uruguay Round of trade negotiations was launched at Punta del Este, Uruguay, in 1986, resulting in intense negotiations until its conclusion in 1993.

The treaty produced by the Uruguay Round, which came into force on January 1, 1995, reduced tariffs on manufactured goods and lowered trade barriers in a number of important areas. At the same time that formal tariffs on merchandise goods were reduced to a very low level, the Uruguay Round decreased or eliminated many import quotas and subsidies. The agreement’s twenty-nine separate accords also reduced trade barriers and for the first time extended trade rules to a number of areas that included agriculture, textiles, services, intellectual property rights, and foreign investment.

2.3.5 THE WORLD TRADE ORGANIZATION (WTO)

The Uruguay Round’s most significant accomplishment was the creation of the World Trade Organization (WTO). In doing this, the Round took an important step toward completion of the framework of international institutions that had originally been proposed at Bretton Woods (1944). Although the WTO incorporated the GATT along with many of its rules and practices, the legal mandate and institutional structure of the WTO were designed to enable it to play a much more important role than the GATT had

played in governance of international commerce. The WTO has more extensive and more binding rules. Moreover, the WTO has, in effect, the primary responsibility to facilitate international economic cooperation in trade liberalization and to fill in the many details omitted in the 22,000-page Uruguay Treaty. That Agreement establishing the WTO expanded and entrenched the GATT principle that trade should be governed by multilateral rules rather than by unilateral actions or bilateral negotiations.

Although the WTO was not given as extensive rule-making authority as some desired, it does have much more authority than the GATT. The GATT dispute-settlement mechanism was incorporated in the WTO, reformed, and greatly strengthened by elimination of such basic flaws as long delays in the proceedings of dispute panels, the ability of disputants to block proceedings, and the frequent failure of members to implement decisions. The agreement also established a new appellate body to oversee the work of the dispute panels. Most importantly—and controversially—the WTO was empowered to levy fines on countries that refused to accept a decision of the dispute panel.

The institutional structure of the trade regime also changed significantly. Whereas the GATT had been a trade accord supported by a secretariat, the WTO is a membership organization that increases the legal coherence among its wide-ranging rights and obligations and establishes a permanent forum for negotiations. Biennial ministerial meetings should increase political guidance to the institution. The Uruguay Round also created a trade-policy-review mechanism to monitor member countries.

Three trade agreements covering entirely new areas emerged from the Uruguay Round: GATS, TRIPs and TRIMs.

2.3.5.1 The GATS

The General Agreement on Trade in Services (GATS) is described by the WTO Secretariat as ‘perhaps the most important single development in the multilateral trading system since the GATT itself came into effect in 1948’.

The GATS extended internationally agreed rules and commitments, comparable to those of the GATT dealing with physical commodities, into the rapidly growing area of the international exchange of services, equivalent in value to about one-quarter of the international trade in goods.

2.3.5.2 The TRIPs

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) claims that widely varying standards in the protection and enforcement of intellectual property rights, together with lack of a multilateral framework of principles, rules and disciplines dealing with international trade in counterfeit goods, have been a growing source of tension in international economic relations. In response, the TRIPs agreement addresses the applicability of basic GATT principles, together with those of already existing international agreements, to the provision of intellectual property rights; enforcement measures for those rights; and multilateral dispute settlement procedures. Part III of the agreement sets out the obligations of member governments to provide procedures and remedies under their domestic laws to ensure that intellectual property rights can be effectively enforced by foreign rights-holders as well as by their own nationals. Governments have to provide for criminal procedures and penalties at least in cases of willful trademark counterfeiting or copyright piracy on a commercial scale, with remedies including imprisonment and fines sufficient to act as a deterrent. The agreement establishes a Council for TRIP Rights to monitor the operation of the agreement and governments' compliance with it.

2.3.5.3 The TRIMs

The Agreement on Trade-Related Aspects of Investment Measures (TRIMs) deals with investment issues thought to restrict and distort trade. It provides that no contracting party shall apply any TRIM inconsistent with the GATT. An illustrative list of TRIMs includes measures against requiring particular levels of local procurement by an enterprise ('local content requirements') or measures that restrict the volume or value of imports an

enterprise can purchase or use to an amount related to the level of products it exports ('trade-balancing requirements'). The agreement requires mandatory notification of all non-conforming TRIMs, and their elimination within two years for developed countries, five years for developing countries and seven years for least developed countries. It establishes a Committee on TRIMs that monitors the implementation of these commitments.

2.3.6 WTO TRADE DISCOURSE

In terms of 'explaining WTO affairs to the public and media' the WTO claims ten benefits for the trading system it administers:

1. *The WTO/GATT system contributes to international peace.* Smoothly flowing trade helps people become better off; and more prosperous, contented people are less likely to fight.
2. *The system allows disputes to be handled constructively.* If we don't have a means to tackling the disputes constructively and harmoniously, some might lead to more serious political conflicts.
3. *A system based on rules rather than power makes life easier for everyone.* Decisions in the WTO, made by consensus, with agreements ratified in all members' parliaments, apply to rich and poor countries alike. The result for smaller countries is increased bargaining power.
4. *Freer trade cuts the cost of living.* All people consume. The prices paid for food and clothing are affected by trade policies. Protectionism raises prices. By comparison, the WTO's global system lowers trade barriers through negotiation and results in reduced costs of production, reduced prices of finished goods and services, and ultimately a lower cost of living.
5. *The system gives consumers more choice,* and a broader range of qualities to choose from. Even the quality of locally produced goods can improve because of competition from imports.

6. *Trade raises incomes.* Lowering trade barriers allows trade to increase, which adds to national and personal incomes.
7. *Trade stimulates economic growth* and that means more jobs.
8. *The basic trading principles make the system economically more efficient and cut costs.* Trade allows a division of labour between countries and lets resources be used more effectively.
9. *The system shields governments from narrow interests.* Governments are better placed to defend themselves against lobbying from narrow interest groups by focusing on tradeoffs made in the interests of everyone in the economy.
10. *The system encourages good government.* For businesses, this means greater certainty and clarity about trading conditions. For governments it can often mean good discipline.

2.3.7 DOHA ROUND

The WTO launched the Doha Development Round of negotiations at the fourth ministerial conference in Doha, Qatar in November 2001. This was to be an ambitious effort to make globalization more inclusive and help the world's poor, particularly by slashing barriers and subsidies in farming. The initial agenda comprised both further trade liberalization and new rule-making, underpinned by commitments to strengthen substantial assistance to developing countries.

The negotiations have been highly contentious. Disagreements still continue over several key areas including agriculture subsidies, which emerged as critical in July 2006. According to a European Union statement, "The 2008 Ministerial meeting broke down over a disagreement between exporters of agricultural bulk commodities and countries with large numbers of subsistence farmers on the precise terms of a 'special safeguard measure' to protect farmers from surges in imports." The position of the European Commission is that "The successful conclusion of the Doha negotiations

would confirm the central role of multilateral liberalisation and rule-making. It would confirm the WTO as a powerful shield against protectionist backsliding”. An impasse remains and, as of August 2013, agreement has not been reached, despite intense negotiations at several ministerial conferences and at other sessions. The next section of the lesson will analyse some of the contentious issues on which the Doha round was stalled, particularly the disputes between Developed and Developing countries.

2.3.7.1 Dispute between Developed and Developing Countries

It is quite natural that the very position of Developed and Developing countries occupied in the global division of economic and financial structure leave them in a clash of interests on many issues. Many reports of the United Nations Commission on Trade and Development (UNCTAD) brought out succinctly this clash of interests. For instance, the UNCTAD *Trade and Development Report* for 2002 addressed the question: why are developing countries trading more, yet earning less? The report notes that the past two decades have seen a rapid opening up to trade in developing countries. Indeed, trade volumes in developing countries have grown faster than the world average. Developing countries now account for one-third of world merchandise trade, and much of the increase in trading volume has been in manufactures. The UNCTAD report notes, however, that this massive increase in exports has not added significantly to developing countries’ income. Why, it asks, have developing countries not benefited from the increased openness to trade that in many cases is a condition for assistance from multilateral institutions?

Many countries have been unable to shift production out of primary commodities such as agriculture and natural resources. The markets for these products have been stagnant and prices tended to go down in the long run (with the exception of fuel). Countries that shifted production from primary commodities to manufactures focused on resource-based, labour-intensive products, which generally lack dynamism in world markets and have a lower value-added. Reliance on exports of labour-intensive manufactures to

galvanize growth in the face of declining commodity prices has been a common development policy. This led to many simultaneous export drives, causing falling prices and intense competition for foreign direct investment (FDI), and hence a weakened bargaining position for developing countries. As a result, developing countries end up competing with each other on the basis of wage levels. And these trends are occurring even while some of the larger countries, such as China, are yet to be fully integrated into the global trading system. At the same time developed countries have themselves liberalized trade slowly and insufficiently in the area of clothing, textiles and other labour-intensive manufactures.

Along with trade liberalization, the last two decades have also seen substantial increases in flows of foreign direct investment. Success in attracting large amounts of FDI, however, has not necessarily resulted in greater growth. Mexico, for example, has experienced massive FDI in the last few years and a corresponding increase in exports. GDP per capita has not, however, risen in response. In contrast, Taiwan (with more state intervention in planning the direction taken by the economy) has seen lower levels of FDI and has been selective and more focused on building domestic investment. Here we have seen growth in exports and a corresponding growth in GDP. UNCTAD concludes that the liberalization of trade and FDI should no longer be the sole focus of development agencies. Instead, developing countries, and the development agencies that impose conditionalities on them, should ensure that trade policies are designed to maximize domestic growth and development – which may not involve reducing external barriers. In other words, the basic argument made for free trade by the WTO turns out not to be proven in the developing country experience.

Similarly, the view that trade benefits developing countries by increasing exports also not proved correct in the post-WTO period. On the contrary, most of the developing countries end up importing more. The sustainability of this process would require, in the long term, a corresponding access to foreign markets for developing countries goods and services. And

while the successive GATT negotiation rounds had produced a significant reduction of tariff levels, a number of sophisticated, and not entirely transparent, non-tariff measures and regulations on the parts of most developed countries were major restrictions to international market access. Developing countries still faced discrimination in terms of market access, especially for their agricultural products. The process of broad market opening undertaken by developing countries since the beginning of the 1990s had not resulted in commensurate access to foreign markets, and this situation was reflected in large trade deficits with the European Union, the USA and Japan. Because of this, the Third World countries complained of problems deriving from the implementation of trade policies and practices, declared very often on a unilateral basis, by developed countries, which had an adverse impact on balance of trade relations at the international level.

2.3.7.2 Trade and labour

The relationship between free trade and labour rights has long been a contentious issue in the GATT/WTO system. Currently, labour standards are not subject to WTO rules and disciplines. Instead the WTO refers labour standards issues to the International Labour Organization (ILO), formed in 1919, and now a UN agency, where labour rights have been discussed since 1930. Most members of the ILO are also members of the WTO.

Instead of leaving matters related to labour to the ILO, the WTO brought those into its purview. The developed countries that justify linking trade with labour rights in the WTO argue that two of the original GATT articles justify trade restrictions based on violations of fundamental labour rights. On the other hand, developing countries believe that core labour standards do not belong in the WTO. Governments in these countries see labour standards as a disguise for protectionist policies on the part of developed countries. In this view, attempts to bring labour standards into the WTO are a smokescreen for undermining the comparative advantage of lower wage developing countries. Instead, developing countries argue that better working conditions and improved labour rights come through economic

growth. Were core labour standards to be enforceable under WTO rules, they say, sanctions imposed against countries with lower labour standards would merely perpetuate poverty and delay improvements in workplace standards. As the developing countries show united strength, the WTO Ministerial Conference held in Singapore in 1996 issued a declaration rejecting the linking of trade issues with labour standards. It clearly stated that the WTO has to focus on trade issues while leaving labour standards and human rights to the ILO.

2.3.7.3 The TRIPs

The most contentious issue between developed countries and developing countries is the TRIPs agreement emerging from the Uruguay Round. TRIPs applies basic GATT principles and existing international agreements to intellectual property rights with the WTO as adjudicator. The agreement has raised concerns about the centralization of control over multiple forms of 'intellectual property' (knowledge and its products) in multinational corporate hands. The pharmaceutical industry was a major player in the agreement. This is a highly concentrated industry in which ten companies control 50 per cent of global sales mainly in developed countries. The main benefits of TRIPs have gone to the international pharmaceutical industry, which aggressively protects a highly profitable business with the intensive use of political power – trade sanctions, withdrawal of aid, and so on.

The most controversial issue involves drugs for people suffering from AIDS. Some of the main national actors include India, where the pharmaceutical industry was regulated by the fiercely nationalistic India Patents Act of 1970 (this issue has been explained in detail in the next lesson). The multinational pharmaceutical companies waged a bitter war against Indian companies that are selling generic medicines in international market charging a fraction of what these global companies charge. The global multinationals filed legal suits against companies of developing countries. However, the public protest and outcry was so huge that they have to not only back out but also reduced the prices of their products.

At the WTO's Ministerial Conference in 2001, the Doha Declaration on the TRIPs Agreement and Public Health was adopted as a response to protests. The resolution recognized the right of member governments to grant compulsory licenses to local drug producers to make drugs needed in emergency situations such as AIDS, malaria and other epidemics. Several flexibilities were established that WTO members can use, such as the right to grant compulsory licenses and the freedom to determine the grounds for these.

2.3.7.4 Contention on Agriculture

Developing countries interests in agriculture have always been dictated by the need to safeguard millions of small farmers who operate the majority of farm holdings in the countryside. Agriculture determines the very social fabric of these countries and is more a way of life and means of livelihood than a question of commerce.

Keeping its agrarian crisis in view, developing countries had made a strong pitch for according adequate tariff protection to certain products by designating them special products. Developing countries strongly demanded for the need for Special Safeguard Mechanism (SSM) which would allow them to impose additional tariffs when faced with cheap imports or when there is a surge in imports. However, developed countries have sought to impose extremely restrictive requirements for invoking SSM, which would render this instrument ineffective. However, they are experiencing stiff resistance from Developed countries, hence there is still a deadlock on critical issue of agriculture.

2.3.7.5 Food Security Issue and Deadlock in WTO

During the December 13, 2013 meeting of the WTO, the assembled trade ministers with some difficulty reached agreement to formally present to the organization's membership an agreement with two principal features. One, the Trade Facilitation Agreement (TFA), considered in Washington to be uncontroversial, would provide for all members to simplify their customs

and other procedures that affect goods crossing borders. The other, which was the subject of passionate disagreement, especially between the United States and India, provided for limits on agricultural stockpiles maintained for food security. This provision included a special exception for developing countries: their subsidies would not be challenged for four years, during which WTO members would work out a permanent solution to the problem of food stockpiles and the associated stockpiles. The issue was hugely important for India and other developing countries, given the large number of people dependent on the government's distribution programme. India agreed for four year period, and the WTO approved the agreement.

In late July 2014, India – now under a new government headed by Narendra Modi – said it would not agree. It argued that since insufficient progress had been made toward a permanent solution, it was no longer willing to allow the Trade Facilitation agreement to pass unless its concerns about agricultural stockpiles were addressed. India's domestic compulsions and the danger of breaching the subsidy cap for wheat and rice forced the government to thwart attempts by other World Trade Organization members to push through a new set of customs rules without addressing its concerns. While India has been demanding a review of the food subsidy limit for several years, the developed countries have refused to play ball. In fact, in the run-up to the Bali ministerial in December 2014, the rich countries had even refused to acknowledge the food security proposal submitted by G-33, which includes countries such as Indonesia, Brazil and China.

Efforts went on behind the scenes at WTO headquarters in Geneva to find a way through the problem. These eventually bore fruit. Agreement came on the margins of a meeting of two East Asia-centred organizations in Myanmar, attended by both President Obama and Prime Minister Modi. It largely restates the original agreement, but with the important change that instead of a four year "peace clause" on agricultural stockpiling, there is no deadline, and the agreement not to challenge India's subsidies will last until

a permanent solution is found. The new proposal still needs to be approved by the full WTO membership.

WTO Director-General Roberto Azevedo said the agreement between India and the US was key to get the multilateral trading system back on track and gave him a basis to intensify his consultations with other WTO members. Now India wants to bring back the long-stalled Doha round on the table. India's Commerce Secretary Rajeev Kher stated in December 2014 that "Doha agenda will be back on tables (in 2015) and we will push for that". Hence, some forward movement can be expected in the near future in establishing trade rules that were elusive in a long history of WTO.

2.3.8 LET US SUM UP

As we have noted, despite the impressive achievements of the Uruguay Round in reducing trade barriers, many vexing issues were left unresolved. Trade in certain areas such as agriculture, textiles, and shipping continues to be highly protected. The failure to reduce tariffs on agriculture and textiles was and continues to be especially vexing because lower tariffs would greatly benefit developing countries. Trade barriers are still high in most developing countries, especially with respect to services, and developed countries continue to restrict imports of automobiles, steel, textiles, consumer electronics, and agricultural products. Completion of the Uruguay Round's so-called "built-in" agenda is crucial, and the many issues unresolved at the close of the negotiations remain problematic. In addition, since the end of the Uruguay Round, a number of new and extremely difficult issues have surfaced, including labour standards, the environment, and human rights.

Understandably in such a large supranational institution like WTO, all the members did not succeed in getting all their views incorporated in the final results. Even a powerful economic power like the US had to compromise. Every country had to concede something in one area and make some gains elsewhere. The final results of the Uruguay Round reflected a delicate balance of conflicting national interests of all trading countries.

However, the very functioning of the WTO left many to see it as organization to carry the trade interests of the developed world. They felt that the contemporary globalization of trade is favouring the rich countries while penalising the poor. Three types of critical response to the WTO have developed: contestation and reform (restrained globalization); globalization from below (democratized globalization); and ‘delinking’ (localization instead of globalization).

2.3.9 EXERCISE

1. What are the reasons for non-establishment of ITO?
2. What are the achievements of various GATT rounds?
3. Write a note on significance of Uruguay Round.
4. How the inclusion of GATS, TRIPS and TRIPs enhanced the role of WTO in international trade regime?
5. Briefly state the reasons given by WTO in support of free trade.
6. The Doha Round of WTO is most controversial and contentious. Elaborate with specific reference to the TRIPS, Agriculture and food security.

M.A. Political Science, Semester III, Course No. 304, International Political Economy
UNIT – II: POST SECOND WORLD WA R INTERNATIONAL
ECONOMIC ORDER

**2.4 INSTITUTIONS OF DEVELOPMENT:
WORLD BANK, ASIAN DEVELOPMENT
BANK AND THE BRICS BANK**

- V. Nagendra Rao

STRUCTURE

2.4.0 Objectives

2.4.1 Introduction

2.4.2 The World Bank

2.4.3 The World Bank: Early Years

2.4.4 The World Bank and Structural Adjustment

2.4.5 Asian Development Bank

2.4.5.1 Criticism on ADB Policies

2.4.6 The Development Debate

2.4.7 The BRICS Bank

2.4.8 Let us Sum Up

2.4.9 Exercise

2.4.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The primary reason for establishment of World Bank;
- World Bank policies in its early years;
- The role of World Bank in structural adjustment policies initiated by developing countries;
- The functioning of Asian Development Bank and major criticism against it;
- The reasons for the establishment of BRCS bank;
- The development debate and how the various banks were critically viewed in this debate.

2.4.1 INTRODUCTION

Economic development differs from ‘economic growth’ in being a qualitative, as well as a quantitative, concept. Without the specification “economic,” the concept of development suggests even broader connotations, such as ‘social’, ‘political’, or ‘human’. Development, as an idea of purposeful improvement of society and human well-being, has emerged in two distinct historical contexts. First, it has been concerned with the ‘original transition’, when Europe was transformed from agrarian to industrial and rural to urban relations. Second, it has been interested in the post-1945 situation when ‘underdeveloped areas’ were seen as a threat to world peace (and the liberal world order), and development’ was taken to be the remedy. Central to the latter idea is the belief that the process of societal change can be intentionally designed by a conscious agent—normally the state— rather than being an imminent historical process.

Since the establishment of Bretton Woods System, development has referred to the process whereby poor countries or communities are able (from within their own resources) or enabled (by others) to improve their situation

economically, socially and culturally. Development has often been presented as though it were a technical process based on scientific findings and agreed knowledge. This has resulted in Structural Adjustment Programmes (SAPs) pursued by World Bank and Asian Development Bank in many countries, as well as pressures for improved governance to reverse the worst abuses of state control. In this lesson, you will study the role of World Bank and Asian Development Bank in the development process post-Second World War period.

2.4.2 THE WORLD BANK

Along with the International Monetary Fund, the World Bank was established in 1944 and began operations in 1946. It is essentially an international development agency whose primary role is to make long-term development project loans in foreign currency to member governments. It is the largest of all official development agencies. Since its creation its role has changed substantially. The World Bank comprises two legally and financially distinct bodies: the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA). Their functions are to lend funds, provide economic advice and technical assistance, and to act as a catalyst to investment by others.

The World Bank group actually consists of five specialized institutions:

1. The International Bank for Reconstruction and Development (IBRD) makes development loans, guarantees loans and offers analytical and advisory services. The IBRD borrows at low interest rates by selling bonds in private capital markets in First World countries and makes near-market interest loans to ‘creditworthy countries’ in the Third World and elsewhere. It has made about \$360 billion in loans over its lifetime and currently lends \$10.5 billion a year for some ninety new operations in thirty-six countries.
2. The International Development Association (IDA) gives loans to countries that are ‘usually not creditworthy’ in international financial

markets. IDA loans carry no interest, but a 0.75 per cent administrative charge is made annually. The IDA, averaging \$6 billion a year in lending to the poorest countries, is funded from member governments' national budgets.

3. The International Finance Corporation (IFC) is the largest multilateral source of loan and equity financing for private sector projects in the developing world.
4. The Multilateral Investment Guarantee Agency (MIGA) provides investment insurance.
5. The International Centre for Settlement of Investment Disputes (ICSID) facilitates the settlement of investment disputes between governments and foreign investors.

The purposes of the World Bank, as stated in Article 1 of the original (Bretton Woods) Articles of Agreement, are:

1. To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
2. To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the

productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.

4. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.
5. To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The World Bank has a capital stock subscribed by its member countries and divided into shares.

2.4.3 THE WORLD BANK: EARLY YEARS

The World Bank was very much a US creation. Americans made up much of its early leadership and staff and provided most of its capital. The result was a strong and enduring American imprint on all aspects of the Bank, including its structure, general policy direction, and forms of lending. The World Bank, in its early form of the IBRD, was largely dependent on selling bonds to raise the bulk of its loan capital. The rest of the available funds came from the subscriptions of member countries – the original capital subscription was \$9.1 billion, of which \$3.2 billion or 34.9 per cent was from the USA. For the first ten years the US part of this subscription, around one-third of the total, provided the only fully usable component, because the deposit was in dollars, the main currency used in post-war international transactions. Additionally, 85 per cent of the Bank's bonds were denominated in US dollars and sold on Wall Street. So, in its early years, as a supplier of loans to western European governments for reconstruction in the late 1940s, and later as attention shifted toward the richer Third World countries in the 1950s, the World Bank's main mission was to gain the confidence of private investors, especially those on Wall Street. The Bank maintained a Marketing

Department (until 1963) on the Street, and employed a syndicate led by First Boston Bank and Morgan Stanley, an investment bank, to sell its bonds.

The Bank garnered Wall Street's confidence by insisting on 'fiscal and monetary discipline' on the part of borrowing countries, and by engaging in 'sound banking practices,' such as confining its activity to project lending for the construction of easily defined, public utilities (electric power, transportation and other economic infrastructure), with strict end-use supervision, including close control over disbursements from loans. Money spent on programme lending (that is, broader social programmes dealing with education and health as well as more directly economic projects) was regarded as a waste of scarce resources.

During the 1950s the World Bank, along with other conventional institutions, evidenced a rising interest in broader issues of income distribution and poverty. This was partly because Bank presidents actually went to Third World countries and saw for themselves the conditions prevailing there, along with the usual Bank missions and official staff visits. The main reason, however, why the World Bank, along with many other First World institutions, suddenly expressed concern for the masses of poor people in the world stemmed from Cold War engagement between the USA and the USSR, with the Third World as its hotspots and ideological battlegrounds.

Thus, the late 1950s saw a number of changes. Within the Bank, lending was directed toward the poorer countries, rather than Europe, or the richer non-European countries, while 'development' was coming to mean poverty alleviation, rather than transportation and electrical power projects. The sectoral coverage of lending was widened from industrial infrastructure investment toward the agricultural sector, where most of the people in poor countries worked.

As part of this shift, the International Development Association (IDA) was established in 1959 to offer 'soft loans' ('soft' meaning over long periods of time and at very low rates of interest) from revenues derived from donor countries, for purposes that were not necessarily revenue-producing, or directly

productive in the usual economic sense, in recipient countries. Most of the money would come from capital subscriptions from donor countries, rather than from bond sales. While funding social projects on education and health, the IDA opened the Bank to a broader perspective on development lending that made possible its emphasis on poverty and basic needs in the 1960s and 1970s. As a result of this new 'crusading energy' the Bank's lending doubled during the 1960s, the size of its staff tripled (with growth especially in professional economists), the number of member countries increased, especially in Africa, and lending escalated for projects in new areas.

The shift towards eradication of poverty is more emphasized when McNamara became World Bank's President. Under his presidency, the Bank continued to believe fundamentally in the efficacy of free markets, but took a more equivocal view of ownership, believing that managerial competence was more important than private entrepreneurship, so that loans could be made under public ownership systems within an overall conception of greater governmental intervention in the development process – it should be added that this political position was not shared by many of the Bank's staff, or by some donor governments. In 1973 McNamara introduced large rural development schemes focused on small farmers as its main vehicle for direct poverty alleviation.

However, most of the World Bank projects outcomes were not satisfactory. It has very poor understanding of local conditions and the institutions in African and Asian countries so primitive that they could not respond to modern technologies. Even more, major land tenure reforms were a prerequisite of any agricultural development aimed at the poor. Otherwise loans went mainly to middle-income and richer farmers, increasing income inequalities. As a result of all this, even the World Bank's own Operations Evaluation Department called most such projects 'failures'. Much before the end of McNamara's presidency, the ardour had gone from the poverty initiative that, at its height, had amounted to no more than a third of Bank lending, with the rest going to the traditional areas of infrastructure investment. Debt

and balance of payments in Third World countries became leading issues, with 'structural adjustment' as the solution

2.4.4 THE WORLD BANK AND STRUCTURAL ADJUSTMENT

Dissatisfied with ad hoc project lending, and with countries needing foreign exchange to pay for oil imports and meet interest payments, from 1979 onwards the Bank started using programme loans to induce 'reforms' in recipient, mainly middle-income, countries. By this time, within an overall policy regime shift from Keynesianism to neoliberalism, the meaning of the term 'reform' was being changed to mean 'structural adjustment' lending to promote export orientation and trade liberalization. In 1980 the Bank laid out the general conditions under which structural adjustment loans (SALs) would be made available. The argument was that the new conditions faced by Third World countries forced them to reconsider how they might 'adjust' their development patterns and economic structures. The Bank's new lending programme would provide loans that were policy-based (rather than project-based), extending over several years, and would provide direct support for specific policy reforms decided upon during 'dialog' with the borrowing country. Due to these directional changes, poverty took a back seat to the new driving forces of macroeconomic policy, stabilization and balance of payments adjustments, all understood within a doctrine of the strict limits of governmental intervention and the virtues of 'flexible, self-adjusting free markets.' More fundamentally, this shift corresponded with a distinct move to the neoliberalism in key donor countries – Margaret Thatcher became prime minister in Britain in 1979, Ronald Reagan was elected president of the United States in 1980, and Helmut Kohl was elected chancellor of West Germany in 1982.

We can follow the Bank's new line of thinking, displayed in this account of structural adjustment, through the various *World Development Reports* published during the 1980s. The 1983 *World Development Report*

said that foreign trade enabled developing countries to specialize, exploit economies of scale and increase foreign exchange earnings. The 1984 report used 'growth scenarios' to argue that developing countries would improve their positions by changing their economic policies: avoiding overvalued exchange rates, reducing public spending, having an 'open trading and payments regime' that encouraged optimal use of investment resources. With this directional change, by the end of the 1980s a set of structural adjustment policies based neoliberal interpretations were firmly in place.

This new attitude on the part of the Bank responded to an environment of increasing criticism, including substantial amounts from within the institution. The Wapenhans Report, named after a Bank vice-president and entitled 'Effective implementation: key to development impact,' found that 'at least twenty per cent of the 1800-odd projects in 113 countries contained in the Bank's \$140 billion loan portfolio presented major problems'. The Bank's Operations Evaluation Department published a report, entitled *World Bank Structural and Sectoral Adjustment Operations*, in June 1992, which critically reviewed its programmes: 'In the 18 Sub-Saharan African countries reviewed, no less than 14 had experienced a fall in investment rates during adjustment.' Less than 20 per cent of adjustment-related technical assistance loans were substantially effective, and 15 per cent had only negligible impact. The report said that decreased social expenditures as part of structural adjustment lending had led to 'unsatisfactory results' in terms of poverty; income inequality had increased in some countries and landless farm workers had borne the greatest burden of higher food prices.

Thus, in the 1990s, the various *World Bank Development Reports* outlined a new 'holistic approach' to development involving social safety nets, poverty, health, education, environment, rural areas and gender considerations, in concert with conventionally neoliberal areas, such as increased property rights, trade liberalization and privatization. It carried the development activities involving bilateral donor agencies, multilateral financial institutions, academics, NGOs and other civil society organizations,

together with the private sector. Also in 1998 the Bank has undertaken an integrated approach to development based on a framework articulated and 'owned' by the country itself, aimed at poverty reduction and sustainable development, known as the Comprehensive Development Framework (CDF). In many respects, this is the Bank's policy answer to criticisms that structural adjustment does little to alleviate poverty.

2.4.5 ASIAN DEVELOPMENT BANK

Established in 1966 to foster economic development and regional economic cooperation, the Asian Development Bank (ADB) comprises regional and non-regional members and has its headquarters in Manila, the Philippines. Japan played a crucial role in the establishment of the ADB and made an initial contribution to the ADB equal to the United States' initial contribution. Many authors assert that the ADB is little more than a foreign-policy tool of Japan and that it is a key component of Japan's overall strategy to gain prestige in the international system. Others recognize the important position of the United States in the ADB. Indeed, Japan hesitated in supporting the original proposal for the ADB until the United States committed itself to the idea of an Asian regional development bank.

The ADB's Articles of Agreement mandates that Asian members comprise a minimum of 60 per cent of the voting weight, with 20 per cent of total votes distributed equally among members. Its governing structure is bifurcated into a Board of Governors and a Board of Directors. The Board of Governors delegates most decisions to the smaller Board of Directors. However, the governors retain the decision-making authority over many internal governance issues, such as admitting new members. Yet the Board of Directors often negotiates governance issues that officially fall under the auspices of the governors. Three countries have individual representation on the Board of Directors: China, Japan and the United States. The remaining fifty members of the ADB are divided into nine voting groups. Each voting group elects one representative to the Board of Directors.

ADB offers a range of financial assistance that help developing member countries (DMCs) build economic growth and social development. These tools include loans, technical assistance, and grants. Public sector (sovereign) financing is extended to DMC governments and public sector entities, such as state-owned enterprises. Sovereign lending or financing secured by a government guarantee forms the greater part of ADB's development assistance. These are called as sovereign loans as they have given only to governments and public sector organizations. ADB also offers non-sovereign loans to private sector organizations. ADB's operations in 2014, including grants and other assistance, totalled \$22.93 billion. ADB obtains its funding by issuing bonds on the world's capital markets. It also relies on the contributions of member countries, retained earnings from lending operations, and the repayment of loans.

The Asian Development Fund (ADF) bridges the development gap in Asia and the Pacific, home to both the world's fast-rising and most vulnerable economies. ADF is a major instrument of concessional financing that has supported equitable and sustainable development in the region since 1973. Funded by ADB's member countries, it offers loans at very low interest rates as well as grants to help reduce poverty in ADB's poorest members.

2.4.5.1 Criticism on ADB Policies

Since the ADB's early days, critics have charged that the two major donors, Japan and the United States, have had extensive influence over lending, policy and staffing decisions. Many NGOs criticized the Asian Development Bank of insensitivity to local communities. The bank also received criticism from the United Nations Environmental Programme, stating in a report that "much of the growth has bypassed more than 70 per cent of its rural population, many of whom are directly dependent on natural resources for livelihoods and incomes".

The bank has been criticized over its role and relevance in the food crisis. The ADB has been accused by civil society of ignoring warnings leading

up the crisis and also contributing to it by pushing loan conditions that many say unfairly pressure governments to deregulate and privatize agriculture, leading to problems such as the rice supply shortage in Southeast Asia.

2.4.6 THE DEVELOPMENT DEBATE

The herculean task of raising the great mass of humanity from poverty to acceptable levels of economic welfare is one of the most difficult tasks facing the world economy. There is intense disagreement among economists, public officials, and other experts over the best ways to achieve this goal. Indeed, there is not even a generally accepted commitment to accord priority to economic development. Early attempts by India and other less developed countries (LDCs) to make economic development an explicit objective of the post-war world economy at the 1944 Bretton Woods Conference were rejected by the United States and other industrialized countries. The World Bank, the International Monetary Fund, and regimes governing the world economy were established primarily to serve the interests of the dominant powers. Although industrialized countries have subsequently provided technical and financial assistance and given trade preferences, they have continued to resist LDC demands for a development regime.

Among both scholars and public officials, there are strong disagreements regarding the relative importance of the state and the market in economic development; these disagreements have been central to the conflict between the developed and the less developed countries. Throughout much of the post-war era, a debate has raged between the neoliberal proponents of reliance on the market and the proponents of state intervention. In the early post-war period (1945–1970), development economics, which emphasized the role of the state, was preeminent. Development economists argued that developing countries required an activist government; moreover, they believed that the international community should play a central role in LDC development. Then, during the 1970s and 1980s, the neoclassical belief in the free market triumphed both in academia and in international institutions,

and the ideology of “neoliberalism” and the doctrine of “structural adjustment” became dominant in the International Monetary Fund, the World Bank and the Asian Development Bank.

At the turn of the century, efforts to understand the task of economic development again emphasized the need for a national development strategy. Official thinking about economic development has, in fact, passed through several distinct stages. In the 1960s, the World Bank regarded economic development as a matter of solving a number of discrete technical problems regarding efficient use of resources and capital transfers. In the 1970s and early 1980s, emphasis was on trade liberalization and elimination of market dislocations caused by government intervention (structural adjustment). Later in the 1980s, the focus shifted to macroeconomic adjustment intended to eliminate inflation and macroeconomic instability (the Washington Consensus). In the 1990s, the World Bank and many experts began to appreciate that development requires transformation of the society. Joseph Stiglitz is purported to have conceded that economists are beginning to understand that development is complex and that there is more to development than trade liberalization and macroeconomic adjustment. Similar lessons are applicable to the problems facing transitional economies.

However, the frustrations in the Transition economies, particularly among the emerging powers, led to a realization that the existing financial architecture would not permit the developing countries to grow and they remain serve the interests of the developed world by providing large market spaces for the goods and services of the developed world. This realization led to look for alternative mechanism that are more inclined to the needs and interests of the developing and underdeveloped countries, which resulted in the establishment of BRICS bank.

2.4.7 THE BRICS BANK

BRICS is the acronym for an association of five major emerging national economies: Brazil, Russia, India, China and South Africa. The

grouping was originally known as “BRIC” before the inclusion of South Africa in 2010. The BRICS members are all developing or newly industrialised countries, but they are distinguished by their large, fast-growing economies and significant influence on regional and global affairs; all five are G-20 members. Since 2010, the BRICS nations have met annually at formal summits. Russia currently holds the chair of the BRICS group, and hosted the group’s seventh summit in July 2015.

As of 2014, the five BRICS countries represent almost 3 billion people, or approximately 40 per cent of the world population; as all five members are in the top 25 of the world by population, and four are in the top 10. The five nations have a combined nominal GDP of US\$16.039 trillion, equivalent to approximately 20% of the gross world product, and an estimated US\$4 trillion in combined foreign reserves. It is estimated that the combined GDP (PPP) of BRICS would reach US\$ 50 trillion mark by 2020.

Among the group of emerging economies, BRICS are playing a crucial, if not systemic, role in global economy. Three main aspects are underlining the relevance of BRIC as protagonists in development cooperation: The outstanding size of their economies; strong growth rates, leading to increasing significance in world economy, and; the demand for a stronger political voice in international governance structures, which corresponds to their economic status. Goldman Sachs has also identified the “next eleven” (Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam), who have improved their position in world economy in a similar way.

As a new multilateral grouping, BRICS acknowledges the differences among its members in terms of history, culture, political systems, economic structures, resource endowment, and levels of development. Members view these as a demonstration of the diversity of the world’s civilizations. BRICS countries recognize in this diversity the possibility for deeper cooperation for mutual benefit, drawing on the comparative advantage of each other country to collectively complement and build on one another’s strength.

BRICS group, in their first meeting, called for a more democratic and multi-polar world order based on cooperation, coordinated action and collective decision-making of all states. Some analysts are interpreting the emergence of BRICS in a neo-realistic way, assuming that BRICS want to challenge and counterbalance US (and western) hegemony. One also has to keep in mind, that BRICS are actually winners of the globalisation process of the last decade (on average GDP) and are opting for participation and influence in multilateral economic and political institutions like G20, IMF and World Bank.

In last few years, Ministerial meetings took place during UN and G20 conferences. Beyond these informal meetings the BRICS dialogue was institutionalized through summit meetings. During these meetings, development cooperation was a major issue. The five countries are forming a strategic alliance in order to increase their political weight at the international level and to enforce common political and economic interests. Issues such as food security and the commitment to provide financial and technical assistance in fighting undernourishment in developing countries have been raised during these summits. BRICS have also committed themselves to achievement of Millennium Development Goals (MDG) goals. To them, eradication of extreme poverty and hunger is a moral, social, political and economic imperative of humankind and one of the greatest global challenges facing the world today, particularly in Least Developed Countries in Africa and elsewhere.

BRICS' New Development Bank

On 15 July 2014, the five BRICS countries formally created a “New Development Bank” at Fortaleza, Brazil, which would be headquartered in Shanghai and would have an Indian as its first president. It would have a capital base of \$50 billion to start with, contributed by the five governments, and would provide development funding to all governments for infrastructure projects. The BRICS proposal also envisages a Contingency Reserve

Arrangement, of \$100 billion, which will give loans to governments for tiding over balance of payments problems.

Many economists and commentators have welcomed the BRICS Bank, each of them citing some mix of the following three arguments: first, it will increase the role of the BRICS countries in “global economic governance”. These countries are currently marginalised in the affairs of the main development lending agency, the World Bank, which operates on the principle of votes according to capital share, and not “one country one vote” (the principle that governs the UN); their economic weight will increase if they jointly have a development bank of their own that has the same objectives that the World Bank was originally supposed to fulfil when it was launched at Bretton Woods. Put differently, the argument is that the BRICS Bank will reduce the clout of the developed countries in “global economic governance” and increase that of the BRICS, which is to be welcomed as it represents a devolution of global economic power.

The second argument is that it will increase the “weight of the South” in “global economic governance”. It is being claimed that the BRICS Bank will operate on the basis not of “votes according to capital share”, but of “one country one vote”, with no veto power given to any country; and in addition to the five countries who own the Bank, there will also be some other countries of the South, on a rotation basis, on the Board of the Bank who will be entitled to vote. Consequently, it will not just be a BRICS Bank but one representing in some ways the entire South.

The third argument is that the BRICS Bank will not be a source of ideological pressure for adopting neo-liberal policies, as the World Bank became. The World Bank put “conditionalities” on its loans. Since the BRICS Bank will be giving project loans, based entirely on the viability of the project itself, it will be unconcerned with the macroeconomic orientation of the government; hence its loans will lack the ideological coercion that the World Bank’s loans bring with them.

A high point in July 2015 summit was further steps for operationalization of the BRICS bank or 'New Development Bank' (NDB). The first President of the NDB was decided to be from India in the previous summit and the Indian government was prompt to name veteran banker KV Kamath as NDB's first president. Kamath stated that the New Development Bank will consider membership of new countries within six months, with the most probable new candidates being African states. The capital base is used to finance infrastructure and, quote, sustainable development projects in BRICS countries initially, but other low- and middle-income countries will be able to buy in and apply for funding. BRICS countries have also created a \$100 billion contingency reserve arrangement (CRA), meant to provide additional liquidity protection to member countries during balance-of-payments problems and other financial shocks. The new bank is being described as a challenge to the IMF and the World Bank, that is, a challenge to American global financial power.

2.4.8 LET US SUM UP

As the world entered into new millennium, the international community has not yet come to terms with the immense problems of economic development. Whether or not a development regime is a possible or appropriate solution may be moot. In an era of neoliberalism with stress on the free market, a development regime is out of the question. On the other hand, free trade and economic openness do not by themselves constitute an adequate solution to the problem of underdevelopment or to the problems of the transition economies. A compromise must be found somewhere between the two extremes of abandonment of neoliberalism and total reliance on the market. The long-term solution to problems faced by developing and poor countries will require that the fundamental problems that they face be solved by the international community: tropical and arid agriculture must be improved, science and technology must be mobilized for development purposes, and major problems of environmental degradation and public health (HIV, malaria, and other tropical diseases) must be reduced or, better,

eliminated. Solving such problems would benefit rich and poor alike. And the survival of Development banks, be it World Bank or Asian Development Bank, will depend on how far they are willing to be guided by a global democratic political-economic process in resolving structural problems faced by the humanity. Otherwise, the developing world attempts for its own alternatives as we witnessed in the establishment of BRICS Bank by emerging powers such as China, India, Russia and Brazil.

2.4.8 EXERCISE

1. Briefly outline the functioning of World Bank in its early years.
2. How do you understand the role of the World Bank in the structural adjustment programmes of the developing countries?
3. What are the major objectives of Asian Development Bank and do you agree that it is fulfilling those objectives?
4. Explain the reasons for the establishment of BRICS bank.
5. Critically analyse the development debate with reference to various development banks.

UNIT – III: BASIC INSTRUMENTS

**3.1 TECHNOLOGY TRANSFER AND
INTELLECTUAL PROPERTY RIGHT: NATURE
AND TRENDS**

- V. Nagendra Rao

STRUCTURE

3.1.0 Objectives

3.1.1 Introduction

3.1.2 IPRs: Historical Background

3.1.3 WTO and the TRIPs

3.1.4 IPRs: Impact on Developing Countries

3.1.5 IPRs: The CIPLA Case

3.1.6 IPRs: A Critical Review

3.1.7 Let us Sum Up

3.1.8 Exercise

3.1.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The historical background intellectual property rights (IPRs);
- The significance of the TRIPs incorporated in WTO, particularly with regard to normative and regulative mechanism placed in it;
- The impact of IPRs in general and the TRIPs in particular on developing countries;
- How the IPRs impinging the interests of the people of the developing countries when their companies offer affordable health provision with a case study of Cipla;
- The critical issues involved in the present day IPR regime.

3.1.1 INTRODUCTION

Technology transfer is a process through which knowledge flows across institutional and organizational boundaries. During the process, technology generated or applied in one place may be utilized elsewhere, and the purpose for which technology is applied may be other the one for which it was originally intended. This process diffuses science and technology throughout human activity.

However, in contemporary times, as capitalism commoditised everything, knowledge /technology also becomes a commodity. When Knowledge becomes subject to ownership, intellectual property rights (IPRs) express ownership's legal benefits. Like material property, these rights are often justified on the grounds that ownership promotes the efficient use of resources. In contemporary times, technology is viewed as essentially a commodity bought and sold in the international market. Once we view technology transfer as a trade relation we have to identify the structure of the technology market, sources of technology and the nature of sellers and buyers to understand the real forces that dynamize the market relation. To the extent

that technology is embodied in physical goods, its market is not independent but constitutes an integral part of the market. Large part of technology transfer thus involves transaction in intermediate goods and capital equipment, or more appropriately, intrafirm goods trade which crosses state boundaries as a part of the international commodity market. As for the disembodied technology (knowledge) a part of it is legally recognized as 'owned' under the international patent, trade mark and other institutions of private property rights which give the seller the monopoly power.

As a result, underdeveloped countries are at a huge technological disadvantage in the global high tech economy today. They have immeasurably fallen behind developed countries in both acquired technology and domestically developed technology. Furthermore, the lack of protection of intellectual property (IP), which governments of developing countries view as necessary to bring their economy and social welfare up to speed with the industrialized world, is at great odds with the goals and moral convictions of the developed countries. Developing countries share a belief that industrialized countries wish to maintain their monopoly over advanced technology by demanding that developing countries implement strong intellectual property rights (IPR).

In this background, this lesson will explain the past and present developments related to international protection of intellectual property and the role of IP protection in technology transfer from the perspective of both developing countries and developed countries.

3.1.2 INTELLECTUAL PROPERTY RIGHTS (IPRS): HISTORICAL BACKGROUND

Intellectual property rights are defined as governmental protection of private innovations and creativity. The Paris Convention of 1883 and the Berne Convention of 1886 were the first international treaties on IPR. The Paris Convention was created to ensure protection of industrial property. This included patents, utility models, trademarks, and industrial designs. It required

member nations to treat both domestic and foreign patent holders and applicants equally. However, it contained a loophole, in that it did not stipulate a minimum standard for such treatment. The Berne Convention is an international copyright treaty for the protection of literary, scientific, and artistic works. It too, required equal protection for domestic and foreign copyright holders, but went further by describing minimum standards for such protection. Notably, neither treaty protects recordings of sound.

In 1967, the World Intellectual Property Organization (WIPO) was created as a division of the United Nations. It is charged with protecting and promoting intellectual property – via the Paris and Berne Conventions – throughout the world, as well as resolving international disputes over IP. However, the dispute resolution mechanism and enforcement capabilities are viewed as weak points of the WIPO. The language of the provision which sets forth remedies to disputes is vague, and the verdicts rely on the good faith of the losing party to enforce the judgment against it. Overall, the WIPO has been largely ineffective at protecting IPR because the Paris and Berne conventions are incomplete, and attempts to amend the Conventions have failed because of stalemates in the voting among members. Nevertheless, the WIPO counts over 170 nations as members, including the United States.

In 1994, under mounting pressure from the United States, Japan, and Europe, the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement was adopted at the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). TRIPs was established as an agreement under the newly formed World Trade Organization (WTO), and today, any nation wishing to join the WTO must comply with the standards set forth in TRIPs. TRIPs defines minimum standards of protection for copyright, trademarks, patents, trade secrets, and contracts. Furthermore, it requires a twenty year protection period for all inventions, products, and processes, in every area of technology.

3.1.3 WTO AND THE TRIPS

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) of Uruguay Round that established WTO claims that widely varying standards in the protection and enforcement of intellectual property rights, together with lack of a multilateral framework of principles, rules and disciplines dealing with international trade in counterfeit goods, have been a growing source of tension in international economic relations. In response, the TRIPs agreement addresses the applicability of basic GATT principles, together with those of already existing international agreements, to the provision of intellectual property rights; enforcement measures for those rights; and multilateral dispute settlement procedures.

The WTO rules are very specific with regard many issues relating to IPRs. With respect to copyright, all the members are required to comply with the substantive provisions of the Berne Convention, in its latest version (Paris, 1971), for the protection of literary and artistic works. Computer programmes are protected as literary works under the Berne Convention, and the TRIPs agreement lays down the grounds for copyrighting programmes, databases and other software. Authors of computer programmes and producers of sound recordings and films are given the right to authorize or prohibit the commercial rental of their works to the public through TRIPs. Performers are given protection from unauthorized recording and broadcast of live performances (bootlegging) for fifty years. There are a number of other similar provisions for trademark and service marks, geographical indications, industrial designs, and so on.

The WTO rules specifies that twenty-year patent protection be available for all inventions, whether products or processes, in almost all fields of technology. Inventions may be excluded from patentability if their commercial exploitation is prohibited for reasons of public order or morality. Compulsory licensing and government use without the authorization of the right-holder are allowed, subject to conditions aimed at protecting the legitimate interests of the right-holder. The conditions are mainly contained

in Article 31. These include the obligation, as a general rule, to grant such licenses only if an unsuccessful attempt has been made to acquire a voluntary license on reasonable terms and conditions within a reasonable period of time; the requirement to pay adequate remuneration in the circumstances of each case, taking into account the economic value of the license; and a requirement that decisions be subject to judicial or other independent review by a distinct higher authority. The WTO members are obliged to provide procedures and remedies under their domestic laws to ensure that intellectual property rights can be effectively enforced by foreign rights-holders as well as by their own nationals. Governments have to provide for criminal procedures and penalties at least in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale, with remedies including imprisonment and fines sufficient to act as a deterrent.

The WTO established a Council for TRIP Rights to monitor the operation of the agreement and governments' compliance with it. Dispute settlement takes place under the integrated GATT dispute-settlement procedures as revised during the Uruguay Round.

The TRIPs provision in WTO reflects the dominant view of IPs, particularly that prevailed in the Western world. Developed countries view IPR as a way of incentivizing innovation. The way IPR are viewed is also a reflection of the western world's views of property in general. Namely, exclusive ownership, the right to limit use, and the ownership right of control over propertized goods. Developed countries argue that patents are essential to international economic development because they provide a means to guarantee a return on invested time and capital in R&D. Thus, it is argued that TNC will be more likely to perform costly research, because a profit incentive will exist.

3.1.4 IPRS: IMPACT ON DEVELOPING COUNTRIES

Technology transfer is essential to all developing countries. Developing countries do not possess a large amount of protected technology upon which

they can build new technology and research. Also, they lack a sufficient pool of trained personnel to perform research and development in new technologies. Consequently, they need technology from developed nations to assist their growth.

The “Two Gap” Theory describes constraints limiting a developing country’s ability to gain technology. First, developing countries are unable to save enough capital to create and maintain their own technological base to promote growth. Second, the cost of importing technology far exceeds export (usually agriculture) revenues.

If technology from developed countries is imported and protected too strongly, the developing country – the importer of technology – will not be able to lay its own technological groundwork. Developing and underdeveloped countries view patents as inhibitors to technology transfer. They bring about high fees for the use of beneficial technology and hinder attempts to foster the development of high technology industries domestically. Additionally, because most patents are owned by corporations in the industrialized world, patents are regarded as instruments used by industrialized countries to exert control over the economic growth of developing countries.

Recent studies show the high extent of costs incurred by developing countries. The former chief of trade policy research in the World Bank, Michael Finger, estimates that the obligations on developing countries to implement TRIPS will result in increased payments by them of US\$60 billion a year. A report by the World Bank estimates that the net annual increase in patent rents resulting from TRIPS for the top six developed countries in this field will be US\$41 billion (with the top beneficiaries being the US with \$19 billion, Germany \$6.8 billion, Japan \$5.7 billion, France \$3.3 billion, UK \$3 billion and Switzerland \$2 billion). Developing countries that will incur major annual net losses include South Korea (\$15.3 billion), China (\$5.1 billion), Mexico (\$2.6 billion), India (\$903 million) and Brazil (\$530 million).

In relation to balance of gains and losses and to the effect on competition, Sreenivasan, Economics professor in Yale University states:

“Most of the gainers from TRIPS are in rich developed countries and only a few, if any, in poor countries. This being the case, even if gains outweigh losses, international transfers would be needed to compensate losers. No such transfers from gainers to losers are envisaged as part of TRIPS. Besides, TRIPS, unlike tariff reductions, involves the creation or strengthening of the monopoly position of developed country producers in the markets of poor countries. Thus, TRIPS creates a distortion of monopoly in developing countries, the rents from which accrue to the rich. Besides, any acceleration of innovative activity, which is the only rationale for granting monopoly rights, if it comes about at all, will take place mostly in rich countries. Whether some of the benefits from any acceleration of innovation in the rest of the world will accrue to poor countries is arguable. In any case the benefits, if any, are uncertain and in the future, but the costs to developing countries are concrete and at the present.”

Aside from its effect on economic growth, the poor countries also argue that stronger patent protection will result in difficulty in providing access to drugs and other health items – due to higher prices – to most people. This concern reflects the fact that policies of these countries towards IP are guided by the idea of insuring access to technology directed to the basic welfare of its people. The dire economic and social situations in many developing countries naturally gives rise to views that nobody should own knowledge, and that beneficial technologies should be easily spread amongst all people.

Finally, there is the consideration of expense in creating a strong IP system in a developing country. This expense is two-fold. First, there is the expense of overhauling the legal system to support enforcement of patents, copyrights, etc. This expense is joined with new training, which all judges and other legal personnel must receive to understand the new rights. The World Bank project experience indicates that it will cost a developing country \$150 million to get up to speed on three new WTO areas (IPRs, SPS and customs valuation). It notes that this amount is more than a full year’s development budget in many LDCs. Second, pirating operations actually

provide jobs and profits to a significant number of people and companies in developing countries. The local government is often unwilling to put so many people in the community out of work.

Currently, developing countries believe – and with good cause – that the dominant international treaties, such as TRIPs, are not geared to suit their long term interests. Namely, the current policies will not help the developing countries grow out of complete dependence upon the technology of developed countries, in the long term. Changes can be made, but only when the developed nations see the long term success of the developing nations as something which is in the best interest of all nations.

3.1.5 IPRS: THE CIPLA CASE

As we have seen above, the TRIPs provisions of the WTO has seriously affected the interests of the developing countries, particularly with regard to centralization of control over multiple forms of ‘intellectual property’ (knowledge and its products) in multinational corporate hands. The pharmaceutical industry was a major player in the agreement. This is a highly concentrated industry in which ten companies control 50 per cent of global sales mainly in developed countries (25 per cent of the world’s people consume 90 per cent of the drugs). The main benefits of TRIPs have gone to the international pharmaceutical industry, which aggressively protects a highly profitable business with the intensive use of political power – trade sanctions, withdrawal of aid, and so on.

The most controversial issue involves drugs for people suffering from AIDS. Some of the main national actors include India, where the pharmaceutical industry was regulated by the fiercely nationalistic India Patents Act of 1970. This act fostered the phenomenal growth of the pharmaceutical industry that came to be regarded by UNCTAD as a model for developing countries. In the mid-1990s prices for four typical drugs were ten times more expensive in Pakistan, seventeen times more expensive in Britain and thirty-seven times more expensive in the USA than in India. A

year's worth of AZT therapy (for treating HIV patients) could be bought in India for \$500, compared with \$10,000–15,000 elsewhere. In Brazil, the state produces most of the AZT drugs and provides them free, cutting the AIDS infection rate in half; and in South Africa, where 20 per cent of the people are HIV-positive, the minister of health was given permission in 1998 to import Indian drugs and cheap pirate copies. Thirty-nine drug companies brought suit against the South African government to prevent this, but the suit had to be withdrawn under public outcry in 2001, with the drug companies forced to reduce prices on limited quantities of drugs provided to Third World countries. The USA, however, continued to pressure Brazil to stop unlicensed production.

The interests of developing countries in general and India's in particular on issues of IPRs have been highlighted by a recent aggressive move into the global marketplace by one of its largest domestically owned pharmaceutical companies, Cipla Ltd of Mumbai. After prolonged negotiations with the international voluntary organisation of doctors - the Nobel Peace prize winning *Medecins Sans Frontieres* (Doctors Without Borders) (MSF) - Cipla announced that it would offer a combination of three anti-AIDS drugs for an annual price per patient of \$350.

Cipla chairman Dr. Yusuf Hamied insists that he is capable of supplying ample volumes of three generic drugs used in AIDS therapy: *stavudine*, *lamivudine* and *nevirapine*. But the special offer made to MSF would not recover costs for his company. To compensate for this loss, Cipla has worked out a three-tier pricing mechanism, offering the same combination of drugs at \$600 to governments and \$1,200 to wholesale distributors.

MSF lost little time in seeking to turn on the moral pressure, challenging the multinational drug majors to match the Cipla offer. All three drugs on offer have been patented by big global players. Bristol-Myers Squibb (Bristol) of the U.S. holds the patent on *stavudine* and sells it under the brand name Zerit. GlaxoSmithKline (Glaxo) of the U.K. has patented *lamivudine* under the brand name Heptovir and Boehringer-Ingelheim (Boehringer) of

Germany retains the rights to *nevirapine*, which it markets under the name Viramune. Cipla's offer is in this sense guaranteed to raise hackles across continents.

The prices at which triple drug therapies are today offered in the industrialised countries range from \$10,000 to \$15,000. Assuming that Cipla's price for the wholesale trade would enable it to more than recover costs and meet the subsidies inherent in supplies to MSF and the government sector, the drug multinationals are today under pressure to cut their prices by a factor of ten. In this context what Cipla's Hamied said was pertinent: "We also offered totally free, technology to any Third World government wanting to produce their own ARV drugs. Subsequently, we also offered to supply free worldwide the single dose drug Nevirapine capable of stopping the transmission [HIV] from mother to child. Surprisingly, the world watched silently and there was no response".

As a result, Cipla suffered a bruising encounter with drug multinationals when it was compelled to pull out of a contract to supply a generic version of Glaxo's patented drug Combivir to Ghana. Cipla offered the combination of lamivudine and zidovudine at \$1.74 a day, against the price of \$16 that Glaxo charged till recently. And even though the African Regional Industrial Patents Authority (ARIPA) rejected the validity of Glaxo's patent in Ghana, Cipla proved unequal to the challenge of taking on one of the world's biggest drug companies.

It has since shored up its legal defences through intensive consultations with MSF. The outcome was a set of near-identical communications that Cipla addressed to four drug multinationals. Apart from the drugs that had been patented by Glaxo, Bristol and Boehringer, Cipla expressed an interest to manufacture Pfizer's patented anti-fungal agent fluconazole, which is of proven efficacy in treating opportunistic infections of meningitis in AIDS patients.

Citing the urgency of dealing with the AIDS pandemic, Cipla sought early clarifications on two questions: which were the countries in which the

four companies sought to assert their patent rights on the drugs concerned? And what would be their terms to grant Cipla a non-exclusive right to supply the same drugs in these countries? Partly pre-empting the response to the latter question, Cipla director Amar Lulla offered unilaterally to pay royalties on the company's sales in these countries, up to a maximum of 5 per cent of revenues. However, if the past is any guide, then the multinationals are unlikely respond positively to let this challenge to their market dominance stand and permit Cipla for the same. The consequence, as the British charity organisation Oxfam recently warned, could be a massive erosion of their rapidly diminishing fund of public goodwill.

Oxfam estimates that since introducing Combivir into the market in October 1997, Glaxo has earned sales revenues of \$1.5 billion on the product. Operating profits on this product alone could be conservatively estimated in excess of \$450 million. Even if the multinationals' claim were to be accepted - that it takes on average \$500 million to bring a new drug to the market - Glaxo would seem to have been amply rewarded for its entrepreneurship.

Pertinent here is a telling statistic brought to notice by Oxfam: that in the period concerned, the total health budget of all member-states of ARIPA was less than two-thirds of the profits earned by Glaxo on Combivir. It is yet another matter altogether, as CPT points out, that the main components of Glaxo's patented anti-AIDS drugs were evolved through publicly funded research in the university system.

For reasons connected to India's capability to manufacture a broad range of generic drugs, the powerful industry lobby in the U.S. - the Pharmaceutical Research and Manufacture, America (PhRMA) - has always targeted India for priority attention. Periodic submissions made by PhRMA to the U.S. government have ensured that India along with Brazil and, in recent times, Thailand, has remained on the "watch-list" of countries that provide insufficient standards of protection for intellectual property. Since 1997, South Africa and even the tiny Dominican Republic have had to abandon ambitious programmes for domestic drug manufacture under the threat of U.S. trade sanctions.

The Doha Declaration of November 2001 (at the Fourth Ministerial conference of the World Trade Organization) was a major victory for countries seeking exceptions to trade related intellectual property rights (TRIPS). The Declaration recognized the right of member governments to grant compulsory licenses to local drug producers to make drugs needed in emergency situations such as AIDS, malaria and other epidemics. On the other hand, the push for protection of intellectual property rights by MNCs in developed countries has intensified, and the United States, in particular, is wielding a heavy hand in forcing governments of developing nations to comply and is making it increasingly difficult for them to avail of the flexibilities built into TRIPS.

Over the last couple of years, news of pharmaceutical patents and India's attempts to protect and manage its market has caught the attention of intellectual property observers everywhere and the pharmaceutical industry in particular. High-profile developments have included India's awarding of its first compulsory licence for a patented drug and Swiss pharmaceutical giant Novartis' long-running court battles challenging India's patent law.

For the first time, using Compulsory Licensing provision of the WTO, India government sanctioned compulsory license for a cancer drug, Nexavar, produced by top multinational company, Bayer AG of Germany in 2014. The company started huge anti-India campaigning and its CEO said that the drug was created for "Western patients who can afford" the expensive product rather than "the Indian market". The comments drew flak from dismayed campaigners. Civil society groups campaigning for improved access to medicines were denouncing the campaign. This recent crisis highlights the tension between the commercial interests of big pharmaceutical companies, and the Indian patent office and judicial system's efforts to safeguard public interest by not blindly granting patents and injunctions that undermine access to low cost generic versions of medicines.

The concerted campaign against India by multinational pharmaceutical companies has resulted in the launch of an investigation by the United States International Trade Commission against India looking at recent changes in

trade and investment policies, and particularly on intellectual property (IP) enforcement. There is also a push by US industry associations to designate India as a “priority foreign country” under the Special 301 provision of the US Trade Act of 1974, with the aim of using the threat of trade sanctions to exert undue pressure on India.

India’s actions are fully compliant with the WTO agreement on TRIPS. Measures taken by India send a clear signal that the industry is too focused on business models to extend monopolies on existing medicines to discourage competition. By not rewarding these strategies, India will hopefully push companies to refocus energies on developing new medicines.

3.1.6 IPRS: A CRITICAL REVIEW

The long term benefits provided by technology transfer under modern international policy on intellectual property are one-sided. Transfer of technology via FDI certainly benefits the transnational corporations, who delight in access to cheap labour, and the establishment of a particular image and reputation as an employer in a new labour market. And while it is true that FDI creates jobs in developing countries, it has done very little to plant seeds for long term prosperity. In fact, 80-85% of patents held in developing countries are held by persons foreign to that country. Since developing countries are so dependent upon what little technology is brought over to them, it becomes difficult to bargain effectively for their needs in the existing forums (WTO, WIPO).

International market for technology thus remains highly imperfect; its structure being characterized by a large number of weak buyers and dominance of few sellers, meaning thereby that transfer is unlikely to be of ‘arms length’ trade. The trade relations can therefore be better explained in terms of unequal exchange than comparative advantage. Relative bargaining power settles the terms of transfer rather than the price mechanism. The bargain will be struck to the greatest disadvantage of the buyers to whom suppliers transfer technology at onerous cost.

The suppliers are mostly multinational corporations oligopolistically organized on a global scale whose main source of strength is technology protected by institutions of private property rights. The monopolistic position bestows upon them advantages which they consolidate fairly easily, given the weakness of buyers. Irrespective of the ownership mix (mode of transfer), technology transfer is forged as an instrument of control on production and marketing decisions of recipients to subserve the global strategy of the multinational framework. Such a vast power has caused widespread concern about its economic dimensions. Multinational corporations either singly or in collaboration with local partners have given a monopolistic character to the emerging industrial structure of developing countries. This has helped the multinationals to orient the product structure of these countries within the former's scheme of things. The advanced market economies' industrial structure, characterized by monopoly, is thus repeated in technology recipient developing countries, arresting their growth prematurely.

The monopoly provided by patents enables the patent holder to block or otherwise discourage rival firms entering the market, or even in some cases to undertake research and innovation. This may be justified if the patents are given correctly, and for the right duration, and moreover if the IP holder does not abuse his right (for example by harassing competitors).

The trend in some developed countries in relaxing the criteria, standards or practice of granting patents, and the practice of some companies owning patents in harassing rivals is increasing the anti-competitive effects of IP. For example, the number of patents tripled from 1983 to 2002 (from 62,000 to 177,000), accompanied by a proliferation of patent awards of dubious merit, for example "inventions" that are not new or are trivially obvious.

The US Patent Office has become so overtaxed and its incentives so skewed to granting patents that the tests for novelty and non-obviousness (to ensure only true inventors get patents) have become largely non-operative. Simultaneously, changes in the court system have made patents more powerful

legal weapons than they used to be, with a patentee more likely to win an infringement suit against a broader array of possible infringers than before. The result has been a dangerous and expensive arms race, which now undermines rather than fosters the crucial process of technological innovation.

The monopoly rights granted to patent holders enables them to restrict competition and charge monopoly prices. Proponents of IP point to the need for innovators to recoup the cost of research, and thus a mark up on normal profits is needed. However, critics claim that in some cases the balance is tilted in favour of the patent holders, who make excessive or even exorbitant profits by over-charging consumers excessively high prices, even after taking account of the need to recoup research costs.

Some surveys show that drug companies can charge more in developing countries than in developed countries for the same branded products. For example, in 1998, retail prices of 10 out of 13 commonly used drugs were higher in Tanzania than in Canada; the average retail prices of 20 commonly used drugs in 10 countries of Central and South America were all higher than the average retail prices of the same drugs in 12 OCED countries.

The present IPRs system is arresting any innovation and technological advancement in developing countries. Where most patents in the country are held by foreign inventors or corporations, local R&D can be stifled since the monopoly rights conferred by patents could restrict the research by local researchers. Strict IPR protection, by its apparent bias, may actually slow the pace of innovation in developing countries, and increase the knowledge gap between industrial and developing countries. In such situations, the IPR system favours those who are producers of proprietary knowledge, vesting them with greater bargaining powers over the users.

In short, the present IP laws practiced through the WTO, WIPO and bilateral/regional agreements, has contributed to the imbalances and the spread of conditions that make it more difficult for developing countries and their enterprises and institutions to compete. This is of concern particularly for

developing countries as the characteristics and conditions of such countries make them especially susceptible to adverse effects.

3.1.7 LET US SUM UP

The present regime of IPRs is meant for protecting those who owns technology and knowledge. Obviously, this benefits the Developed countries. Through WTO provisions, we are witnessing a trend towards the adoption of stronger IPR around the world. The long term prosperity of developing countries is clearly in jeopardy as they are being figuratively strip-mined for cheap labour. Developed countries must realize that policies for technology transfer which do not help developing countries become self sufficient, will only yield a long term financial burden for developed countries. Such policies will result in developing countries' continuing requirement of loans and other measures of support to prevent political and social problems, due to economic problems. The developed countries should address this danger immediately, but it seems that their representatives cannot see beyond the profit-driven goals of their large, high-tech companies. Indeed, the prospects for developing countries to free themselves from dependencies on western technology, and to export domestically developed technologies, is bleak for the foreseeable future.

3.1.8 EXERCISE

1. Outline the historical background of Intellectual Property Rights.
2. How the TRIPs provisions incorporated in WTO are significantly changed prevailed norms regarding IPRs?
3. How the IPRs impeaching the interests of the developing countries?
4. The present IPRs undermining the basic health provisions of the vast people of the world. Explain this while referring to Cipla case.
5. Critically review the present IPR system vis-a-vis the interests of developing countries and on newer innovations and alternative technologies.

**3.2 FOREIGN AID AND ARMS TRADE:
CHANGING DYNAMMICS**

- V. Nagendra Rao

STRUCTURE

3.2.0 Objectives

3.2.1 Introduction

3.2.2 Defining Foreign Aid

3.2.3 History of Foreign Aid

3.2.4 Trends in the Quantity of Aid

3.2.5 Aid Tying

3.2.6 Summing up Foreign Aid

3.2.7 Arms Trade

3.2.8 Arms Trade: Historical Background

3.2.9 Trends in International Arms Trade

3.2.9.1 Trends during Cold War Period

3.2.9.1 Post-Cold War Period Trends

3.2.10 Arms Trade: The Consequences

3.2.11 Let us Sum up

3.2.12 Exercise

3.2.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The definition and history of Foreign Aid;
- The trends in quantity of Foreign Aid during post-Cold War period;
- The meaning of aid tying and its impact on developing countries;
- The historical background to arms trade;
- How the Cold War rivalry between the two superpowers determined the major trends in Arms Trade during Cold War period;
- The changing pattern of Arms Trade during post-Cold War period;
- The consequences of the Arms Trade, particularly on developing countries.

3.2.1 INTRODUCTION

Foreign aid has been an area of active scholarly investigation since the end of the Second World War, but particularly since the early 1950s when a large number of the erstwhile colonies became independent. Few areas of public policies, involving the developed countries and developing countries, have aroused more passion and ideological debate than foreign aid.

What drives a country to donate aid to another country? Is it altruism or the expectation of something in return? Many of the scholars find that motives of donating nations have varied over the decades, but two stand out: humanitarianism and strategic interests. Both have existed in different and changing proportions since about World War I, and both still exist today. Many scholars interrogate the link between the evolution of aid and the strategic response by ‘capital’ to the needs of the time.

3.2.2 DEFINING OF FOREIGN AID

A common tool for the definition and measurement of foreign aid is official development assistance, which is used by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD). Official development assistance consists of grants and loans, which a government or multilateral organizations give a developing country to promote economic development and welfare. This assistance can be provided in concessional terms, which means at least 25% of loan must be in the form of a grant. The data on official development assistance also includes technical cooperation, such as farmers ought to learn new techniques or advising in making economic reforms, they exclude military assistance, political development programmes, credit exports and debt forgiveness for military loans. OECD also uses a wider concept called official development finances, which combines official development assistance and other official flows – that is, financial flows from government organizations in developed countries and multilateral organizations into developing countries. Other official flows usually include loans in or near the market interest rate. All incomes that benefit a developing country in the form of grants, concessional loans or unconcessional loans by government organizations are considered as foreign aid.

3.2.3 HISTORY OF FOREIGN AID

The rise of aid has been a post–1945 phenomenon, though it has its precursor in the programmes carried out by colonial authorities, such as the successive Colonial Welfare and Development Acts of the United Kingdom. The origins of aid are normally ascribed to three factors. First, there was the success of United States’ Marshall Plan aid to Europe (explicitly emulated, for example, in the Colombo Plan for Asia). Second, there was the first wave of independence in Asia in the late 1940s and African independence in the 1960s gave a renewed impetus to aid programmes. The Cold War was the third factor, as the superpowers used aid and arms supply as one instrument

to obtain influence and secure the position of “friendly regimes” (friendly to the relevant superpower, that is, but usually less so to the people they ruled).

The nature of aid has changed as the above trends have evolved. Point Four of President Truman’s inaugural address in 1949 launched the United States aid programme and during the 1950s the United States was the major donor, accounting for about two-thirds of all aid. The situation changed somewhat following Krushchev’s announcement, at the Twentieth Party Congress in 1956, of an expanded Soviet aid programme. The second wave of independence in the 1960s contributed to two important changes in the aid scene. First was the rise of bilateral donors, as flows to former colonies became institutionalized into the nascent aid programme. Second has been the growth of the UN system and the growing demands for changes in the global economic system, including increased aid.

There have been changing fashions in both aid instruments and the underlying ideology of aid donors. In the early years, bilateral agencies engaged in technical assistance, with some budget support to newly independent countries, in the belief that projects were best undertaken by the multilateral agencies with the requisite skills. But by the 1970s projects had become the mainstay of the aid business. More recent trends toward budget support and sector programmes notwithstanding, projects continue to dominate the aid scene. A further development in the 1970s was an increased emphasis on aid for social sectors, which has once again become a popular theme. But the ideology changed from one of state-directed development to a vision of market-based growth. There have been indications of a move back towards a more balanced view of the complementary roles of state and market, but they are taking quite some time to feed through to the practice of aid.

3.2.4 TRENDS IN THE QUANTITY OF AID

In nominal terms, aid increased in nearly every year until the early 1990s, when it peaked at US\$62.7 billion in 1992. In the next four years the

total then fell by US\$15 billion, dropping to US\$48.5 billion in 1997, recovering slightly and erratically in the following years. The rise in real aid in the 1980s was quite marked, though since then real aid has fluctuated quite substantially, but with no evident trend, in the 1990s. The trend in aid's share of donor income also shows the deterioration in the 1990s. The average for the whole period is well under one-half of one per cent: aid is a tiny share of donor income. The aid as a percentage of donor Gross National Product (GNP) was 0.4 to 0.5 per cent in the 1960s, but had declined to 0.3 to 0.4 per cent by the early 1970s and stayed at the level for two decades. However, in the 1990s the percentage has fallen again, reaching to 0.25 per cent in middle of 1990s and further declined in 2000s reaching its lowest level of 0.22 per cent in 2001. The UN target, adopted by all DAC members other than the US and Switzerland, is that aid should be 0.7 per cent of GNP. But that target is further away than ever from being met.

The most important reason for declining aid from 1990s onwards is the end of Cold War. The aid was always politically motivated, once the Western world gained upper hand in the international politics due to disappearance of Soviet Union, they lost interest in developing world once the Cold War was won. Western countries have no longer felt the need to provide aid as a means of discouraging the spread of communism. Moreover, the rapid growth of private flows in recent years has brought the share of aid in total resources flows to developing countries down from two-thirds in the late 1980s to only one-fifth in the mid-1990s. The rise of neoliberal ideology and politics in the 1980s also one of the important reasons for declining levels of foreign aid since neoliberal ideology does not consider aid as a public good. The effect of this shift in ideas is manifest in the programmes of various political movements to cut 'welfare' both domestically and internationally. In this context, it is not surprising that with the end of Cold War, with less generous welfare programmes than in Europe, and a culture which is less supportive of state intervention, ideologically more inclined towards neoliberalism, the cut in aid budgets has been particularly high in the United States.

3.2.5 AID TYING

Aid tying has various means. The most common, which is that mainly pursued here, refers to the practice of linking aid to the procurement of goods and services from the donor country. However, it has also been taken to mean linking the use of aid to particular projects and to making aid conditional on implementing agreed policy changes. The bulk of aid has always had, and continues to have, its intended use specified by the donor. Initially, food aid constituted major part of the foreign aid, however, its share of total aid has fallen from around 15 per cent in the 1970s to less than 5 per cent today, with much of it being used in 'food for work' programmes, i.e., as project aid. By the 1980s, financial programme aid was more important than food programme aid, and was increasingly linked to policy change. By the 1990s most bilateral donors were also giving programme aid linked to policy reform. Moreover, the scope of these reforms has spread over time, from macro stabilization to market liberalization and then onto the allocation of spending. By the late 1980s governance concerns were starting to be raised and became an established part of conditionality in the early to mid-1990s. And now the increased use of the sector approach introduces a policy dialogue framework for many activities previously restricted to the project level.

Aid tying is criticized for distorting project choice and design, and because goods and services procured using tied aid are more expensive than market prices. Despite protests to reduce aid tying, the amount of aid which is formally untied has reduced only slowly: from just under 40 per cent in the early 1970s to just under 60 per cent in the mid-1990s. In addition, official data understate the extent of tying, which is often through informal means.

This is the reason for many to see Aid as political instrument for Developed or Western world to influence the policies of the Developing countries. They see it as an instrument for entrapping developing countries in the international capitalist system and so furthering their exploitation. Proponents of this position would point out how aid opens economies up to the outside world by financing infrastructure projects and requiring

liberalization of recipient economies. Until recently, they could also point to how blatantly aid was used as a weapon in the Cold War, with scant regard for the authoritarian nature of many beneficiary regimes. From this point of view, aid may provide the occasional benefits, but its overall impact will be to increase poverty by the subordination of developing countries in the global economy.

The critics also point out to the fact that irrespective of the toll claims of the Western donor countries, the effectiveness of the aid in reducing poverty is minimal. The most striking fact is that there is no real data to reveal aid's impact on poverty. Project and programme design is not usually carried out in such a way as to allow proper evaluation of their impact on poverty, so evaluators rely on *ad hoc* judgements. This fact alone indicates that poverty reduction has not been a central concern and it can be said that only 10-20 per cent of aid has been used for direct poverty reduction, although agency officials would reply that all aid is poverty-reducing. Against that view, one can point to aid interventions (in particular those involving involuntary or forceful resettlement of populations) that have been poverty-increasing.

3.2.6 SUMMING UP FOREIGN AID

Aid is the transfer of goods and services on a concessionary basis to developing countries for development purposes. Aid flows grew rapidly in the post-war period until the late 1970s, since when they have experienced erratic growth and occasional stagnation. Many question aid's effectiveness, especially to the central objective of poverty alleviation pointing out the donor countries strategic interests and foreign policy objectives of superpowers during Cold War period to keep the developing countries to their respective side. Many scholars also pointed out the constraints imposed on aid by donor's use of aid funds for their own commercial and political ends. In the mid-1990s, as private capital flows to developing are once again growing, some argue that we have come to 'the end of aid', but this view seems premature given the number of low-income countries with limited access to international capital markets.

3.2.7 ARMS TRADE

Although the arms trade is a persistent feature of international relations, it has often been ignored in analytic and policy circles. After World War II, analysts, academics and public officials interested in international security focused considerable attention on issues related to nuclear weapons. Chemical and biological weapons were given less attention, but were still the focus of major international campaigns and treaties. Major conventional weapons garnered far less attention at national and international levels, and light weapons even less. Nonetheless, major and light conventional weapons have been responsible for millions of deaths since World War II. Understanding the widespread effects of the arms trade is an important factor in comprehending the causes and consequences of conflict.

3.2.8 HISTORICAL BACKGROUND

The militarization of Third World countries with foreign weapons dates far back into history. The rise, spread and global penetration of capitalist ways to organize production and the rapid development of productive forces appears as vitally dependent upon manifold functions of armaments. Albeit appearance and patterns of the deployment of military power did change significantly in the course of development, the threat and the execution of armed force remained continuously a key instrument in different phases of capitalist reproduction. The emergence of economic support and fringe areas (peripheries), which fell into ever increasing economic and political dependence from the centres of industrial production (métropoles), is hardly understandable without the role of military force.

In order to specify the process of Third World militarization, and in particular to assess the role of metropolitan proliferation, six prevalent levels of the problem need to be considered:

- (a) After 1965, one can trace an increase in the arms race dynamics in developing countries, indicated by a marked rise in military spending, number of men under arms, and weapons procurement. The rate of

increase is bigger than the one in industrialized countries, both the capitalist and the socialist ones. In some regions, particularly in oil-producing countries, the rise is indeed a jump which must be measured not in percentages of former outlays, but by multiplying the earlier military potential.

- (b) There is an impressive strife for the build-up of Third World capacities to produce arms. Two strategies are predominant. The older concept, concerned with motives of ruling classes (e.g. to gain political less dependence from metropolitan arms suppliers), provides for indigenous weapons design and production. This concept has been overtaken in practical relevance by a massive wave of proliferation of means for the production of arms, or parts thereof, by multinational corporations, whose action overlaps with strategies of militarized industrialization in certain oil-rich countries. This spread of military production is claimed to show even now a marked impact on efforts to improve the standard of living for the 60 to 80 per cent of marginalized Third World population, because decisive resources are geared to support the process.
- (c) Many times poor Third World countries have been used as proving grounds for the testing of innovative arms technologies, to an extent unknown before. For instance, the Vietnam and Arab-Israeli war experience has been used globally by military planners as evidence for the evaluation of modern military technology and its application.
- (d) Militarization of Third World countries is not at least limited to the kind of arms build-up. As the concept of militarization implies, the armed forces become more and more a decisive agent in the organisation and management of these countries. Starting with civil action, or the management of certain productive facilities by military personnel, military ways of organizing groups and executing orders tend to creep into social structures beyond the fringe of military institutions. Military academies become foremost training centres also

for civil servants. Creeping militarization is to be observed in a variety of countries, with alarming repercussions at least for the long-term development of these countries.

3.2.9 TRENDS IN THE INTERNATIONAL ARMS TRADE

The 'modern' arms trade dates largely from the 1960s: a key factor was the US President Kennedy's decision to move from transferring surplus World War II vintage weaponry for free to selling newer weapons. The increased emphasis on weapons sales was reinforced in the 1970s by Britain's decision to withdraw from east of Suez and by the implementation of the Nixon Doctrine, which supported the militarization of Israel and Iran as regional 'policemen' within West Asia. Both of these decisions were cited by countries in the affected regions as reason to seek additional weaponry. New weapons were much easier to obtain after the 1973 war in West Asia, when increases in the price of oil in a very short period of time dramatically increased the access to cash of the oil-rich countries. With cash resources, countries demanded modern weapons, which were seen as both a means of bolstering their defences and symbols of modern militaries and societies.

The Cold War provided a structure for the arms trade. States were generally the suppliers and recipients; recipients tended to choose sides and remain with either NATO or Warsaw Pact countries as their dominant suppliers. Suppliers sometimes provided weapons to insurgent groups, but most transactions were on a state-to-state basis.

3.2.9.1 Trends During Cold War Period

For much of the Cold War period, from the early 1960s to the late 1980s, the global arms traffic was largely governed by the competitive practices of Washington and Moscow. Eager to establish and maintain close military ties with the rising powers of the Third World, the two superpowers offered increasingly sophisticated arms to those regimes willing to align themselves with one or the other of the major blocs. As a result, arms supplied

by the two superpowers (and by their close allies) constituted a large share of the global weapons flow: according to the US Arms Control and Disarmament Agency (ACDA), US and Soviet arms accounted for 65% of the total worldwide weapons traffic in 1972-88 (when measured in dollars), while those provided by all NATO and Warsaw Pact countries combined accounted for around 90% of the traffic during this period.

The Cold War competition between Washington and Moscow also governed the direction and composition of the arms flow during this period. In their pursuit of Third World allies, the superpowers concentrated their arms-supply activities in a number of major areas considered pivotal to the global correlation of forces – most notably the West Asia, South Asia and East Asia. As a result, the great bulk of the weapons transferred internationally during this period as delivered to a number of key states in each of these regions, including Algeria, Egypt, Ethiopia, India, Iran, Iraq, Israel, Libya, Pakistan, Saudi Arabia, Syria, Taiwan, Turkey and the two Koreas. Together, these key states (along with favoured allies like Cuba and Vietnam) accounted for some three-quarters of all arms transfers during this period. In seeking to maintain their friendly ties with these states, moreover, the superpowers provided them with major combat systems – tanks, fighter planes, missiles, and so forth – of increasing sophistication, thus generating the high dollar values for global arms transfers in the late 1970s and the 1980s.

Cold-war patterns influenced other aspects of the global arms traffic. As part of their efforts to gain influence and retain allies in the Third World, Washington and Moscow often took sides in regional conflicts, supplying their local partners and surrogates – which could be states or insurgent forces – with immense quantities of modern weapons. This accounts for the prominence in arms transfer statistics of such recipients as Angola, Afghanistan, Cuba, El Salvador, Ethiopia, Mozambique, Nicaragua, North and South Korea, and North and South Vietnam – all of which figured significantly in the overseas military and political activities of the two superpowers. In some cases, the competitive arms-supply behaviour of

Washington and Moscow also fuelled local arms races, with each side in these rivalries turning to their superpower patrons for arms of increasing lethality and sophistication. As a result, the arms inventories of such states as Egypt, India, Iran, Iraq, Israel, Pakistan, Saudi Arabia and Syria increasingly came to resemble those of the front-line powers in NATO and the Warsaw Pact.

Together, these various patterns constituted what might be called the Cold War paradigm of global arms trafficking. To summarise, this paradigm entailed: (1) the overwhelming dominance of the two superpowers (and their respective allies) over the global arms flow; (2) the primacy of ideological and geopolitical factors in determining the recipients of arms; (3) the emergence and acceleration of regional arms rivalries in key Third World areas; and (4) a preference, on the part of leading recipients, for transfers of sophisticated front-line combat systems. The durability and vitality of this paradigm is clearly evident in the statistics on arms trafficking, which show a more-or-less continuous increase in the quantity and quality of weapons supplied by the superpowers to their respective allies during the four decades of the Cold War.

3.2.9.2 Post-Cold War Trends

It is now evident, however, that this paradigm has largely changed. The USSR/Russia has seen its arms export orders drop from about \$18 billion per year in the late 1980s to \$3 billion in the early 1990s, a decline of 83%. Even more striking, a number of major arms recipients in the 1980s, including Afghanistan, Angola, Cuba and Vietnam, have virtually dropped off the charts of major recipients in the 1990s. Statistics on the arms trade also show a sharp decline in transfers of major combat systems, especially tanks, heavy artillery pieces and supersonic combat planes. As a result of these, and related developments, total world arms transfers (as tallied by the ACDA) dropped from an average of \$66 billion per year in the late 1980s to \$50 billion in 1990, \$32 billion in 1991, \$25 billion in 1992 and \$22 billion in 1993.

Some analysts have chosen to interpret this data as a simple contraction in the arms trade, with deliveries proceeding more-or-less as before but at reduced levels of arms and dollars. However, such analyses miss the main point: the arms trade has not simply evolved into a smaller version of its old self, but has changed into something new, producing a new paradigm of arms trafficking. This new post-Cold War paradigm is still evolving and its essential features are gradually becoming evident. These include: (1) the unrivalled dominance of the USA in the global arms traffic; (2) the primacy of economic (as against ideological and geopolitical) motives for arms exports; (3) the emergence of new arms rivalries in East Asia and the expansion of existing markets in a number of other areas; (4) a focus on internal (as against external) defence in the selection of arms by many states; (5) the growing salience in the arms trade of sectarian militias, insurgent groups, black-market dealers and other non-state actors.

These factors are evident, to some degree, in the publicly available data on global arms transfers. While the Soviet Union accounted for 43 per cent of the world trade in major conventional weapons in 1986, falling to 40 per cent in 1987 and accounting for less than 20 per cent from 1991. At the same time, the United States' share increased from less than 30 per cent in 1986, to nearly 50 per cent in 1991 and more than 50 per cent in 1992. The growing prominence of East Asia in the global arms traffic is also evident in the statistics: Taiwan, South Korea, China, Malaysia and Singapore all figured among the Third World's top ten arms recipients in the 1991-94 period (ranked numbers 2, 5, 6, 7 and 10, respectively), while none of them appeared on this list in the 1987-90 period.

Alongside these structural factors, however, one can see the impact of deeper shifts in the international system – shifts that have been described as significant because of the profound and long-lasting nature of their effects. These include: the globalisation of the market economy; a pronounced shift in the centre of gravity of global economic activity from the North Atlantic region to East Asia and the Pacific; a generalised decline in the ability of

most nation-states to satisfy the rising expectations of growing populations and to balance the competing demands of various groups within the population; the growing vigour and importance of political movements based on ethnic, religious, tribal and linguistic ties; and a growing imbalance between resources and population in many underdeveloped areas. While the full effects of these phenomena may not be apparent yet, it is already evident that they are having a substantial impact on world politics and, in particular, on the global flow of weapons.

Long-term political trends have also had an impact on the arms trade. The decline in the state's ability to satisfy popular expectations, along with the growing assertiveness of ethnic, religious and tribal forces, has led to an increase in political and sectarian disorder in many countries. This, in turn, has led many governments to beef up their internal security and counter-insurgency capabilities. As a result, spending on imported tanks, planes, and other front-line systems has declined in many areas, while purchases of infantry weapons, counter-insurgency gear and anti-riot devices have increased. By the same token, stepped-up military activity by insurgents, separatists and private militias has led to an increase in black-market arms trafficking; as such groups are normally excluded from normal trade channels and must rely on illicit, underground sources.

3.2.10 ARMS TRADE: THE CONSEQUENCES

In contemporary international relations, arms trade is continuing to fuel regional arms races, supply potential belligerents with the means to initiate and sustain armed combat and exacerbate tensions in areas of conflict. However, the nature of the arms trade's impact is changing, as the weapons flow itself has experienced profound transformation.

In the 1970s and 1980s, the arms trade was a critical factor in the superpowers' competitive efforts to secure and retain allies and influence in key areas of the developing world. Through this process, arms transfers fuelled regional arms races in several areas, particularly the West Asia and South

Asia, and sustained a series of local conflicts that pitted the chosen allies of the superpowers against one another. In the post-Cold War period, dangerous new patterns of arms trafficking have begun to form, supplanting those of the Cold War era. Driven largely by economic considerations, the USA, Russia and the major European suppliers are battling with one another to line up new weapons contracts with the rising powers of Asia, igniting a new arms race in the region. Increased levels of arms deliveries have also helped to inflame relations between Greece and Turkey, and to provoke fresh tensions between India and Pakistan.

Several other emerging patterns are cause for serious concern. The growing transfer of weapons technology to the East Asian countries is contributing to the development of major military industries in the region, leading both to an accelerating arms race there and to a long-term increase in the world's arms-making capabilities. Whether these capabilities will someday be used to sustain major conflicts in Asia or elsewhere cannot, of course, be foreseen at this time; it is likely, however, that the East Asian countries will become major suppliers of modern weapons in the early 21st century, greatly complicating future efforts to curb the global arms trade.

The growing flow of small arms and light weapons to both states and non-state actors is another source of concern. While ethnic and civil conflicts within states usually have deep roots – often involving longstanding disputes over contested territories and the control of resources – the expanding worldwide availability of light weapons is making it increasingly easy for militias, insurgent groups and separatist forces to conduct wars of great scope and duration. An estimated 2,00,000 people died during the fighting in Bosnia, and many thousands more have died in Afghanistan, Angola, Mozambique, Rwanda, Somalia, Sri Lanka, Sudan and other countries torn by internecine warfare. With light weapons of all types available in such great abundance, it is likely that such conflicts will continue to generate high levels of death and destruction.

Despite all this, there is no evidence that the major powers are prepared

to impose significant controls on the worldwide flow of conventional weapons. It appears, then, that the arms trade will continue to flourish in the years ahead, with few barriers to its continued development and growth. It is essential, therefore, that analysts and peace researchers chart its continuing transformation, and that international policy makers take steps to alleviate its most harmful consequences.

However, there is a ray of hope recently in reducing some of the negative effects of arms trade. After weeks of intense negotiations at the UN Conference, including a roadblock put up by some countries, a final treaty was adopted by the U.N. General Assembly on April 2nd, 2013. The treaty prohibits arms transfers that would be used to commit genocide, crimes against humanity and war crimes. We are now closer than ever to preventing arms transfers where there is a substantial risk that they will be used to commit serious violations of human rights.

3.2.11 LET US SUM UP

Every day, millions of people suffer from the direct and indirect consequences of the irresponsible arms trade: thousands are killed, others are injured, many are raped, and/or forced to flee from their homes, while many others have to live under constant threat of weapons. The poorly regulated global trade in conventional arms and ammunition fuels conflict, poverty and human rights abuses. The problems are compounded by the increasing globalization of the arms trade – components being sourced from across the world, and production and assembly in different countries, sometimes with little controls. Domestic regulation of the arms trade has failed to adapt to these changes. While existing national and regional controls are important, these are not enough to stop irresponsible transfers of arms and ammunition between countries. This is why many called on the member states of the United Nations to deliver a strong and effective Arms Trade Treaty (ATT) to help save lives, prevent human rights abuses, and protect the livelihoods of people around the world. After more than 10 years of

campaigning, the first international Arms Trade Treaty has become a reality in 2013. The next step is to make sure it is properly implemented to reduce the human cost associated with the uncontrolled trade in conventional weapons and ammunition.

3.2.12 EXERCISE

1. Outline the history of Foreign Aid.
2. Analyse the trends in Foreign Aid in post-Second World War Period.
3. What are the reasons for decline in Foreign Aid in post-Cold War period?
4. How do you understand Aid Tying?
5. Explain the trends in Arms Trade during the Cold War period.
6. The post-Cold War Arms Trade trends are completely different from the Cold War period. Do you agree with this statement? If yes, state the reasons.
7. Critically analyse the consequences of Arms Trade.

**3.3 FOREIGN DIRECT INVESTMENT (FDI) AND
MULTINATIONAL CORPORATIONS (MNCs)**

- V. Nagendra Rao

STRUCTURE

3.3.0 Objectives

3.3.1 Introduction

3.3.2 MNCs: Definitions

3.3.3 FDI and MNCs: Divergent Perspectives

3.3.3.1 Economic Nationalist Perspective

3.3.3.2 Liberal Perspective

3.3.3.3 Structural Perspective

3.3.3.4 Marxist or Radical Perspective

3.3.4 MNCs and Globalization of Production

3.3.5 MNCs and the Nation-State

3.3.6 Impact of MNCs

3.3.7 An International Regime for FDI and MNCs

3.3.8 Let us Sum up

3.3.9 Exercise

3.3.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The definition of MNCs and the differentiation between transnational corporation and multinational corporation;
- Various perspectives that explain the nature, functioning and impact of MNCs ;
- The role of MNCs in the globalization of production;
- The impact of MNCs on the functioning of Nation-states;
- The positive and negative impact of FDI and MNCs in contemporary international political economy;

3.3.1 INTRODUCTION

The importance of the multinational corporation (MNC) is a key feature of globalization of the world economy. Many have written on the subject of transnational production, on the causes of foreign direct investment (FDI) for host country. Despite the extensive literature on transnational production no consensus exists on either the causes or impact of this phenomenon, although the growth of transnational production, it is widely agreed, has profoundly shaped the evolution of the global economy. Some commentators believe that the multinational corporation has broken free from its home economy and has become a powerful independent force determining both international economic and political affairs. Others reject this position and believe that the multinational corporation remains a creature of its home economy.

In one sense, multinational firms have existed for a very long time. The Dutch East India Company, the Massachusetts Bay Company, and other companies of merchant-adventurers were forerunners of today's MNCs like IBM, Sony, and Daimler-Chrysler. These earlier transnational firms, however, were far more powerful than contemporary MNCs are; they commanded

armies and fleets, had their own foreign policies, and controlled vast expanses of territory: the sub-Asian continent (India, Pakistan, and Bangladesh), the East Indies (Indonesia), and South Africa. The major difference between those early transnational firms and today's is that the former were principally interested in agricultural products and extractive industries in particular regions of the world, whereas major firms in the early twenty-first century are principally involved in manufacturing, retailing, and services, tend to operate on a regional or worldwide basis, and usually pursue an international corporate strategy.

The MNC is one of the defining features of economic life in the contemporary global economy. TNCs account for the major part of the global production structure, and approximately 70 per cent of world trade and 80 per cent of international investment. They account for the major part of the global production structure, and approximately 50 per cent of world trade.

In this lesson, the first section will make you understand the various terms such as MNCs and transnational corporations that have been used to describe large international firms. The second section will throw light on various theoretical perspectives; third section outlines the globalization of production. The final section analyses three key issues addressed in the contemporary global production system, that is the costs and benefits of MNCs especially for developing countries, the changing relationship between the state and the firm, and the international regulation of MNCs.

3.3.2 MNCS: DEFINITIONS

Economists distinguish between two types of foreign investment – foreign direct investment (FDI) and indirect investment, also termed portfolio investment. FDI refers to investment made outside the home country of the investing company in which control over the resources transferred remains with the investor. It consists of a package of assets and intermediate goods such as capital, technology, management skills, access to markets and entrepreneurship. Foreign indirect (portfolio investment refers to specific

assets and intermediate products (for example, capital, debt or equity, technology) which are separately transferred between two independent economic agents through the modality of the market. In this instance, control over the resources is relinquished by the seller to the buyer. Overseas expansion is frequently accompanied by mergers, takeovers, or inter-corporate alliances with firms of other nationalities.

FDI began to grow extensively after the Second World War. In the 1950s and 1960s FDI was predominantly in the manufacturing sector, and initially, the largest amount of FDI flowed from the US, though later on EU and Japan also became significant players. FDI continued to grow rapidly in the 1980s and 1990s. For example, in the early 1980s the annual growth rate of FDI was approximately 14 per cent and between 1986 and 1996, FDI rose 350 per cent. This growth was fuelled by investment in services as well as manufacturing.

There is no agreement on the term to be applied to firms engaging in beyond their national boundaries or in FDI. These firms are variously called multinational, international, transnational or global. It is now common to speak of multinational corporations (MNCs) or transnational corporations (TNCs) or global corporations. Most writers make no distinction between these terms and have settled for one terminology rather than another without any seeming reflection on the implication of these terms. The term multinational corporation was first given prominence by the Harvard Multinational Project which produced a number of important studies. These studies did much to establish the term 'multinational' to describe this new phenomenon.

While the term multinational first gained widespread usage to describe large international firms, it was challenged from the mid-1970s by the term transnational corporation. The term transnational reflected UN usage, and proponents of its use argued that whereas multinational suggested a merger of capital from more than one nation-state, with a few notable exceptions, most large international firms are owned and controlled by nationals of one

country and conduct activities across national borders. The term transnational corporation more accurately reflects the fact that these firms are usually owned and controlled by the nationals of one country and enters into direct productive activities abroad.

However, considering the popularity, the term MNCs used in this lesson without undermining the argument in favour of transnational corporation as more accurate to understand the contemporary phenomenon of FDI.

3.3.3 FDI AND MNCS: DIVERGENT PERSPECTIVES

This section explains some of the most influential theories devised to explain the growth of transnational production. Economic nationalist perspectives emphasize the importance of global production and focus on the ability of states to control the activity of TNCs. Liberal theory gives greater stress on the relevance of the market for explaining the growth of overseas production and in assessing the impact of MNCs on the state. Radical theorists emphasize the changing nature of capitalist relations and exhibit scepticism concerning the impact of TNCs on host economies.

3.3.3.1 Economic Nationalistic Perspective

Economic nationalistic writings on the multinational corporation assert that the rise and success of the MNC in the modern world could have happened only within a favourable international political environment. They maintain that despite the several theories of liberal economists, the MNC cannot be explained solely in terms of market forces. While economic factors are obviously important for the emergence and success of MNCs, they could not exist without a favourable international political environment created by a dominant power whose economic and security interests favour an open and liberal international economy. Just as the Pax Britannica provided a favourable international environment for the overseas expansion of British firms and investors in the late nineteenth century, American leadership following World War II provided a similarly favourable international environment for the overseas expansion of American and other capitalist firms in the post-World

War II era. In the 1980s and 1990s, the United States, Western Europe, and Japan all had an interest in maintaining and even strengthening international conditions that favoured MNCs. The nationalist state-centric writers believe that if the consensus and cooperation of the major capitalist powers were to break down, the predominant role of the MNC in the world economy would gradually diminish.

The nationalistic state-centric position also assumes that multinational firms are essentially national firms competing with one another around the world. Proponents of this position argue that these firms are closely attached to and ultimately dependent on their respective home economies. As Paul Doremus and his colleagues point out in their excellent book, *The Myth of the Global Corporation* (1998), each MNC is a distinctive product of its home base and reflects its social, economic, and political values. Despite the hyperbole of corporate executives and business consultants that MNCs have shed themselves of national coloration and become stateless enterprises, MNCs are actually deeply embedded in and very much a product of the history, culture, and economic systems of their home societies.

3.3.3.2 Liberal Perspectives

Liberal and business economists have long had a strong interest in the wellsprings of corporate behaviour, an interest strongly influenced by the pioneering scholarship of Alfred Chandler. Beginning in the 1960s, interest in corporations has been extended to firms operating internationally. Research on the MNC has been pursued almost exclusively by American and British business economists with a liberal commitment toward the overwhelming benefits of FDI to both home and host countries. Three of the most important liberal theories were proposed by Raymond Vernon, John Dunning and Michael Porter. Vernon's product cycle model of FDI stressed the importance of economic and technological leadership and provided an important insight into the overseas expansion of American MNCs in the 1960s. John Dunning attempted to provide a general explanation of the MNC in which he offered an eclectic theory of FDI that accounted in large part for the second stage of

the MNC's evolution. The most recent explanation is generally identified with Michael Porter's extensive and almost encyclopaedic empirical research on the firm as a strategic player in the game of international economic competition.

Vernon's Product Cycle Theory

The crux of Vernon's product cycle theory was that every product follows a life cycle from innovation through maturity to decline to eventual obsolescence. American firms, Vernon argued, had a comparative advantage in product innovation due to the huge size of the American market (the demand side) and to American superiority in research and development (the supply side). During the initial phase of the product cycle, firms export new products from their home industrial base, but in time a number of changes associated with the maturing of the product, such as standardization of production techniques, diffusion abroad of industrial know-how, and creation of significant foreign demand for the product, stimulate the entry of foreign imitators into the market. To deter foreign firms from entering the market and undercutting their monopoly position, the original firms establish production facilities in other economies. Thus, according to Vernon's product cycle theory, FDI is principally a device used by firms to pre-empt foreign competition and to maintain their monopoly rents.

Product cycle theory could not account for the subsequent expansion abroad of European and Japanese firms and the firms of many other nations. It also fails to factor many other developments that took place from 1970s onwards and which changed the moment of FDI. The 'eclectic' theory, primarily associated with John Dunning and the Reading school, was the most systematic effort to incorporate the many developments during this second stage in MNC evolution into a coherent general explanation of the MNC and FDI.

Dunning's Eclectic Theory

The eclectic theory of the MNC, developed by John Dunning provides

important insights into the MNC, as it emphasizes technology as a factor in MNC development. Revolutionary advances in communications and transportation have made it technically possible for businesses to organize and manage services and production systems on a global basis. In effect, technological advances have greatly reduced the transaction and other costs of internationalizing. According to Dunning, the unique nature and extraordinary economic success of the MNC are due to particular characteristics that give the MNC important advantages over purely domestic corporations. These oligopolistic firms usually possess some proprietary or firm-specific advantage (for example patents) that they want to exploit rather than lose to a rival firm. Many firms also possess locational advantages, because MNCs have access to factors of production around the world and can, therefore, employ such country-specific advantages as access to low-cost skilled labour or to other special local resources.

However, the usefulness of the eclectic theory is most relevant for understanding a particular stage in the evolution of the MNC; subsequent changes in the MNC have necessitated newer explanations for their behaviour.

Porter's Strategic Theory

Another noteworthy liberal interpretation of the MNC has emerged from the research of Michael Porter at the Harvard School of Business. Porter argues that the MNC has entered an era of strategic management. Porter assumes that international business is characterized by a 'value chain' of activities ranging from extraction to production to marketing. The individual firm must decide which and how many of these activities it wishes to pursue and in what locations around the globe. These decisions in turn depend on the overall competitive strategy of the firm. Porter argues that the firm's strategy determines its structure and its location of economic activities throughout the world economy. The overwhelming advantage of the MNC over domestic firms, according to Porter, is that it provides access to a wide array of possible strategies through which it can 'tap into the value chain'.

The essence of strategic management is that the transnational firm has available to it more extensive options and techniques than do even the largest domestic firms. These mechanisms include not only FDI, but also strategic alliances, outsourcing component production and licensing technologies. These corporate activities create international complexes or networks of corporate relations with the parent MNC in its home economy. Through modern information technologies and monopoly of information resources, the multinational corporation can become dominant over both its domestic and international competitors.

3.3.3.3 Structural Perspectives

Susan strange has provided a structuralist alternative to the liberal theories which shifts the emphasis from the decisions of firms to major structural change in the global economy. Strange lists three key structural changes that have accelerated transnational production – falling real costs of transport and communication; development of new technologies; and the creation of new financial instruments. She argues that structural changes in technology, communications, and finance created the conditions for the growth of TNCs. She claims that a rapid increase in technology spurred by the revolution in information technology has quickened the pace of globalized production; increased capital mobility has facilitated dispersion of industry, and changes in the knowledge structure has made trans-border communication and transportation cheaper and faster.

3.3.3.4 Marxist or Radical Perspectives

Marxist writers with their traditional focus on the centralization and concentration of capital were well placed to provide explanations for the growth of transnational production. An interesting contribution to the radical perspective was made by Stephen Hymer. Stephen Hymer's innovative ideas present the most systematic critique of the MNCs. At the time of Hymer's writings in the early 1960s, economists scarcely distinguished between foreign direct investment and foreign portfolio investment. Hymer showed, on the

other hand, that FDI was fundamentally different from portfolio investment and could be explained as part of a firm's expansionist strategy and by its desire to control productive or other facilities in foreign countries. Economic, political, and technological developments in the post-war world had made overseas expansion of American corporations possible and even necessary. Hymer argued that American firms invested abroad to exploit and preserve some firm-specific or monopolistic advantage.

In his Marxist or quasi-Marxist theory of the MNC, Hymer set forth many (if not most) of the ideas that we now associate with radical critiques of the MNC. He believed that monopoly capitalism is driven by two fundamental laws. The **first** law of international capitalism to be the law of increasing firm size: that as firms grow in size and scope, they expand both within and across national borders, creating a hierarchical core/periphery structure and international division of labour around the world. At the core of this international structure are the advanced capitalist economies, while the periphery is composed of dependent and exploited less developed economies.

Hymer's **second** law is the law of uneven development. He argued that due to their large size, considerable mobility, and monopolistic power, the MNCs exercise control over and exploit the whole world to their own advantage. These corporate activities produce a world economy composed of the exploiting wealthy societies of the north and the exploited impoverished societies of the south. Or, in language also used by dependency theorists, the development of the capitalist north and the underdevelopment of the peripheral south are integral and complementary aspects of international capitalism in the age of the MNC. Almost all the subsequent writings by radical scholars are in large part just variations on Hymer's provocative ideas. This generalization also applies to many of those protesting the multinational corporation at the time of the WTO meetings in Seattle in 1999 and the IMF/World Bank meetings in Washington in 2000.

The theoretical dispute over the causes of transnational production is mirrored in the conflict concerning the impact of this activity on the nation-state and on national societies. Two broad positions are discernible – the positive and negative. Some analysts have developed arguments that emphasize the positive results of direct foreign investment but these findings are disputed by those who claim that on balance the net effect of TNC investment is negative for host countries.

The liberal economists and business community contend that the net impact of TNC activity is positive and beneficial to the host countries. They cite many reasons for this. They argue that the FDI provides additional resources and capabilities, that is, capital, technology, access to markets and management skills. Furthermore, it provides additional tax revenues through the increase in economic activity in the host country. Moreover, by better linking the host economy with the global marketplace, MNCs help to advance economic growth by fostering a more efficient division of labour. They also claim that TNCs bring new management styles and more dynamic competitive practices by injecting entrepreneurship, management styles and work cultures. MNCs help in upgrading the domestic resources and capabilities, and the productivity of local firms, and also foster clusters of related activities to the benefit of the participating firms.

The Marxist and radical critics document four main negative direct effects. They argue that MNCs transfer too few or the wrong kind of resources or assets. MNCs can cut off foreign markets to domestic firms; can fail to adjust to localized capabilities and needs; and may not provide an addition to capital at all. Secondly, MNCs use transfer pricing and other devices to lower taxes paid. Also by restricting growth there is an overall loss of tax revenue. Thirdly, FDI promotes a division of labour likely to be in the company's interests and this can be detrimental to the country's comparative advantage. The division of labour is likely to be based on what the firm perceives to be in its global interests which may be inconsistent with dynamic comparative advantage as perceived by the host country. Finally, MNCs worsen the balance

of payments through limiting exports and promoting imports and outcompeting local firms which export more and import less.

3.3.4 MNCS AND GLOBALIZATION OF PRODUCTION

The globalization of production is aptly captured by phrases such as ‘from national to global’, and ‘from local markets to global markets’. It refers to the proliferation and stretching of corporate activity and business networks across the globe. For many analysts the creation of American hegemony in the aftermath of World War II brought with it the beginnings of globalized production ‘based on offshore low-wage assembly’. This was also partly the consequence of American foreign policy which encouraged manufacturing firms to invest in anti-communist countries to support its position during the Cold War. In the past three decades, however, transnational production has escaped its early origins in US economic growth and policy choices and has become a driving force in the global economy.

Central to MNCs investment is the acquisition and deployment of capital. Developments in international finance have created integrated financial markets which facilitate global production. Firms have been able to finance their production operations overseas as a result of the internationalization of finance. There has been a widespread liberalization of capital markets around the world. As the US is succeeded in eliminating the barriers for financial flows across the globe, the mobility of capital went up. A variety of financial instruments and capital mobility support the globalization of production and cross-border transactions of MNCs in global financial markets. As a result, capital moves across borders and boundaries in places where previously it was difficult for it to do so. The impact of these developments transcends capital markets, in that capital mobility has introduced major changes in international trade and the organization of the MNCs. This sustained growth of commerce and international investment is a central element in the globalization of production because it has provided the financing for the expansion of MNCs operations.

Due to these development, now the world's largest MNCs account for approximately four-fifths of world industrial output. Foreign direct investment (FDI) has been growing at a rapid rate. Between 1985 and 1990, FDI grew at an average rate of 30 per cent a year, an amount four times the growth of world output and three times the growth rate of trade. FDI has in fact become a major determinant of trade patterns. FDI global inflows touched 1911 billion US dollars in 2007 though later on declined due to global recession. Due to financial crisis and recession, the present times witnessed changing direction of FDI flows from developed countries to developing countries. The economies of the developing countries are not facing the kind of severe recession that was witnessed in developed countries.

Developing economies saw their FDI reaching a new high of more than US\$700 billion in 2014, with a global share of 56 per cent. It is largely due to the drastic decline in FDI inflows to developed countries due to severe financial crisis and recession faced by European countries. At the regional level, flows to developing Asia were up, those to Africa remained flat, while FDI to Latin American declined. In 2014, China with a modest increase of 3%, became the world's largest recipient of FDI. The United States fell to the 3rd largest host country. Among the top five FDI recipients in the world, four are developing countries. After 2008, for the first time, India again broke in to the top 10 recipients of FDI during 2014, as reported by the UNCTAD in its World Investment Report 2015. India jumped to the ninth rank in 2014 with a 22 per cent rise in FDI inflows to \$34 billion. This trend is continuing for India in 2015. With \$31 billion of foreign capital inflows, India has even surpassed China and the US to take the first position in attracting largest FDI in the first half of 2015, as reported by The Financial Times.

The gross statistics, however, hide noteworthy aspects of FDI and of other activities of MNCs. Despite much talk of corporate globalization, FDI is actually highly concentrated and is distributed unevenly around the world. Although FDI has grown rapidly in developing countries, most FDI has been placed in the United States and Europe, while only a small percentage of

U.S. foreign direct investment has gone to developing countries. This concentration of FDI is due to the simple fact that the United States and Europe are at present the world's largest markets. Nevertheless, throughout most of the 1990s, FDI in less developed countries (LDCs) grew at about 15 per cent annually. However, FDI in LDCs has been highly uneven and concentrated in a small number of countries, including a few in Latin America, especially Brazil and Mexico, and in the emerging markets of East and Southeast Asia. The emerging markets were attractive due to their rapid economic growth, their market-oriented policies, and their cheap labour. One should note, however, that the least developed countries in Africa and elsewhere have received a pitifully small percentage of the total amount invested in the developing world.

The increasing importance of MNCs has profoundly altered the structure and functioning of the global economy. These giant firms and their global strategies have become major determinants of trade flows and of the location of industries and other economic activities. Most FDI is in capital and technology-intensive sectors. These firms have become central in the expansion of technology flows to both industrialized and industrializing economies and therefore are important in determining the economic, political, and social welfare of many nations. Controlling much of the world's investment capital, technology, and access to global markets, such firms have become major players not only in international economic but in international political affairs as well, and this has triggered a backlash in many countries.

3.3.5 MNCS AND THE NATION-STATE

There are divergent views of the MNCs' role in the world economy and of their relationship to their home economies. On the one hand are some who believe that the MNCs' increasing importance in the organization and management of the international economy constitutes a transformation of global economic and political affairs. For them, globalization of production and the central role of the multinational firm in the world economy represent

the triumph of market forces and economic rationality over the nation-state and a politically fragmented international economy. On the other hand, the state-centric position argues that the extent and impact of globalization are greatly overstated and that the nation-state continues to set the rules that MNCs must follow. In this debate, the importance of multinational corporations is really not at issue, and few observers other than economists deny their significance. Powerful corporations, their far-flung subsidiaries, and their global alliances have been recognized as major features of contemporary international affairs. However, arguments continue regarding the extent to which these corporate giants have affected the nature and organization of the international economy and the relative significance of the nation-state in its functioning.

Hence, the issue of the net impact of FDI on host societies is intimately connected with the wider question of the changing relations between the state and the MNCs. The central issue often debated here concerns the relative power of the state and the MNC. A number of commentators and social groups are concerned that the globalization of production has created or is creating a situation in which the state is losing some of its authority and power and is being replaced by the MNC in many areas.

MNCs act as the producers of wealth within the international political economy and as such have increased their ability to influence political systems. When firms were generally confined within national borders they relied on the state to represent their interests at the international level. Now, however, MNCs are becoming important actors within the global political economy and it is arguable that at times their influence can be greater than that of states. Increasingly in both developed and developing countries states need to cooperate with TNCs to achieve economic, political and social goals. Trying to control the activities of many large firms through regulatory policies can be difficult and risky considering that the opportunities offered by foreign investment can be an important part of economic planning and growth. States have therefore moved into a new policy environment in which they must try

to find a balance between attracting and encouraging investment while still maintaining a range of social goals and promoting the so-called national interest.

This resulted in diminished national authority of many nation-states in developing countries. The sheer size and resources of many MNCs in comparison to developing countries provides for an unequal relationship between the two. This predisposes developing states to modify the demands they make of MNCs. Additionally the capacity of firms to locate anywhere in the world exerts an inordinate amount of pressure on countries to accept to their demands, or suffer negative consequences in their economic stability. The mobility of capital increases the alternatives available to MNCs while at the same time reducing those available to states. Thus, for many, the benefits developing countries derive from FDI will remain negligible given the structural imbalances between MNCs and Third World governments.

The globalization of production has altered the attitudes of governments, shifted the bargaining power between states and MNCs, and also transformed the nature of state. This change is captured by the phrase 'the competition state'. States have become increasingly compelled to liberalize because of competitive deregulation pressures resulting from the mobility of capital. The threat of shifting production from one country to another causes countries to compete against each other. The competitive processes between states can lead to a situation in which wages, working conditions and environmental standards become compromised or reduced.

Many also expressed the concern on issues related labour and working conditions. MNCs are shifting production process using low-skilled and unskilled labour to developing countries to take advantage of the low wages. But they were not only escaping higher wage rates of developed countries, they were also trying to circumvent minimum health and safety requirements and to reap the benefits of working with a largely non-unionized workforce. Instead of protecting their workers, many Third World governments colluded with transnational capital to maintain poor working conditions.

3.3.6 IMPACT OF MNCs

The role of MNCs in the world economy remains highly controversial. Critics charge that FDI and the internationalization of production are transforming the nature of international economic and political affairs in ways that undermine the nation-state and integrate national economies. Impersonal market forces and corporate strategies are believed to dominate the nature and dynamics of the international economic and political system. The critics believe that giant firms, answerable only to themselves, are integrating societies into a mass in which individuals and groups lose control over their own lives and are subjugated to firms' exploitative activities. The world, these critics charge, is coming under the sway of a ruthless capitalist imperialism where the only concern is the bottom line.

These debates between supporters and opponents of FDI erupted in 1960s and continue today. During the 1970s when the Third World's demand for a New International Economic Order was its peak, and dependency analyses were popular, the views of the critics were given greater prominence. But with the triumph of neo-liberalism and the imposition of adjustment policies in the developing world it is the views of the proponents of FDI that have been in the ascendancy.

Thus, as a matter of fact, FDI can have negative or beneficial impacts but that this is essentially an empirical question which can only be answered in relation to concrete circumstances. It depends on a particular country's level of development, its relative position in global political economy and the consumer base. Moreover, within a nation-state the MNCs might appeal to a particular social class (rich and middle class) with their sophisticated consumer products while leaving vast masses of poor without touching any manner.

The benefits and costs of FDI have been assessed through the use of economic, political and cultural criteria. Economic criteria include the balance of payments, economic growth, and tax revenues; political issues include

interference in domestic politics, and the effects on sovereignty; crucial cultural issues focus on taste transfer and protecting traditional national culture. The evaluation of the costs and benefits of MNCs investment in a host country will therefore vary depending on which of these criteria the analyst think is most important.

One of the major points of contention over the net benefits of FDI for developing countries concerns the transfer of technology. Indeed, this is one of the main reasons why many governments allow greater foreign investment, as they realize that in the absence of the finance and knowledge provided by MNCs, it would be much harder, and in many cases almost impossible, for them to gain access to industrial technologies. However, if technology transferred by MNCs is less advanced compared to the technology which is being developed and used in home countries at any given, then the FDI would not bring any value addition to host countries. Studies have shown that the technology frequently transferred from industrial countries to developing countries is designed to maintain low-level productive activities in developing countries. On the other hand, in advanced countries, the transfer of technology tends to be more effective with their better capabilities allowing them to absorb leading edge technologies from foreign investors.

Moreover, there is concern in developed and developing countries that the plants established by MNCs in host countries serve only as offshore satellites for the main activities in home countries. The result is that few benefits accrue to the host country since the profits are returned to the parent company. Even more importantly, high value-added activities, research and development activities for example, tend to remain concentrated in home countries and few of the cutting-edge technologies are transferred to foreign subsidiaries, limiting the opportunities for host governments to establish industries capable of producing high-end exports, or in some cases moving beyond basic component manufacture. Many points that the export-oriented industrialization achieved by some Third World countries was much more a result of the First World shedding the production of consumer goods rather

than a positive attempt to assist developing countries along the path of industrialization.

Furthermore, if the entry of foreign firms into local markets results in local firms being squeezed out despite an improvement in efficiency, this will be seen as a negative development which will ultimately undermine the economic development of the country. During the industrialization of the West, infant industries were often given the benefit of protectionist government policies to allow them to establish themselves before they faced competition. With the involvement of MNCs and the liberalization of international trade however, new local industries in developing countries are not provided with similar opportunities. Without careful management and policies by the host government, the technological transfer and industrializing promises of MNCs do not actually help developing countries come any closer to catching up with industrialized states. While some benefits have accrued to developing countries from investment by MNCs it has been argued by many critics that this is only a by-product of the move away from manufacturing and unskilled production by the advanced industrial countries. The Third World thus became an inexpensive source of consumer goods that are no longer viable to produce in highly industrialized countries.

3.3.7 AN INTERNATIONAL REGIME FOR FDI AND MNCs

In light of the increased significance of the MNCs in every facet of the global economy, it is remarkable that there are no international rules to govern FDI, not even any that are comparable to those affecting international trade and monetary affairs. There are national, bilateral, regional, and multinational agreements on MNCs and FDI, but no overall comprehensive agreement. Although the Uruguay Round moved toward establishment of such rules, it fell far short of establishing a satisfactory regime to regulate FDI.

Several important initiatives have been launched to govern MNCs and FDI, but none have advanced very far by the beginning of the twenty-first

century. FDI impinges directly on national economies and can infringe on national values and economic independence. For this reason, states, especially less developed countries (LDCs), are reluctant to surrender jurisdiction in these matters to an international body. They fear domination by the huge corporations of the United States and other industrialized economies. Moreover, the very fact that MNCs operate across two or more national jurisdictions makes the task of framing an international regime extraordinarily difficult.

To the observers of the contemporary global economy, MNCs are increasingly exercising a parallel authority alongside government in matters of economic management affecting the location of industry and investment, in the direction of technological innovation, and in the extraction of surplus value. Corporations have actively sought through industry associations and individual contacts with governments to influence the architecture of national, regional and global regulations. MNCs have argued successfully for minimal regulations, and for self-regulation rather than public authority control in situations where some direct form of regulation is required. They have become endowed with a greater political role as it uses more diverse means of achieving its objectives. Not only have MNCs resorted to using access to the highest levels of decision making with national governments, but also access to the WTO and other multinational institutions to ensure corporate agenda is prioritized everywhere.

To some extent MNCs have joined states as the authorities exercising power over the course of national and global economic developments. Moreover, companies exert considerable influence over the global economy as they account for an increasing proportion of international intercourse than do governments. This development facilitated by technological change has redefined state sovereignty by reducing the magnitude of authority claims asserted by state. Despite this, governments remain the decisive holders of authority in regard to the territories over which other states recognize their supremacy, but are restrained in their capacity to affect economic decisions within their borders.

3.3.8 LET US SUM UP

The spread of MNCs since the 1950s and the creation of a global production structures have had significant effects on international economic and trade structure, industrial development and government policies. The growth and nature of transnational production has changed over time and MNCs have greatly affected national and regional developments around the world. Much of the uneven development and industrialization that occurred in the final years of twentieth century can at least partly be explained by differences in MNC involvement and government policies towards FDI. The shift towards transnationalization by many enterprises has also changes state-firm relations, with policies of cooperation essential to the economic planning of both actors. The large amount of capital owned and controlled by MNCs combined with their participation in virtually every national economy in the world has given them a great deal of strategic power in the global political economy and their role in influencing international trade negotiations and other international agreements in an important issue in the contemporary global economy.

3.3.9 EXERCISE

1. Transnational Corporation is the better term than Multinational Corporation to describe the activities of the global firms. Do you agree with this?
2. Critically analyse divergent perspectives on FDI and MNCs.
3. Write a note on role of MNCs in globalization of production.
4. Do you agree with a view that the MNCs are undermining the role of Nation-states?
5. Critically analyse the impact of MNCs on contemporary international political economy.

**3.4 INTERNATIONAL ECONOMIC
TRANSACTIONS: PERSPECTIVES OF
DEVELOPED AND DEVELOPING COUNTRIES**

- V. Nagendra Rao

STRUCTURE

3.3.0 Objectives

3.3.1 Introduction

3.3.2 Post-War Economic Transactions: An Outline

3.3.3 1980s: Latin American Debt Crisis

**3.3.4 The 1990s: The Transition of the Former Soviet Bloc and Debt
Crisis**

3.3.5 Economic Transactions: Developed Countries Perspectives

3.3.6 Developing Countries Perspective

3.3.7 Let us Sum up

3.4.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The International Economic Transactions in the post-war Period;
- Major Developments in International Economic Transactions;

- The perspectives of Developed Countries with regard to Development of the International Political Economy;
- Developing Countries differences with the economic models advanced by the Developed countries.

3.4.1 INTRODUCTION

The growing economic interdependence of the world economy, including the internationalization of markets for goods, services, financial assets, and factors of production, is creating increasing demand for the measurement and monitoring of economic influences across national boundaries. The international repercussions of sharp policy shifts and structural changes over the last two decades have rendered obsolete conventions of closed-economy measurement and assessment. In addition, fluctuating exchange rates, growing external imbalances, mounting U.S. net international indebtedness, and wide swings in financial markets across countries have stimulated international consultation and cooperation in the formulation of economic policies. These developments in research and policy analysis necessarily have depended increasingly on the monitoring and measurement of international transactions.

At the same time, concern is growing among economists that existing international economic data have not kept fully abreast of structural changes in the global economy and that they are in need of critical assessment, and in some cases significant overhaul. Federal budget support of data collection and maintenance has declined in real dollars over the past ten years. Methodological research and new ideas for measurement have borne the brunt of budget cutbacks. Lack of adequate data has inhibited empirical research of the highest quality in some areas of international economics, and ruling theoretical paradigms have not been tested sufficiently. While the same concern exists for economic measurement and research more generally, the relative severity of the concern for international economics is generally acknowledged to be growing.

There is a considerable increase in the international economic transactions during the previous three decades, particularly after the collapse of the Soviet Union. However, this economic interdependence of the international system is shrewdly favouring the developed countries, leaving developing countries in poverty and backwardness. Hence, there is a growing concern across the developing and underdeveloped world that the status quo needs to be changed.

3.4.2 POST-WAR ECONOMIC TRANSACTIONS: AN OUTLINE

The current system of international economic and financial transactions owes much to the postwar construction, yet it has considerably evolved since then. This evolution has been driven by two main considerations: pragmatism and effectiveness. The old system has adapted to a succession of events, including the end of the Bretton Woods system of fixed exchange rates, the oil shocks, decolonization, the development of global banking, the end of the Cold War and the accumulation of crises in emerging market countries. The decolonization was bringing many new participants into the community of nations with needs that were radically different from most of the established members. These needs began to get the attention of the World Bank relatively quickly in keeping with the expanded mandate for the Bank that the Latin Americans had asked for at Bretton Woods. The Bank's reconstruction job was nearing completion and its capacity to support development in poorer countries was broadened by the establishment of the International Development Association (IDA) in 1960, which could make loans that were concessionary and did not expose the parent bank to loss. The needs of these new member countries only moved to the centre of attention in the IMF in the 1970s although a number of developing countries drew on the IMF in the 1960s.

As the Bretton Woods institutions are no more an alternative to govern international economic transactions, pragmatism has meant the creation of various informal groupings, especially the G7, which functioned effectively

for many years as a crisis manager and agenda-setter for the international community but cannot be expected to do so for much longer, in light of the changes and challenges arising from globalization. More recently, regional integration has become fashionable, although the record remains modest outside of Europe.

There are good reasons why international coordination is difficult to achieve in a world of sovereign states. Ideally, coordination should be orchestrated by bodies that satisfy four traditional criteria: effectiveness, legitimacy, representativeness and accountability. This is a tall order, and this is why there exist only few formal institutions and many informal arrangements. The IMF and World Bank go a long way to meeting all four criteria, but their effectiveness has been wanting in key areas at crucial times. The need for effectiveness is why the G7 was set up. Its legitimacy has, however, been questioned increasingly. The creation of the G20 was meant to respond to the need for legitimacy, but its role has been limited. The G-20 nevertheless left an institutional legacy. The first was its recommendation, quickly adopted by the IMF governors, to create an Interim Committee of Governors with a representative from each Executive Board seat to deal with both immediate and systemic reform issues. This body met twice a year until 1999 when it was reconstituted as the International Monetary and Financial Committee (IMFC). The G-20 also sowed the seeds of the G7 finance ministers and central bank governors when the finance ministers of the United States, France, Germany and the United Kingdom met separately in the library of the White House in March 1973. This group, which soon grew to five members with the inclusion of Japan and brought in central bank governors, became known as the Library Group or the G5. For a number of years its meetings remained discreet and without communiqués.

3.4.3 1980S: THE LATIN AMERICAN DEBT CRISIS

The Mexican government announced that it could not meet the payments on its debts in August 1982, followed in short order by almost all

other Latin American governments and some developing countries in other parts of the world. For the rest of the decade, the Latin American debt crisis was a principal preoccupation of international financial meetings. The response to the crisis brought the IMF and World Bank back into central roles as their lending conditionality and technical assistance combined with continued commercial bank lending kept countries, except Peru, from defaulting on their debts and bought time for banks to rebuild their damaged balance sheets. Collaborating closely with the Managing Director of the Fund, the G5 and subsequently G7 finance ministers and central bank governors played an active role in charting the policy course. The G7 finance deputies also began to acquire prominence because of their role in the process.

For several years, the debt strategy of the IMF, commercial banks and creditor country governments was to provide additional financing subject to IMF policy conditions in the expectation that the indebted countries could grow out of difficulty. The persistence of the debt problem finally brought finance officials, led by a new US Treasury Secretary, James Baker, to the recognition that indebted countries were not growing out of trouble. The Baker Plan, which called for new lending by banks and the international organizations, was discussed with the G5 ministers and governors and then presented to the Annual Meetings of the Bank and Fund in October 1985. This debt strategy was supported in subsequent Summits, but the reliance on voluntary lending proved a fatal weakness of the Baker Plan. It was again a new US Treasury Secretary, Nicholas Brady, who finally began the process of resolution by putting forward a plan that involved a reduction of debt burdens through restructuring of bank loans into what became known as Brady bonds. Brady put the plan forward in March 1989 after the Mexican finance minister threatened default,¹² and it was supported at the G7 Summit in Paris the following summer after discussion by the finance ministers and central bank governors.

3.4.4 THE 1990S: THE TRANSITION OF THE FORMER SOVIET BLOC AND DEBT CRISIS

Other issues came to dominate the international financial agenda in the 1990s. With movement toward economic and political reform in the Soviet bloc, followed by the dissolution of the bloc and eventually of the Soviet Union itself, the Western response to these developments became a critical issue. The specifics of the Western response to the aspiration for reform in Central and Eastern Europe were much more contentious than the broad principles. They commanded the attention of G7 Summits, meetings of finance ministers and central bank governors, and deputies for a decade. The G7 deputies became hands-on managers of the Western response, dealing with the structure, location and staffing of the EBRD, treatment of bilateral official credits in the Paris Club, IMF and World Bank lending programmes and questions of the structure of reform. The United States became a much more enthusiastic supporter of the Russian government after the arrival of the Clinton administration.

3.4.4.1 International Indebtedness

Another focus of G7 attention in the 1990s was international indebtedness. This had two aspects. One was the response to the series of financial crises that struck emerging markets beginning with Mexico in December 1994. Participants have different recollections of the extent of consultation among G7 finance ministry and central bank officials as the United States and the IMF prepared loan packages for Mexico. US officials recall extended conversations with G7 counterparts. Others recall being taken by surprise by the size of the IMF support package. A fair view is that there was an effort to consult, but it fell short under time pressures and that the United States was, in any event, firmly committed from the beginning to large-scale support on an accelerated timetable. Once the immediate support had been arranged, however, the US Treasury took the lead through the G7 in addressing a number of weaknesses in the international financial system that were highlighted by the Mexican crisis. These included:

- Lack of transparency concerning government financial positions.
- The need for stronger IMF surveillance.
- The appropriate size of IMF programmes and hence of IMF resources, and the conditionality that ought to apply in the event of a sovereign liquidity crisis.
- The need to strengthen banking systems in emerging markets.
- The need for new workout mechanisms in a world where widely held bonds were rapidly replacing more closely held bank loans in sovereign finance.
- The need to contain moral hazard – that is, the incentives of sovereign borrowers to take on excessive debt and for lenders to provide it when they expect a ‘bailout’ in the event of a crisis.

The Mexican crisis gave focus to calls for reform of the ‘international financial architecture’ from Summit participants and their foreign affairs advisers, some of whom dreamed of a new Bretton Woods. The gradualist-minded finance officials fed incremental reforms aimed at the identified problems to the Summits in Halifax in 1995 and Lyon in 1996.

Furthermore, the Asian debt crisis in 1997 demanded emergency coordination. The G7 finance ministers and central bank governors provided the principal venue, and this group played a crucial role in restraining the withdrawal of bank funds from Korea in the last weeks of December 1997. The crisis also gave a new impetus to financial reforms, as have several sovereign debt crises since. The Asian crisis produced a rare public conflict among G7 finance officials when Japan backed the establishment of an Asian Monetary Fund, which the others (most publicly the United States) opposed because of the threat that it posed to the authority of the IMF.

The indebtedness of the poorest countries also became a central concern within the G7. The need for debt reduction for the highly indebted poorest countries (HIPC) was put on the agenda by the British at the Houston

Summit in 1990. It was not until the Naples Summit in 1994 that terms for bilateral official debt reduction were agreed, however. By this time, it was evident that bilateral debt reduction would not be enough to bring debt to manageable levels; multilateral debts would have to be reduced. The IMF and World Bank resisted because they wished to maintain the principle that they were always repaid, and they did not want the write-down to come from 'their resources'. The question of how to pay for debt reduction was especially contentious, but the G7 finance ministries fashioned an agreement that was endorsed by the Lyon Summit in 1996. The agreement had some loose ends and other creditors needed to be brought on board. The road proved difficult, and the HIPC initiative has required sustained attention from the G7 to ensure its implementation and get results.

IMF and World Bank policies toward the poorest countries are where differences between the G7 and others have often been most sharp. Since the resources to support these institutions come largely from the G7, they have economic power behind their voting shares. Hence, it is inevitable that they will have dominant voices. It is, however, the poorest countries that stand to benefit or not, and that are asked to meet conditionality. The interests of middle-income countries are also involved. For example, the middle-income countries see the World Bank profits devoted to HIPC debt reduction or to IDA as coming from the interest spreads, they pay on their loans from the Bank.

3.4.5 ECONOMIC TRANSACTIONS: DEVELOPED COUNTRIES PERSPECTIVE

The most important change over the past 60 years has been an astounding broadening and deepening of financial linkages between countries and their extension from a small group of 10 or 11 financially important countries to a much larger set of actors. With this has come not only greater financial interdependence of the traditional kind but a whole new set of concerns about corporate governance, tax evasion, criminal money laundering and terrorist money flows.

The informal groupings have evolved somewhat in the light of changes in the world, but groups have been easier to form than to dissolve, and membership has been easier to extend than to withdraw. The result is a cluttered calendar of meetings, not all of which are a good use of officials' time. G8 Summits, for their economic contribution in recent years, might well be thought of as one of these. They have evolved, however, to fulfil other useful purposes beyond economic policy. That has left some loss of political focus on economic and financial issues that need attention. Groups of economic and financial officials are nonetheless carrying on with a much broader agenda than one could have imagined 30 years ago.

The Developed countries assumes that the sign of success for the world economic order is the process of economic and financial integration. World trade now stands at nearly 30% of world GDP, a 50% increase over a quarter century. Even more impressive is that gross capital flows rose seven times faster than world GDP over the same period, as did the flow of foreign direct investment. Trade integration picked up speed in the early 1990s, followed by financial integration in the mid-1990s. Financial integration started earlier among the OECD countries, but the major news is that it soon spread to the emerging market countries. A number of financial crises have not lastingly dampened the volume of capital flows. Many countries gross private flows exceeded 15% of GDP in 1980 and 2000. The phenomenon is quite widespread, bypassing only South Asia but including a number of African countries. This evolution is well known and sometimes decried. For better or worse, it is reshaping international economic and political relations and deeply transforming the fabric of all societies, in the North – through immigration and outsourcing, for instance – as well as in the South.

The end of the Soviet bloc has brought Russia into the group of market economies, even if much more remains to be done there to complete the transition. Russia's seat at the IMF and its admission to the G8 are not fully justified by its economic weight. Of greater significance is the fact that the Socialist model, which used to rule a majority of the world's population, has

been discredited enough to prompt nearly every country in the world to seek to integrate itself into the world economy. This is the case of China, of course, but it is also true to various degrees of many other countries like India, as well as the former European satellites of the Soviet Union. China and India, whose combined population amounts to almost 40% of the world's total, seem likely to continue to grow at a fast pace. Their 2001 GDP rankings at market exchange rates have not yet changed much from 40 years ago, but current trends predict the emergence of a new world deeply at variance with that of the twentieth century. Brazil too could well assume much greater economic importance. This evolution in the making must surely influence the way economic cooperation is conducted in the future.

3.4.6 DEVELOPING COUNTRIES PERSPECTIVE

Contrary to the understanding of Developed World, the Developing countries argues that for cooperation to be durably effective, it must be legitimate. It further observed that G7 leadership finds its justification in its expected effectiveness, but legitimacy, accountability and representation are also important. The international financial institutions have legitimacy, since all member countries are represented in their key decision-making bodies, but because each country's influence is tied to its voting weight, power is firmly held by a small number of countries, mostly those that belong to the G7. There is, however, little prospect of change in the systems for weighted voting which rule in the international financial institutions. The countries that place their taxpayers' money in the international financial institutions or stand behind them would not do so without a proportionate means to control their activities and so safeguard their taxpayers' commitment. That proportionate means is a system of voting where votes are broadly weighted to the financial exposure of taxpayers.

The Debt crisis in Latin America and Asia strengthened the resentment of developing countries toward existing international economic architecture. Criticism has moved beyond the narrow circles where it had long been confined. Some Asian governments that had previously been praised for

conducting prudent policies felt more coerced than helped when they unexpectedly found themselves in need of emergency assistance. When they asked for urgent short-term loans to prevent a catastrophic collapse of their exchange rates, they were handed a long series of structural conditions that it would take months or years to fulfil. In addition, many of these structural conditions were intrusive, implying significant wealth redistribution and reaching deep into national sovereignty. The fallout has been wide, leading the IMF to pull back more closely to its core business of macroeconomic management.

This is also when the anti-globalization movement appeared on the horizon. It erupted on the scene when protesters managed to block the WTO meetings in Seattle in 1998. Since then, from Washington, DC to Prague, from Geneva to Trieste, WTO, IMF, World Bank, and G7 meetings have been disrupted or threatened with disruption. Crowds that had not assembled in large numbers since the Vietnam War era took again to the streets. The Davos World Economic Forum, seen as a symbol of globalization insensitive to social needs, had to be moved to New York. The anti-Davos World Social Forum, launched in Porto Allegre, has become a focal point criticism; it always draws influential politicians – including ministers – from both the developed and the developing countries. The actual level of support for this ‘politics of the street’ varies from country to country, but such issues as the environment, debt and trade are now widely discussed.

On the other side, many emerging economies, such as China, India, Brazil and South Africa, are taking initiatives to developing alternative economic architecture to the existing problems of the inequality. However, the conflict of national interests of these countries is not allowing these countries to move forward in the direction of forging alternatives to the models advanced by developed countries. China and India, who once led the fight against the developed world, are now involved in perpetual conflict of interests and not contributing anymore meaningfully to the cause of developing and underdeveloped countries.

3.4.7 LET US SUM UP

One of the major implications of economic integration is that the list of issues of collective interest is expanding. From tax competition to mutually recognized standards, the list has become wide, and it is still growing. For a long time, the tradition has been to deal with each new issue by setting up a new international organization. However, the tradition of dealing with each issue by setting up an institution seems to have come to an end. Although international financial stability has emerged as a major international concern, no new institution has been created.

Yet new issues continually arise in international financial cooperation and present the international financial community with the challenge of devising ways of dealing with them which are above all effective, but to the fullest extent possible, legitimate, accountable and representative. The current challenge is not just to deal with a proliferation of new issues, but to adapt existing institutions, most of which were set up decades ago when many now independent countries were parts of vast empires and economic integration was limited. Back in 1944, when much of the current system was conceived, an old order was dead and discredited. It was then possible to start from near zero and dream up the best possible response to the needs as they were perceived at the time. Sixty years later, deep reforms on the 1944 model are not conceivable. Today is a time for patience and ingenuity to build on and modify an existing structure on an ongoing basis. Even that, in our world of competing interests and enormous complexity, will require statesmanship of the highest order.

**4.1 GLOBALIZATION: CONTRASTING
PERSPECTIVES (BHAGAWATI AND STIEGLITZ)**

- V. Nagendra Rao

STRUCTURE

4.1.0 Objectives

4.1.1 Introduction

4.1.2 Defining Globalization

4.1.3 Perspective of Jagadish Bhagwati

4.1.3.1 Criticism on Bhagwati

4.1.4 Joseph Stiglitz Perspective

4.1.4.1 Stiglitz Criticism specific Policies of Financial Institutions

4.1.4.2 Criticism on Stiglitz's Views

4.1.5 Let us Sum Up

4.1.6 Exercise

4.1.0 OBJECTIVES

After going through this lesson, you should be able to know:

- What is globalization and how it is important in contemporary international political economy;

- The views of Jagdish Bhagwati and main criticism against his view;
- The perspective of Joseph Stiglitz and his critique on specific policies pursued by global financial institutions.

4.1.1 INTRODUCTION

Although the word ‘global’ is over 400 years old, the common usage of such words as ‘globalization’, ‘globalize’ and ‘globalizing’ did not begin until about 1960. *The Economist* reported in 1959 ‘Italy’s “globalised quota” for imports of cars has increased’ and in 1961 *Webster* became the first major dictionary to offer definitions of globalism and globalization. Robertson, who attempt to theorize globalization informs us that the term was not recognized as academically significant until the early or possibly the mid-1980s but thereafter its use has become, well, globalized. In the context of a debate about the growing interconnectedness of human affairs, world systems theory, theories of complex interdependence and the notion of globalization itself emerged as largely rival accounts of the processes through which the fate of states and peoples was becoming more intertwined. Following the collapse of state socialism and the consolidation of capitalism worldwide, academic and public discussion of globalization intensified dramatically. Coinciding with the rapid spread of the information revolution, these developments appeared to confirm the belief that the world was fast becoming a shared social and economic space – at least for its most affluent inhabitants. However, whether the notion of globalization ultimately helps or hinders our understanding of the contemporary human condition, and strategies to improve it, is now a matter of intense intellectual and public controversy. In short, the great globalization debate has been joined. This lesson shed some light on this dynamic debate which is going on for some time.

4.1.2 DEFINING GLOBALIZATION

There is no uniformity among the scholars on precise definition of globalization. Since there is no consensus on nature and impact of

globalization, the scholars also differ on defining globalization. However, some of the definitions that have attracted wider acceptability are given here to make sense of globalization. Robertson definition of globalization as follows:

Globalization as a concept refers both to the compression of the world and the intensification of consciousness of the world as a whole . . . both concrete global interdependence and consciousness of the global whole.

The first part of the definition, global compression refers to an increasing level of interdependence between national systems by way of trade, military alliance and domination, and ‘cultural imperialism’. However, the more important component of the definition is the idea of an intensification of global consciousness which is a relatively new phenomenon. On the other hand, according to Anthony Giddens:

Globalization can . . . be defined as the intensification of worldwide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa. This is a dialectical process because such local happenings may move in an obverse direction from the very distanced relations that shape them. Local transformation is as much a part of globalization as the lateral extension of social connections across time and space.

This definition usefully introduces explicit notions of time and space into the argument. It emphasises locality and thus territoriality and by this means stresses that the process of globalization is not merely or even mainly about such grand, centre-stage activities as corporate mega-mergers and world political forums but about the autonomization of local life-worlds. Localization implies a reflexive reconstruction of community in the face of the dehumanizing implications of rationalizing and commodifying.

Simply put, for *optimists* of globalization denotes the expanding scale,

growing magnitude, speeding up and deepening impact of interregional flows and patterns of social interaction. It refers to a shift or transformation in the scale of human social organization that links distant communities and expands the reach of power relations across the world's major regions and continents. However, as the *sceptics* point out, globalization should not be read as prefiguring the emergence of a harmonious world society or as a universal process of global integration in which there is a growing convergence of cultures and civilizations. Not only does the awareness of growing interconnectedness create new animosities and conflicts, it can fuel reactionary politics and deep-seated xenophobia (fear). Since a significant segment of the world's population is either untouched directly by globalization or remains largely excluded from its benefits, it is arguably a deeply divisive and, consequently, vigorously contested process.

The following sections of the lesson highlight this duality of globalization and divergent viewpoints of globalization debate to explore its nuances in their multiplicity.

4.1.3 PERSPECTIVE OF JAGADISH BHAGWATI

In the flurry of popular and scholarly books addressing the nature and impact of contemporary economic globalization, Jagdish Bhagwati's *In Defence of Globalization* is an important contribution. As the title reveals, the book articulates strong support for globalization, particularly in the guise of free trade and direct foreign investment. Bhagwati's goal is to systematically debunk the principal arguments of anti-globalization activists, whom he divides into two camps: anti-establishment forces with total opposition to market-based systems, and critics who focus on more specific aspects of globalization yet, he contends, base their arguments on incomplete or poor information. Dismissing the former group, Bhagwati takes on the arguments of the latter to expose flaws in their reasoning and reveal the "human face" of globalization.

The globalization that Bhagwati defends is economic globalization.

He defines economic globalization as the “integration of national economies into the international economy through trade, direct foreign investment (by corporations and multinationals), short term capital flows, international flows of workers and humanity generally, and flows of technology”. However, throughout the course of the book it becomes clear that he is most committed to the defence of trade and foreign direct investment which he sees as part of an outward oriented economic policy strategy that is necessary for growth.

In response to critics’ arguments that globalization increases poverty and income disparities, undercuts worker rights and labour standards, imperils democracy, harms the economic and social positions of women, erodes local cultures, and harms the environment, Bhagwati aims to show that the opposite is often true.

Bhagwati argues that economic growth is necessary to reduce poverty and that increased trade can lead to economic growth. While there may be obstacles that prevent the war from fully anticipating an economic growth of the nation, without economic growth, there will not be resources available to lift them out of poverty. Thus, in contrast to the cliché that “a rising tide lifts all boats”, is essentially arguing that without a rising tide it will be hard to lift anybody’s boat. As for the link between trade and growth itself, Bhagwati argues that outward oriented strategies of growth have proven themselves to be superior to inward oriented strategies such as import substitution industrialization.

The relationship between growth and poverty reduction is also empirically robust, says Bhagawati. According to him, in the two countries, China and India, where poverty has been immense, this relationship has worked dramatically since the 1980s when both countries retreat from autarkic (national economic self-sufficiency and independence) policies and opened to trade and direct foreign investment, more dramatically in China and with more dramatic effects on growth rates and associated poverty reduction. The ability of a rapidly growing economy to such people up into gainful employment, and thus to make a sustained dent on poverty, has rarely been

demonstrated so well. It puts to rest the absurd contention that growth is a conservative, feeble “trickle down” strategy for reducing poverty. Instead, for Bhagwati, it is instead a radical, effective “pull up” strategy for poverty reduction.

Bhagwati carefully distinguishes between different kinds of international flows of goods, services, and people. In particular, he emphasizes the distinction between long- and short-term capital flows. Although he is an ardent proponent of globalization, Bhagwati is less than sanguine about the impact of short-term capital flows on developing economies and he blames the East Asian financial crisis on the absence of adequate capital controls in the most affected countries.

By adopting a more tempered and socially conscious perspective, Bhagwati differs from other proponents of the global spread of free markets. For example, he shuns “shock therapy”, or the rapid and comprehensive implementation of market-oriented reforms, in favour of a more gradual course of economic change that avoids social dislocation and, hence, political backlash.

Bhagwati’s discussion of the positive effects of globalization on poverty alleviation is a key component in his effort to expose the humane aspects of globalization. The author claims that globalization reduces poverty through a two-step process: trade increases growth, which in turn reduces poverty. Secondly, poverty reduction as a result of growth is not only contingent on absolute growth in the size of the national economy but also on the nature of distributional policies. Indeed, Bhagwati observes, “the ability of the poor to access the growth process and to share in the prosperity depends at least as much on their ability to get their voices heard in the political process.” Thus, deliberate policy interventions and political systems that empower the poor are critical for more equitable patterns of economic growth.

With regard to child labour, Bhagwati says that if globalization brings increased incomes to parents, will parents then send more children to work now that their income have improved or less because they do not need children

to work and can send them to school instead? If the former, then clearly globalization create a trade off between increased prosperity and the reduction of child labour and policies that inhibit globalization become sensible. But if the later, then we are likely to ask: what can we do to accelerate the pace at which child labour will be reduced by globalization? According to him when globalization leads to increased prosperity, it also leads to less child labour.

Bhagwati analyzes many of the criticisms by feminist groups in depth, so it is hard to summarize here. However, one piece of research he cites stand out. *Black and Brainerd* (2004) look at wage discrimination in the US and find that the wage gap between men and women decreases in industries that face increased competition from trade. Therefore, to the extent that globalization exposes industries to greater competition, it should diminish any wage gap that is the result of non-economic (and, thus, inefficient) discrimination.

The charge that globalization forces people to work for exploitative wages comes up in connection with effects on women and criticism of multinational corporations. Bhagwati cites several studies that show that, rather than paying their workers poorly, multinationals pay their workers a wage premium of up to 10% and that US affiliated multinational often pay a premium of 40 to 100% above the local market wage.

Bhagwati's support for globalization cum social policy reflects his reasoned approach to the subject. While he clearly favours allocation processes based on markets rather than government officials, his calls for social policy interventions to temper the ill effects of globalization boosts the credibility of his arguments. Nonetheless, he spends far more time defending globalization from its critics than formulating viable policy solutions to some of the real and perceived problems associated with globalization.

Bhagawati's analysis ultimately highlights a tension between the forces of globalization and their critics. Bhagwati systematically critiques the arguments of anti-globalization groups yet, at the same time, recognizes that

globalization can be exploitative without social legislation. In part, this is because the “rules” of global economic exchange tend to reflect the interests of wealthy, industrialized countries. Although he devotes little attention to the detrimental impact of US and European farm subsidies on agricultural exports from developing countries, he emphasizes the distortionary effects of intellectual property protection legislation. In short, globalization may enhance aggregate economic welfare, but active policy-making ensures that the human face of globalization is more agreeable.

But this does not make Mr Bhagwati a laissez-faire capitalist. His commitment to social justice is firm. He is highly critical of large companies that erect barriers to protect their dominance. He has challenged the intellectual property regime and taken on drug manufacturers for trying to convert the WTO into a “royalty collection agency”. While he provides an argument against the soundness of the basic principle (i.e., that preventing the diffusion of intellectual property can be as bad as undermining the incentives of innovators to create it), he also regards adding side issues to the WTO as ultimately harmful to its primary function of enabling greater trade. Furthermore, he sees an imbalance in power and capability between Western nations and NGOs that will ensure that any WTO rules will reflect their interests and values more than those of developing nations and their much less affluent NGOs.

In general, Bhagwati concludes that globalization does have a human face in the sense that it has a benign impact on most of the issues that concern its critics. However, it can have occasional unintended bad effects. He argues that the way to deal with these is, not to try to avoid them ahead of time by limiting the liberalization of trade or FDI, but to deal with them as they occur. One of the main reasons for taking a reactive approach is that the specific effects of changes in trade policy are difficult to predict, and many anticipated problems may not arise, while other unanticipated ones almost certainly will.

Bhagwati says that globalisation should be managed to “reinforce and ensure” its benign effects. To achieve this, he would tax skilled workers who

leave developing countries to work overseas, and he would encourage NGOs to continue acting as watchdogs and blow the whistle when big companies behave badly. He does not like child labour, but he would prefer to see a solution come from the International Labour Organisation, not the WTO.

4.1.3.1 Criticism on Bhagwati

Many criticised Bhagwati's proposition that globalization and growth reduces poverty. The experience of developing, particularly Least Developing Countries (LDCs), shows that globalization retarded growth, increased social and economic inequalities, ruptured overall economic development. It led to catastrophic phase where violence and unrest spread in many countries and destabilized their political development as well.

Secondly, many researchers whom he cited to justify his claim that globalization benefits poor countries, themselves changed the opinion, especially the economists of World Bank, and agreed the negative consequences of uncritical imposition of the globalization on developing and least developed countries.

Thirdly, Bhagwati criticizes many NGOs as abstractionist as they are opposing the globalization due to the severe economic distress they have experienced. The irony is that the efforts of the very NGOs that Bhagwati critiques expose the not-so-human face of globalization by maintaining constant pressure for change. In other words, NGOs – perhaps even the anti-establishment groups that Bhagwati dismisses at the outset – serve an important function. While they may not succeed in halting the particular practices to which they object, they bring injustice to the forefront, thereby forcing globalization to take on the benevolent guise that Bhagwati claims is inherent in the process itself. Indeed, Bhagwati recognizes as much when he comments that NGOs “can play an important role in the design of appropriate governance to improve outcomes from globalization”.

4.1.4 GLOBALIZATION: JOSEPH STIGLITZ PERSPECTIVE

Joseph Stiglitz is a Nobel Prize–winning economist. Over a long career, he has made incisive and highly valued contributions to the explanation of an astonishingly broad range of economic phenomena, including taxes, interest rates, consumer behaviour, corporate finance, and much else. Especially among economists who are still of active working age, he ranks as a titan of the field. In recent years Stiglitz has also been an active participant in economic policymaking, first as a member and then as chairman of the US Council of Economic Advisers (in the Clinton administration), and then, from 1997 to 2000, as chief economist of the World Bank.

In *Globalization and Its Discontents* Stiglitz bases his argument for different economic policies squarely on the themes that his decades of theoretical work have emphasized: namely, what happens when people lack the key information that bears on the decisions they have to make, or when markets for important kinds of transactions are inadequate or don't exist, or when other institutions that standard economic thinking takes for granted are absent or flawed.

The implication of each of these absences or flaws is that free markets, left to their own devices, do not necessarily deliver the positive outcomes claimed for them by textbook economic reasoning that assumes that people have full information, can trade in complete and efficient markets, and can depend on satisfactory legal and other institutions. As Stiglitz nicely puts the point, “Recent advances in economic theory”—he is in part referring to his own work—“have shown that whenever information is imperfect and markets incomplete, which is to say always, *and especially in developing countries*, then the invisible hand (market) works most imperfectly.”

As a result, Stiglitz continues, governments can improve the outcome by well-chosen interventions. At the level of national economies, when families and firms seek to buy too little compared to what the economy can produce, governments can fight recessions and depressions by using

expansionary monetary and fiscal policies to spur the demand for goods and services. At the microeconomic level, governments can regulate banks and other financial institutions to keep them sound. They can also use tax policy to steer investment into more productive industries and trade policies to allow new industries to mature to the point at which they can survive foreign competition. And governments can use a variety of devices, ranging from job creation to manpower training to welfare assistance, to put unemployed labour back to work and, at the same time, cushion the human hardship deriving from what—importantly, according to the theory of incomplete information, or markets, or institutions—is no one's fault.

Stiglitz complains that the IMF has done great damage through the economic policies it has prescribed that countries must follow in order to qualify for IMF loans, or for loans from banks and other private-sector lenders that look to the IMF to indicate whether a borrower is creditworthy. The organization and its officials, he argues, have ignored the implications of incomplete information, inadequate markets, and unworkable institutions—all of which are especially characteristic of newly developing countries. As a result, Stiglitz argues, time and again that the IMF has called for policies that conform to textbook economics but do not make sense for the countries to which the IMF is recommending them. Stiglitz seeks to show that the consequences of these misguided policies have been disastrous, not just according to abstract statistical measures but in real human suffering, in the countries that have followed them.

4.1.4.1 Stiglitz Criticism on Specific Policies Pursued by Global Financial Institutions

Most of the specific policies that Stiglitz criticizes will be familiar to anyone who has paid even modest attention to the recent economic turmoil in the developing world (which for this purpose includes the former Soviet Union and the former Soviet satellite countries that are now unwinding their decades of Communist misrule):

Fiscal austerity. The most traditional and perhaps best-known IMF policy recommendation is for a country to cut government spending or raise taxes, or both, to balance its budget and eliminate the need for government borrowing. The usual underlying presumption is that much government spending is wasteful anyway. Stiglitz charges that the IMF has imposed these policies on countries during deep recessions. He argues that cuts in spending or tax hikes only make the downturn worse. He also emphasizes the social cost of cutting back on various kinds of government programmes—for example, eliminating food subsidies for the poor, only to be engulfed by food riots.

High interest rates. Many countries come to the IMF because they are having trouble maintaining the exchange value of their currencies. A standard IMF recommendation is high interest rates, which make deposits and other assets denominated in the currency more attractive to hold. Stiglitz argues that the high interest rates imposed on many countries by the IMF have worsened their economic downturns. They have forced the bankruptcy of countless otherwise productive companies that could not meet the suddenly increased cost of servicing their debts.

Trade liberalization. The IMF usually recommends (in effect, requires) eliminating trade barriers as a condition for receiving credit. The argument is the usual one, that in the long run free trade practiced by everyone benefits everyone. Stiglitz points out that today's industrialized countries did not practice free trade when they were first developing, and that even today they do so highly imperfectly (examples are recent increase in agricultural subsidies and new barriers to steel imports in the US). He argues that forcing today's developing countries to liberalize their trade before they are ready mostly wipes out their domestic industry, which is not yet ready to compete.

Liberalizing Capital Markets. Many developing countries have weak banking systems and few opportunities for their citizens to save in other ways. As one of the conditions for extending a loan, the IMF often requires that the country's financial markets be open to participation by foreign-owned

institutions. Stiglitz argues that the larger and more efficient foreign banks drive the local banks out of business; that the foreign institutions are much less interested in lending to the country's domestically owned businesses; and that mobilizing savings is not a problem because many developing countries have the highest savings rates in the world anyway.

Privatization. Selling off government-owned enterprises—telephone companies, railroads, steel producers, and many more—has been a major initiative of the last two decades both in industrialized countries and in some parts of the developing world. Stiglitz argues that many of these countries do not yet have financial systems capable of handling such transactions, or regulatory systems capable of preventing harmful behaviour once the firms are privatized, or systems of corporate governance capable of monitoring the new managements. Especially in Russia and other parts of the former Soviet Union, he says, the result of premature privatization has been to give away the nation's assets to what amounts to a new criminal class.

Stiglitz repeatedly claims that the IMF's policies stem not from economic analysis and observation but from ideology—specifically, an ideological commitment to free markets and a concomitant antipathy to government. Again and again he accuses IMF officials of deliberately ignoring the “facts on the ground” in the countries to which they were offering recommendations. In part his complaint is that unfettered markets do not necessarily deliver positive results when information or market structures or institutional infrastructure are incomplete.

More specifically, he argues that the IMF ignores the need for proper “sequencing.” Liberalizing a country's trade makes sense when its industries have matured sufficiently to reach a competitive level, but not before. Privatizing government-owned firms makes sense when adequate regulatory systems and corporate governance laws are in place, but not before. The IMF, he argues, deliberately ignores such factors, instead adopting a “cookie cutter” approach in which one set of policies is right for all countries regardless of their individual circumstances. But importantly, in his eyes, the underlying

motivation is ideological: a belief in the superiority of free markets that he sees as, in effect, a form of religion, impervious to either counterarguments or counterevidence.

The IMF, in Stiglitz's view, systematically acts in the interest of creditors, and of rich elites more generally, in preference to that of workers, peasants, and other poor people. As a result, the IMF recommended policies resulted in steeper downturns and more widespread joblessness. Hence, the IMF and other international financial institutions are responsible for worsening—in some cases, for actually creating—the problems they claim to be fighting.

Stiglitz considers, and rejects, the view that these and other choices are the result of a conspiracy between the IMF and powerful interests in the richer countries—a view that is increasingly popular among the anti-globalization protesters who now appear at the IMF's and the World Bank's meetings. Stiglitz's view is that in recent decades the IMF “was not participating in a conspiracy, but it was reflecting the interests and ideology of the Western financial community.”

4.1.4.2 Criticism on Stiglitz's Views

Many critics disagree with Stiglitz's criticism on IMF and World Bank. They say that we cannot reliably know whether the consequences of the IMF's policies were worse than whatever the alternative would have been. Many long-time observers of the developing world will notice that Stiglitz rarely mentions economic policy mistakes that poor countries make on their own initiative. Nor does he pay much attention to the large-scale corruption that is endemic in many developing economies. He also never points out that the typical developing country spends far more on its military forces than it receives in foreign aid.

Defenders of the IMF cannot claim that all went well after countries implemented the Fund's recommendations. But they would presumably argue that events would have turned out even worse on some alternative course.

They would also argue that of course they knew that information was imperfect, and markets incomplete, and institutions absent, in the countries that came to the IMF for assistance. The issue, to be argued on a case-by-case basis, is just what different set of actions might therefore have proved more beneficial.

Stiglitz complains at length, and with many specific cases to cite, that the IMF violates countries' economic sovereignty when it requires them to carry out its policy recommendations as a condition for its granting credit. But don't responsible lenders normally impose such conditions on borrowers? Stiglitz never acknowledges that today the IMF faces serious criticism from many economists and politicians in the West on the ground that it makes loans with too few conditions, so that the borrowing countries often simply end up wasting the money.

Irrespective of the criticism mentioned above, his *Globalization and Discontent* is well-argued, and subtle attack against globalization in the past few years. Stiglitz strongly believes that bad policymaking can be reduced by enlightened policymaking, both nationally and on a global scale. And that when international economic agencies do not behave properly, they must be reformed, made more transparent and accountable, and less dependent on special interests. Stiglitz strongly makes a case for framing broader set of rules on the basis of fairness and consensus, and they should be designed through a democratic process so as to guarantee social justice and meet the needs of everybody.

4.1.5 LET US SUM UP

The great globalization debate, summarized above with two different perspectives of Bhagwati and Stiglitz, identifies some of the most fundamental issues of our time. Both the perspectives elaborated highly important and carefully considered arguments. These pose key questions about the organization of human affairs and the trajectory of global social change. They also raise matters which go to the centre of political discussion, illuminating

some of the strategic choices societies confront and the constraints which define the possibilities of effective political action in response to contemporary globalization. Although there are, of course, very significant differences between each perspective, there is some common ground. The debate does not simply comprise ships passing in the night. Indeed, both sides would accept that: a) there has been some growth in recent decades in economic interconnectedness within and among regions, albeit with multifaceted and uneven consequences across different communities; b) interregional and global (political, economic and cultural) competition challenges prevailing hierarchies and generates new inequalities of wealth, power, privilege and knowledge; c) there has been an expansion of international governance at regional and global levels – from the IMF to the WTO – which poses significant normative questions about the kind of world order being constructed and whose interests it serves.

4.1.6 EXERCISE

1. How do you understand globalization?
2. Bhagwati's favourable views on globalization doesn't make him a laissez-faire capitalist. Analyse.
3. Why Stiglitz criticises the policies pursued by the global financial institutions like IMF and World Bank policies?

4.2 POLITICAL ECONOMY OF REGIONALISM: EU AND ASEAN

- V. Nagendra Rao

STRUCTURE

4.2.0 Objectives

4.2.1 Introduction

4.2.2 Defining Regionalism

4.2.2.1 Regional Cooperation

4.2.3 Regionalism: Historical Development

4.2.3.1 New Regionalism

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4.2.4 European Union

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4.2.5 ASEAN

4.2.5.1 Objectives

4.2.5.2 Aims and Purposes

4.2.5.3 Fundamental Principles

4.2.5.4 ASEAN Community

4.2.5.5 ASEAN Charter

4.2.5.6 ASEAN Critical Assessment

4.2.6 Let us Sum up

4.2.7 Exercise

4.2.0 OBJECTIVES

After going through this lesson, you should be able to know:

- The concept of regionalism and regional cooperation;
- The differentiation between earlier regionalism and new regionalism in globalized world;
- The evolution of European Union, its objectives;
- The functioning of Europe as a single market with its monetary union
- The aims, objectives, purposes and fundamental principles of ASEAN;
- The evolution ASEAN community and importance of ASEAN Charter in it;
- The critical assessment of ASEAN with its democratisation process and domination of national oligarchies.

4.2.1 INTRODUCTION

The contemporary International politics is defined by the re-emergence of the phenomenon of 'Regionalism'. Its development has been perceptible especially during past two decades. One can notice the proliferation of regionalism and regional organisations in almost all parts of the globe. The 'new regionalism' as the phenomenon has come to be known, is not a uniform but a heterogeneous phenomenon taking different forms. However, what makes it important is its range and scope. Though uneven in its development,

it is a global in nature with proliferation of regionalism and regional organisations all over the world. Movement towards regional cooperation is taking place almost everywhere and even the conflict-ridden countries are exploring the possibilities of regional cooperation.

Regionalism in the contemporary period has evolved in response to the changing realities of the world. The changed international political setting after the end of the Cold War – the decline in the United States (US) hegemony, the rise of the Asia Pacific region, the reorientation of the development strategies of Third World – all have contributed to the process of regionalisation. The changing international environment has created new demands and needs which are being met by regionalism. This new international environment is more open and provides sufficient space for the regional identities to assert and negotiate. Regionalism is therefore not only an initiative of the strong nations but also of the weaker and marginalised states.

4.2.2 DEFINING REGIONALISM

In the field of International Relations (IR), regions are defined as continents or as supranational formations of countries sharing a common political and economic project and having a certain degree of common identity. Many scholars of IR agree with the minimum definition of region set out by Joseph Nye: “a group of states linked together by a geographical relationship and by a degree of mutual interdependence”. For the scholars of IR, the focus on region implies that ‘states’ are not isolated entities or discrete categories. They “cannot be understood without reference to the neighbouring environment, the region, in which the country has developed. By the same token, regions are not discrete categories and must be understood in a global perspective”.

Had Soesastro defined regionalism as “the creation of preferential trading arrangements or the result of other types of institutional integration”. Albert Fishlow and Stephan Haggard sharply distinguish between

‘regionalisation’, which refers to the regional concentration of economic flows, and ‘regionalism’, which they define as a political process characterized by economic policy cooperation and coordination among countries. For Schulz, *regionalism* represents the body of ideas, values and concrete objectives that are aimed at creating, maintaining or modifying the provision of security and wealth, peace and development within a region. It indicates the willingness of actors, political as well as non-political, to reorganize along a particular regional space.

According to Louise Fawcett, the aim of regionalism is to pursue and promote common goals in one or more issue areas. Understood thus, it ranges from promoting a sense of regional awareness or community (*soft* regionalism), through consolidating regional groups and networks to pan- or sub-regional groups formalised by inter-state arrangements and organisation (*hard* regionalism). For him “a truly successful regionalist project...presupposes eventual linkages between state and non-state actors, but also cooperation across regions creating an interlocking network of regional governance structures.

4.2.2.1 Regional Cooperation

Regional cooperation is a basic concept that can be analysed through different approaches. Cooperation could for example, be the initiation of a process or the effect of earlier confidence building measures. The initiation of cooperation can be caused by a wide array of reasons such as integration and regionalization, but cooperation could also be the reason for integration and regionalization.

Ernst B. Haas has defined the concept as follows: “regional cooperation is a vague term covering any interstate activity with less than universal participation designed to meet commonly experienced need’. According to Schulz, Regional cooperation can be defined as an open-ended process whereby individual states or other actors within a given geographical area act together for mutual benefit and in order to solve common tasks, in spite

of conflicting interests in other fields of activity. It may be formal and involve a high degree of institutionalization, but may also be based on a much looser structure.

According to Swanstrom, “Cooperation is a series of actions taking place between political or economic entities, aiming to increase mutual benefits for all included actors. Regional cooperation incorporates such a diverse set of actions as assisting each other in controlling tropical diseases, disaster assistance, drug control military alliances, nuclear programmes and space missions”. This wide array of possibilities for cooperation makes it necessary to limit the scope of the analyses. He points out that regional cooperation can be analysed through four broad perspectives: first, overall cooperation and regional integration which can be political, economical or military in nature; second, multilateral cooperation in the military field which can range from military alliances to confidence building measures, to management of interstate disputes; third, political cooperation relating to questions such as common political institutions, common foreign policy etc.; and fourth, economic issues such as common markets or tariff reductions.

The concept of regional cooperation cannot be grasped without understanding two more concepts associated with it: *regional organisation* and *regional integration*. In contemporary international relations, ‘regional organisation’ has assumed such a pre-eminent position that in most of the cases regionalism is often analysed in their relation with a particular regional organisation. According to Bjorn Hettne, the regional organisation “tries to shape what it defines as ‘its’ region by promoting cooperation among states and other actors, which is possible to the extent that a genuine experience of shared interests in a shared political community exists – that the region is ‘real’ and not only ‘formal’”.

When it comes to ‘regional integration’, it refers to a deeper process than regional cooperation and regional organisation. Basically, ‘integration’ means joining parts into a whole. According to Joseph Nye, the concept of *integration* joins too many disparate phenomena to be helpful to understand,

and should therefore be broken down into economic integration (the formation of a transnational economy), social integration (the formation of a transnational society) and political integration (the formation of a transnational political system).

Thus regional integration is a wide spread phenomenon that transpires in almost every part of the world. The General Agreement on Trade and Tariffs (GATT) received 124 notifications of regional trading arrangements in the period 1948-94 and between 1995-96 additional 90 arrangements have been notified. Among them, about 134 Regional Trade Agreements (RTA's) are in force at present. Currently, almost every member of the World Trade Organization (WTO) is a member of one such arrangement. However, few regional trading arrangements, except the European Union (EU) have moved in substantial ways beyond the stage of free trade area and customs Union.

Despite of the parallel process of globalization, regionalization assumed an important role in the contemporary international relations. Both the number and membership of regional organizations as well as interest in what was dubbed as the “new regionalism”, have grown exponentially.

4.2.3 REGIONALISM: HISTORICAL DEVELOPMENT

According to Edward Mansfield and Helen Milner, the world has witnessed four waves of regionalism in the past two centuries, two before the Second World War and the remaining in the post-War period. The first one occurred during the second half of the 19th century and was largely a European phenomenon. During this period, intra-European trade rose dramatically and constituted a vast portion of global commerce. The economic integration of this period was so extensive that by the turn of the 20th century, Europe had begun to function as a single market in many respects. Apart from industrialisation, the creation of various customs unions and bilateral trade agreements clearly had pronounced effects on European integration. Though World War I disrupted the growth of regional trade arrangements, however, a second wave of regionalism began soon after the war ended. The

regional arrangements formed between the two World Wars tended to be highly preferential. Some were created to consolidate the empires of major powers: for example, France formed customs union with members of its empire in 1928 and Britain established the Commonwealth with its colonies.

Scholars of international relations distinguish two waves of regionalism since World War II. The first began in the late 1950s and lasted until the 1970s; the second began in the mid-1980s continuing to the present. The first was marked by the establishment of many regional organisations in all parts of the world such as NATO, European Economic Council (EEC), the Council for Mutual Economic Assistance (CMEA), etc. These arrangements were initiated against the backdrop of the Cold War and in the process of decolonization. So in many ways, the post-Cold War environment demanded a greater regional awareness and involvement, and was actively promoted by a range of international actors.

Though the enthusiasm for regional integration was somewhat diminished in the early 1970s due to its limited impact and achievements, nevertheless, in the post-Cold War period the number and membership of regional organisations, as well as interest in what was termed as the *new regionalism*, has grown exponentially. This most recent wave of regionalism has arisen in a different context than earlier episodes. It emerged in the wake of attendant changes in interstate power and security relations. As pointed out by the Fawcett, “The regionalisation of the 1990s was promoted by the decentralisation of the international system and the removal of superpower overlay; growth of regional identities. Changing regional power balances found expression in new institutional forms and practices”. As Robert Z. Lawrence notes, “The forces driving the current developments differ radically from those driving previous waves of regionalism in this century. Unlike the episode of the 1930s, the current initiatives represent efforts to facilitate their members’ participation in the world economy rather than their withdrawal from it. Unlike those in the 1950s and 1960s, the initiatives involving developing countries are part of a strategy to liberalize and open their

economies to implement export-and foreign investment-led policies rather than to promote import substitution”. And unlike the interwar period, the most recent wave of regionalism has been accompanied by high levels of economic interdependence and a multilateral framework to mediate trade dispute by economic actors. How this “new regionalism” has to be theorised and how to understand its relation with the larger globalisation process has become one of the most focused issues of the scholars of the international relations.

4.2.3.1 New Regionalism

The literature on regionalism clearly makes a distinction between “new regionalism” that started in the middle of 1980s with that of old regionalism. While the regionalism that started in the early years of post-War period had been dominated by the bipolar Cold War structure with nation-states as the uncontested primary actors, the new wave of regionalism is associated with a multitude of often inter-related structural changes in the global system. According to Schulz, these changes are: (1) the move from bipolarity towards a multipolar or perhaps tripolar structure, centred around the EU, NAFTA and the Asia-Pacific, with a new division of power and new division of labour; (2) the relative decline of American hegemony in combination with a more permissive attitude on the part of the United States towards regionalism; (3) the restructuring of the nation-state and the growth of interdependence, transnationalization and globalization; (4) recurrent fears over the stability of the multilateral trading order, hand in hand with the growing importance of non-tariff barriers (NTBs) to trade; and (5) the changed attitude towards (neo-liberal) economic development and political systems in the developing countries as well as in the post-communist countries.

With regard to the *content*, while the old regionalisms was often imposed, directly or indirectly, from outside and above in the interests of the superpowers (hegemonic regionalism), the current trend towards regionalism is a more spontaneous process emerging from below and from within the region itself. Moreover, the old phenomenon was often specific with regard

to objectives and content (free trade areas or security alliances), and sometimes explicitly exclusive in terms of member states, the new one is a heterogeneous, comprehensive, multidimensional phenomenon, which involves state, market and society actors and covers economic, cultural, political, security and environmental aspects. The contemporary wave of regionalism cannot be understood as a distinct alternative to the national interest and nationalism, but is often better explained as an instrument to supplement, enhance or protect the role of the state and the power of the government in an interdependent world.

The new regionalism, therefore, cannot be understood merely from the point of view of the single region in question, but only in a global perspective. Globalism and regionalism stand in a symbiotic relationship to one another, sometimes complimenting and at other times contradicting.

According to Mary Farrell, globalisation as a multi-faceted phenomenon is influencing the countries positively as well as negatively and the countries are responding to this challenge using regionalism both as a defensive and an offensive strategy. Since the world has been unable to construct a truly global governance system with the capacity to manage and regulate, the states have turned to other forms of cooperation at the regional level in order to deal with common problems and shared interests. In a world where the state system faces attacks on its sovereignty and authority, governments have come to view cooperative decision-making as a crucial means to strengthen that sovereignty and to exercise shared authority in the framework of regional cooperation; the non-state actors have also engaged in an extension network of cross-border relations. In the contemporary world, much of this cooperation is prompted by concerns over such issues as crime, terrorism and counter-terrorist policies.

Though the recent surge in various regionalist projects are influenced to a large extent by the changes in larger international context, however, several other factors give a shape to the nature, character and direction of these projects. Apart from the domestic socio-political, cultural, economic

and security context, the regional context, the actors involved in a particular regional project, the relative growth of private and civil society groups and nature of opportunities and threats perceived by these political and non-political actors also shapes regionalisation process.

4.2.3.2 Regionalism: Actors

Several factors operating at multiple levels generate interest towards establishing durable structures of regional cooperation. Both state and non-state actors, domestic and external factors influence the trajectory of a particular regionalist process.

For many, regionalism is a political phenomenon shaped by political actors, both state and non-state, who may use regionalism for a variety of purposes. The main actors and driving forces of top-down regionalization are states (governments) and “authorities” at various levels. For example, the preferences and political influence of domestic groups can influence the regional strategies of the countries and particular policies formulations they support or oppose. Similarly, the bureaucracy also plays crucial role in influencing regionalisation process. Many observers maintain that the feasibility of creating a regional agreement depends on prospective members having relatively similar economic or political institutions.

Contrary to state-driven, top-down process, regionalisation may be influenced by the market and civil society forces in bottom-up process. The actors are from markets, business networks, firms, transnational corporations, peoples, NGOs and other types of social networks and social movements contributing to the formation of a transnational regional economy and civil society.

Similarly, socio-economic conditions and security context of the regions also influence the process of regionalisation. For instance, economic complementarities among regional states may favour cooperation; the lack of such complementarities may diminish incentives to pursue and to institutionalise cooperation. Likewise, the sharing of cross-border assets (e.g.

watercourses) can foster cooperation or competition. A shared culture and shared values may also promote cooperation; the existence of significant cultural disparities can operate as a significant obstacle to collaboration. On security domain, the emergence of cross-border challenges, such as terrorism, narcotics trafficking, migration, environmental degradation, may foster cooperative ties as states seek to manage together what they are incapable of managing alone. On the other hand, such challenges may evoke hostile reactions from some of the states upon which these corrective measures impinge.

Regional cooperation can also be affected by actors outside the region. For instance, frequent interventions of an external power may generate a sense of threat that produces collective defence mechanisms at regional level by regional actors; absence of this threat may remove an often potent incentive to cooperate. Moreover, outside powers may seek to structure cooperation within a particular region in tune to their perceived interests – either to deny influence in the region to an adversary or to establish control over the region’s affairs. We can see this phenomenon in US efforts to cultivate friendly relations with East Asian countries and India to contain China.

4.2.4. EUROPEAN UNION

The EU, as a modern political phenomenon, has evolved out of the social, historical and economic context of the 20th century. It is a result of a process of voluntary economic and political integration among states in Europe. The EU was created by the Maastricht Treaty on 1st November, 1993 as a political and economic union among European countries which makes its own policies concerning the members’ economies, societies, laws and to some extent security.

The historical origin of European Union can be traced back to 1948 when the Organisation for European Economic Co-operation (OEEC) was created to organize the Marshall Plan. In May 1949, the Council of Europe formed to discuss closer co-operation among the European countries. In 1950

Robert Schuman, foreign minister of France proposed that the coal and steel industries of France and West Germany be coordinated under a single supranational authority. France and West Germany were soon joined by four other countries Belgium, Luxembourg, the Netherlands, and Italy as a result of which the European Coal and Steel Community Treaty signed among these six countries forming the European Coal and Steel Community (ECSC) in 1952. The European Economic Community (EEC) and Euratom were established by the Treaty of Rome in 1958. The EEC, working on a large scale to promote the convergence of national economies into a single European economy, soon emerged as the most significant of the three treaty organizations. The Brussels Treaty (1965) provided for the merger of the organizations into what came to be known as the European Community (EC) and later the EU. Under Charles de Gaulle, France vetoed (1963) Britain's initial application for membership in the Common Market, five years after vetoing a British proposal that the Common Market be expanded into a transatlantic free-trade area. In the interim, Britain had engineered the formation (1959) of the European Free Trade Association. In 1973 the EC expanded, as Great Britain, Ireland, and Denmark joined. Greece joined in 1981, and Spain and Portugal in 1986. With German reunification in 1990, the former East Germany also was absorbed into the Community.

The Single European Act (1987) amended the EC's treaties to strengthen the organization's ability to create a single internal market. The Treaty of European Union was signed in Maastricht, the Netherlands in 1992. This treaty provided for a central banking system, a common currency – the Euro – to replace the national currencies, a legal definition of the EU and a framework for expanding the EU's political role, particularly in the area of foreign and security policy. The member countries completed their move toward a single market in 1993 and agreed to participate in a larger common market, the European Economic Area, with most of the European Free Trade Association (EFTA) nations. In 1995, Austria, Finland, and Sweden, all former EFTA members joined the EU.

In 1998, as a prelude to their 1999 adoption of the Euro, 11 EU nations established the European Central Bank. The Euro was introduced into circulation in 2002 by 12 EU countries. As a result of charges of corruption and mismanagement in its executive body, EU formed the European Commission (EC) in 1999. Further, the EU agreed to absorb the functions of the Western European Union, a comparatively dormant European defence alliance, thus moving toward making the EU a military power with defensive and peacekeeping capabilities. In 2003 the EU and ten non-EU European nations – Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary, Slovenia, Cyprus and Malta – signed treaties that resulted in the largest expansion of the EU. In October, 2004, EU countries signed a constitution with a provision requiring a supermajority of countries to pass legislation. The EU nations signed the Lisbon Treaty in 2007. The Treaty reorganized the European Council, established an elected President of the European Council and a single EU foreign policy official, and reformed the EU's system of voting, among other changes. In July, 2013, Croatia joined the EU. At present, EU has 28 member countries.

In brief, it can be argued that EU emerged as a political system through a gradual historical process as a result of the demands of its member countries including the solution of economic problems, maintenance of peace, cooperation and security. The gradual process of economic and political integration has produced a complex allocation of executive, legislative, and judicial policy-making powers at multiple levels of government, including the European level. Simon Hix argues that the EU is the first genuine 'supranational polity' to exist in human history. He states that the EU possesses all the four characteristics of a political system because of the following reasons:-

The level of institutional development and complexity in the EU is far greater than in any other international or regional integration organization. In fact, the EU possesses the most formalized and complex set of decision-making rules of any political system in the world.

A large number of public and private groups, from multinational corporations and global environmental groups to individual citizens are trying to influence the EU policy process continuously.

The policy outcomes of EU are highly significant and are felt throughout the EU. The direct redistributive capacity of the EU is indeed small, since the EU budget is only about one per cent of the total GDP of the EU. However, the single market, European social and environmental regulations, the single currency, justice and interior affairs policies and the myriad of other policy outputs of the EU system have an enormous indirect impact on the allocation of resources and social relationships in European society.

The EU political system is a permanent feature of political life in Europe. The quarterly meetings of the heads of government of the member states in the European Council may be the only feature that many citizens and media outlets notice. Nevertheless, EU politics is a continuous process, within and between the EU institutions in Brussels, between national governments and Brussels, within national public administrations, between private interests and governmental officials in Brussels and at the national level, and between private groups involved in EU affairs at the national and European levels.

4.2.4.1 Objectives of European Union

The Constitutional frame work of the EU in its article-1 to 3 explains the objectives of this entity. The main objectives of the Union are to promote peace, the Union's values and the well-being of its peoples. These general objectives are supplemented by a list of more detailed described as below:-

- an area of freedom, security and justice without internal frontiers;
- an internal market where competition is free and undistorted;
- sustainable development, based on balanced economic growth and price stability, a highly competitive social market economy, aiming at

full employment and social progress, and a high level of protection and improvement of the quality of the environment;

- the promotion of scientific and technological advance;
- the combating of social exclusion and discrimination, and the promotion of social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child;
- the promotion of economic, social and territorial cohesion, and solidarity among Member States.

Apart from this, the EU respects cultural and linguistic diversity and ensures that Europe's cultural heritage is safeguarded and enhanced. Paragraph 4 of article 1-3 is devoted to promotion of EU's values and interests in the rest of the world. This paragraph discusses the objectives of the EU in the context of the common foreign and security policy.

4.2.4.2 The European Union as Single Market

The EU has established a single market across the territory of all its members. Out of 28 member countries, 19 member states have also joined a monetary union known as the Eurozone, which uses the Euro as a single currency. Thus, EU is considered as the most successful common market in the world. Of the top 500 largest corporations measured by revenue, 161 have their headquarters in the EU. This has been achieved by the removal of barriers to trade such as tariffs as well as other economic initiatives such as regulation concerning competition. To a certain extent, the progress towards making a Single European Market over the last fifty years has been similar to the initial economic unification of federal states such as Germany in the 19th Century; standards are established and tolls and tariffs are reduced or removed completely. This creation of standards is similar to Europe today: with the European Union regulating all products produced within each member state to a certain level so as to fully implement the Single Market

initiative. The Single European Market initiative, specifically the Cohesion policy, reflects a federal system further in that it provides financial assistance to the EU's less economically developed states. This distribution of resources reflects a centralized system that is typical of federal political systems. Introduction of a single currency across the majority of countries in the Eurozone highlights further the extent to which economic unity is present in the EU. Hence, this level of economic integration in the absence of the same level of the aforementioned political integration highlights the extent to which the EU is a unique political system.

4.2.4.3 Monetary Union of European Union

The creation of a European single currency became an official objective of the European Economic Community in 1969. In 1992, after having negotiated the structure and procedures of a currency union, the member states signed the Maastricht Treaty and were legally bound to fulfil the agreed-on rules including the convergence criteria if they wanted to join the monetary union. The states wanting to participate had first to join the European Exchange Rate Mechanism. In 1999 the currency union started, first as an accounting currency with eleven member states joining. In 2002, the currency was fully put into place, when euro notes and coins were issued and national currencies began to phase out in the Eurozone, which by then consisted of 12 member states. The Eurozone has since grown to 19 countries, the most recent being Lithuania which joined on 1 January 2015. Denmark, the United Kingdom, and Sweden have not joined the Eurozone. Since its launch the Euro has become the second reserve currency in the world with a quarter of foreign exchanges reserves being in Euro. The Euro and the monetary policies of those who have adopted it in agreement with the EU are under the control of the European Central Bank (ECB).

To prevent the joining states from getting into financial crisis after entering the monetary union, they were obliged in the Maastricht treaty to fulfill important financial obligations and procedures, especially to show

budgetary discipline and a high degree of sustainable economic convergence, as well as to avoid excessive government deficits and limit the government debt to a sustainable level. Some states joined the euro but violated these rules and contracts to an extent that they slid into a debt crisis and had to be financially supported with emergency rescue funds. These states were Greece, Ireland, Portugal, Cyprus and Spain. Even though the Maastricht treaty forbids Eurozone states to assume the debts of other states, various emergency rescue funds had been created by the members to support the debt crisis states to meet their financial obligations and buy time for reforms that those states can gain back their competitiveness.

And for a long time the regional integration project worked very well, as Europe grew steadily more prosperous, peaceful, and free. However, recently, the European Union is experiencing a severe existential crisis with economic decline and political disunity. Despite elite hopes, the sense of political legitimacy that would be needed to manage that interdependence is gradually missing.

There's widespread consensus among economists that Europe's financial woes were mainly caused by mood swings among private investors, who recklessly poured money into southern Europe after the creation of the euro, then abruptly reversed course a decade later. The cost of bank bailouts and much more fell on national governments, so that private-sector overreach soon spilled over into fiscal crisis.

Ideally, Europe would respond to these setbacks by strengthening its union, creating more of the institutions it needs to manage interdependence. But the political will for that kind of move forward seems lacking, even for the most obvious steps. There is a growing realization that the European treaty needs to be revised in order to deal with the structural defects of monetary union, but a clear perspective for the future is missing. In the wake of these crises, support for "euroskeptic" parties has risen, from the right-wing National Front in France to left-wing Podemos in Spain. The rise of ultra-nationalist parties in many other European

countries is creating doubts among the minds of many observers for the very survival of European Union.

4.2.5 ASEAN

ASEAN was founded on 8 August 1967. The founding Member States included Indonesia, Philippines, Malaysia, Singapore and Thailand. The Association was first enlarged after Brunei was admitted on 7 January 1984, after attaining independence from the United Kingdom. That there are no permanent friends or foes in international relations was reaffirmed when Vietnam became an ASEAN member on 28 July 1995, despite a decade of antagonisms. Laos and Myanmar became Member States on 23 July 1997. Cambodia was the last to join on 30 April 1999.

4.2.5.1 Objectives

The ASEAN Declaration states that the aims and purposes of the Association are: (1) to accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian nations, and (2) to promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to the principles of the United Nations Charter. In 1995, the ASEAN Heads of State and Government re-affirmed that “Cooperative peace and shared prosperity shall be the fundamental goals of ASEAN”.

4.2.5.2 Aims and Purposes

As set out in the ASEAN Declaration, the aims and purposes of ASEAN are:

- To accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian Nations;

- To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries of the region and adherence to the principles of the United Nations Charter;
- To promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields;
- To provide assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres;
- To collaborate more effectively for the greater utilisation of their agriculture and industries, the expansion of their trade, including the study of the problems of international commodity trade, the improvement of their transportation and communications facilities and the raising of the living standards of their peoples;
- To promote Southeast Asian studies; and
- To maintain close and beneficial cooperation with existing international and regional organisations with similar aims and purposes, and explore all avenues for even closer cooperation among themselves.

4.2.5.3 Fundamental Principles

The Treaty of Amity and Cooperation (TAC) in Southeast Asia, signed at the First ASEAN Summit on 24 February 1976, declared that in their relations with one another, the High Contracting Parties should be guided by the following fundamental principles:

1. Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations;
2. The right of every State to lead its national existence free from external interference, subversion, or coercion;
3. Non-interference in the internal affairs of one another;

4. Settlement of differences or disputes by peaceful manner;
5. Renunciation of the threat or use of force; and
6. Effective cooperation among themselves.

4.2.5.4 ASEAN Community

The ASEAN Vision 2020, adopted by the ASEAN Leaders on the 30th Anniversary of ASEAN, agreed on a shared vision of ASEAN as a concert of Southeast Asian nations, outward looking, living in peace, stability and prosperity, bonded together in partnership in dynamic development and in a community of caring societies. At the 9th ASEAN Summit in 2003, the ASEAN Leaders resolved that an ASEAN Community shall be established. At the 12th ASEAN Summit in January 2007, the Leaders affirmed their strong commitment to accelerate the establishment of an ASEAN Community by 2015 and signed the Cebu Declaration on the Acceleration of the Establishment of an ASEAN Community by 2015. The ASEAN Community is comprised of three pillars, namely the ASEAN Political-Security Community, ASEAN Economic Community and ASEAN Socio-Cultural Community. Each pillar has its own Blueprint, and, together with the Initiative for ASEAN Integration (IAI) Strategic Framework and IAI Work Plan Phase II (2009-2015), they form the Roadmap for an ASEAN Community 2009-2015.

4.2.5.5 ASEAN Charter

The ASEAN Charter serves as a firm foundation in achieving the ASEAN Community by providing legal status and institutional framework for ASEAN. It also codifies ASEAN norms, rules and values; sets clear targets for ASEAN; and presents accountability and compliance. The ASEAN Charter entered into force on 15 December 2008. A gathering of the ASEAN Foreign Ministers was held at the ASEAN Secretariat in Jakarta to mark this very historic occasion for ASEAN. With the entry into force of the ASEAN Charter, ASEAN will henceforth operate under a new legal framework and establish

a number of new organs to boost its community-building process. In effect, the ASEAN Charter has become a legally binding agreement among the 10 ASEAN Member States.

4.2.5.6 ASEAN Critical Assessment

The Association of Southeast Asian Nations (ASEAN) was formed to achieve regional integration through building a political, economic, and cultural community of Southeast Asian countries. In 1997, the spelt out the “ASEAN Vision 2020” for the establishment of a region that is peaceful and stable, economically integrated, and holds a common cultural identity. Then in 2007, with the adoption of the ASEAN Charter, they declared with heightened confidence that their integration targets can be accelerated earlier, or sooner than 2020 – thus, the much-publicised “ASEAN Community 2015” came into existence.

Despite attaining virtually zero tariffs on trade leading up to the 2015 deadline, overall implementation of integration commitments have been going at a slower pace than required at both the national and regional levels. Thus, in their summit conference in 2013, the region’s leaders floated the idea of a “Post-2015 Vision” and created a high-level task force to carry out a visioning process to write the blueprint for the “ASEAN Community Vision 2025”. It basically reaffirms the long-held vision to realise a region that is “politically cohesive, economically integrated, socially responsible and a truly people-oriented, people-centred and rules-based ASEAN”.

Regionalisation without Democratisation

There has been relative peace and stability among the 10 Southeast Asian neighbouring countries for at least the last 20 years. This phenomenon can be regarded as a “peaceful coexistence among authoritarianisms”, since most ASEAN member countries that are at peace with each other are, in essence, non-democracies. In recent years, Southeast Asia has been a region of non-democratic political regimes, namely: semi-authoritarian governments in Malaysia and Singapore; military rule in Myanmar and Thailand; one-

party states in Cambodia, Laos, and Vietnam; and the monarchical state of Brunei. Even the relatively “more democratic” countries of the Philippines and Indonesia also had decades-long histories of dictatorships and still have some features of authoritarianism in their respective socio-political structures, including the practices of executive dominance and the persistence of human rights violations and abuses. The relative peace in the region has been largely credited to the prevailing norm of “state sovereignty” in the conduct of security relations among nations, specifically observed through the policy of non-interference in a country’s domestic political affairs.

The ASEAN Economic Community (AEC) scheme is aimed at cementing “market sovereignty” through the policy of government non-intervention in the economy while preserving “state sovereignty” of individual ASEAN member countries through the policy of “non-interference” in domestic political and cultural affairs. But since there is practically no clean separation between the political, the economic, and the cultural spheres of social life, what ASEAN’s “convergence club” model of regional integration suggests is that economic neo-liberalism will have to be embedded in a variety of political regimes and cultural orientations in the region. In other words, neo-liberal capitalism can be made to operate even within an authoritarian, or non-democratic, political framework, as well as with different cultural or religious belief systems. This formulation is particularly plausible because the ASEAN community-building project is a process of regionalisation without political-economic democratisation.

The regional integration framework for the ASEAN community delineates the region-wide convergence of 10 member countries on the economic pillar while maintaining a diversity of political and cultural communities. The idea is to create a single economic system of competitive capitalism adapted to distinctive political and cultural structures, forming an open regional bloc integrated into the world market.

National Oligarchies and Regional Integration

National oligarchies – often in alliance with key government decision-makers – carry a lot of clout over public policy-making processes, which may be mobilised to resist liberalisation measures that are deemed to challenge their monopolies or put their businesses at high risk of losing when faced with competition. But these established oligarchies also have “first-mover advantages” on the accumulation opportunities presented by liberalisation and privatisation – either because it would be relatively easy for them to diversify their businesses, or because of their political connections to state apparatuses, which decide, for example, who will be the favoured and winning bidders in the privatisation of government assets, and to whom infrastructure projects associated with liberalisation will be awarded.

Domestic elites have different ways of negotiating and articulating their interests in the process of neo-liberalisation. Such room for manoeuvre has not been completely closed off for local oligarchies, despite the official accession of all 10 ASEAN states to the rules-based World Trade Organization, and the series of free trade agreements signed by the ASEAN bloc with the governments of Australia, China, India, Japan, New Zealand, and South Korea. Corporate elites in first-world Singapore, or in oil-rich Brunei, may have sound rationales for welcoming the opening up of all of the region’s national economies for foreign investments and ownership. Oligarchs in the emerging markets of Indonesia, Malaysia, the Philippines, and Thailand may lobby for continued protection of their industries; or they may opt for selective liberalisation of certain economic sectors. Local political-business elites in the lesser-developed economies of Cambodia, Laos, Myanmar, and Vietnam may assert the strategic need for infant industry protection; or they may find it profitable to form joint ventures with foreign investors at the infant stages of their economic development.

Hence, the future of regionalism in Southeast Asia is open-ended. The contradictions arising from the elitist nature and elite-driven character of ASEAN community-building and regionalisation processes point at the ways

where opposition can be mounted and the reasons why an “alternative regionalism” project “from below” is possible and necessary.

4.2.6 LET US SUM UP

In this lesson an attempt has been made to make you understand the manifestation of regionalism in contemporary international political economy. In the beginning of the lesson some of the important concepts like region, regionalism, regionalisation, regional cooperation, regional organization, regional integration etc, has been explained. The Second section dealt with the historical developments, especially the earlier period, of Regionalisation. The third section throws light on the ‘New Regionalism’ that emerged in the background of contemporary globalization. As you studied, instead of undermining the regional specificities, the globalization is consolidating the regions into various blocs, particularly economic blocs. And in the final two sections you have studied two case studies related to regionalism, the European Union (EU) and Association of Southeast Asian Nations (ASEANS). Apart from understanding their objectives and aims and the consolidation of these blocs towards political and economic integration, you have also understood the crisis faced by these two regional blocs and the factors that are causing this crisis.

4.2.7 EXERCISE

1. How do you understand regionalism?
2. Briefly state the concept of regional cooperation.
3. How do you differentiate ‘new regionalism’ with the earlier regionalism?
4. What are the main objectives of the European Union?
5. Explain Europe as a single market with reference to its monetary union.
6. Do you agree with the proposition that European Union is the single

most example for the regional integration in contemporary international political economy?

7. Briefly explain the objectives, aims and fundamental principles of ASEAN.
8. Analyse the notion of ASEAN community on the basis of the 'charter' it approved.
9. Critically review ASEAN with special reference to prevailing authoritarianism and oligarchies of its member countries.

**4.3 CHANGING IDEAS OF DEVELOPMENT:
DEVELOPMENT, HUMAN DEVELOPMENT
AND SUSTAINABLE DEVELOPMENT**

- V. Nagendra Rao

STRUCTURE

4.2.0 Objectives

4.2.1 Introduction

4.2.2 Changing Ideas of Development: The Background

4.2.3 Development

4.2.4 Human Development

4.2.5 Defining Sustainable Development

4.2.5.1 Sustainable Development: A Synthesis of Perspectives

4.2.6 The Millennium Development Goals (MDGs)

4.2.7 From MGDs to SDGs

4.2.8 Let us Sum up

4.2.9 Exercise

4.3.0 OBJECTIVES

After going through this lesson, you should be able to know:

- Historical outline of the Development and how the ideals of what constitutes development changed over the period;
- How the notion of Human Development progressively contributed to the understanding of Development;
- The meaning of sustainable development and various perspectives centred around the concept;
- What are the Millennium Development Goals and the objectives and targets to be achieved and their progress;

4.3.1 INTRODUCTION

Sustainable development is maintaining a delicate balance between the human need to improve lifestyles and feeling of well-being on one hand, and preserving natural resources and ecosystems, on which we and future generations depend. Sustainable development implies economic growth together with the protection of environmental quality, each reinforcing the other. The essence of this form of development is a stable relationship between human activities and the natural world, which does not diminish the prospects for future generations to enjoy a quality of life at least as good as our own. But the focus of sustainable development is far broader than just the environment. It's also about ensuring a strong, healthy and just society. This means meeting the diverse needs of all people in existing and future communities, promoting personal wellbeing, social cohesion and inclusion, and creating equal opportunity. Many observers believe that participatory democracy, undominated by vested interests, is a prerequisite for achieving sustainable development.

4.3.2 CHANGING IDEALS OF DEVELOPMENT: THE BACKGROUND

Prior to the second half of the twentieth century, the idea of development as we know it today barely existed. The structures of imperial and colonial power which dominated the world in the nineteenth and early twentieth centuries made little provision for economic and social advance in what we now call the developing world. Colonial regions functioned primarily to supply imperial powers with raw materials and cheap labour – including slave labour as late as the mid-nineteenth century.

Within the richer countries of Europe, North America, and Japan, economic growth was of course central to the generally accepted goals of “progress” and “modernization”, but there was relatively little concern for issues of equity and social justice. The desperate poverty and weak or non-existent social safety nets in Europe and the United States during the Great Depression showed how even in these countries, policy was not driven by the needs of the majority of people.

By the end of the Second World War, perceptions and policy had changed drastically. Economic and social improvement for the majority had become a major preoccupation of governments, and with the crumbling of colonial power relations this goal was extended to the poorer nations of the world. Economic development, with its social and institutional correlates, came to occupy an essential place in theory and policy, as well as in the Cold War competition between capitalism and communism.

The economists, other social scientists, and policymakers adopted a framework of thought which was much more ambitious in its scope than previous formulations of political economy. The clear goal of economic development policy was to raise living standards throughout the world, providing steadily more goods and services to an expanding population. The international institutional structures set up after the Second World War, including the International Monetary Fund, the World Bank, and the United Nations, were specifically designed with this goal in mind.

4.3.3 DEVELOPMENT

Development is a broad concept that entails social, economic, political and human development. Human development constitutes the foundation on which the first three concepts are based. According to Burkey, economic and political development must translate into social development. As a broad concept, development has been extensively explored with a view to realise economic growth and social development. However, the emphasis shifted from industrial and economic development as the determining factors in societal transformation. Economic growth may bring material gain to the people, but development is much about enrichment of the lives of all the people in the society. The shift moved from holistic theorisation of development towards local ‘participation’ and ‘empowerment’. The underlying principle of such a phenomenon is the people’s control of the processes. Todaro and Smith also agree with Edwards that if a development strategy results in robust economic growth and political stability without a significant change in the quality of life of the masses of people, something is wrong. High growth performance without people participation is clearly economic growth without development.

This is evident in Brazil, a country that experienced and suffered the consequences of “growth without development”. Its growth performance was the best in Latin America between the 1960s and the 1980s. However, due to its low social spending on health, education, pensions, and other benefits, it remained one of the countries with the highest levels of social inequalities in the world. Numerous development definitions presently focus on the capacity of people to make and implement decisions. Basic human needs form a base for this conception. It is normatively assumed that satisfaction of basic human needs should take precedence over all other development thoughts and efforts. This evolution of development thoughts was promoted by the United Nations since the 1970s and the World Bank became vocal about it in the 1990s.

Many community development theories emphasise people participation in decision-making as being important, particularly in respect of initiation, planning, implementation and evaluation of a development programme. The strategy of “voluntary development sector” evolved from relief and welfare to community development approach and it also suggested, that in future greater attention should be given to development facilitation as people’s movement.

As development policy has evolved, different approaches have been emphasized at different times. The original emphasis was on promoting more productive agriculture and industrialization. In the late 1970’s a focus on basic needs was advocated by Paul Streeten, Mahbub Ul Haq, and others. Education, nutrition, health, sanitation, and employment for the poor were the central components of this approach – reflecting an acknowledgment that the benefits of development did not necessarily “trickle down” to those who needed them most. This perspective inspired the creation of the United Nations Development Programme’s Human Development Index, which uses health and education measures together with Gross Domestic Product (GDP) to calculate an overall index of development success.

4.3.4 HUMAN DEVELOPMENT

The term ‘human development’ may be defined as an expansion of human capabilities, a widening of choices, ‘an enhancement of freedom, and a fulfilment of human rights. At the beginning, the notion of human development incorporates the need for income expansion. However, income growth should consider expansion of human capabilities. Hence development cannot be equated solely to income expansion. Income is not the sum-total of human life. As income growth is essential, so are health, education, physical environment, and freedom. Human development should embrace human rights, socio-eco-politico freedoms. Based on the notion of human development. Human Development Index (HDI) is constructed. It serves as a more humane measure of development than a strictly .income-based benchmark of per capita GNP.

The first UNDP Human Development Report published in 1990 stated that: “The basic objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives.” It also defined human development as “a process of enlarging people’s choices”, “and strengthen human capabilities” in a way which enables them to lead longer, healthier and fuller lives.

From this broad definition of human development, one gets an idea of three critical issues involved in human development interpretation. These are: to lead a long and healthy life, to be educated, and to enjoy a decent standard of living. Barring these three crucial parameters of human development as a process enlarging people’s choices, there are additional choices that include political freedoms, other guaranteed human rights, and various ingredients of self-respect.

One may conclude unhesitantly that the absence of these essential choices debars or blocks many other opportunities that people should have in widening their choices. Human development is thus a process of widening people’s choices as well as raising the level of well-being achieved.

What emerges from the above discussion is that economic growth measured in terms of per capita GNP focuses only on one choice that is income. On the other hand, the notion of human development embraces the widening of all human choices—whether economic, social, cultural or political. One may, however, contest GDP/GNP as a useful measure of development since income growth enables persons in expanding their range of choices.

To understand the dynamics of development, the United Nations Development Programme (UNDP) developed the concept of Human Development Index (HDI) in the 1990s. This index brought in revolutionary changes not only in development, but also in the policy environment in which the government was assigned a major role instead of market forces.

Economic development now refers to expanding capabilities.

According to Amartya Sen, the basic objective of development is ‘the expansion of human capabilities’. The capability of a person reflects the various combinations of ‘doings and beings’ that one can achieve. It then reflects that the people are capable of doing or being. Capability thus describes a person’s freedom to choose between different ways of living.

The noted economist Mahbub-ul Haq considered four essential pillars of human development: Equality, Sustainability, Productivity, and Empowerment.

The challenge of human scale development is to nurture diversity instead of being threatened by it, to develop processes of political and economic decentralisation, to strengthen democratic, indigenous traditions and institutions and to encourage rather than repress emerging social movements which reflect the people’s need for autonomy and space.

Social and Human Development, therefore necessarily requires a unified approach, integrating the economic and social components in plans, policies and programmes for people’s betterment. The challenge is to simultaneously integrate cross sectoral and regional developmental needs as well as to make for a participative development. The issues of environment, pollution, women, habitat, hunger and employment have come to the fore one by one and continue to require public and institutional attention along with resource allocations. Two major contemporary concerns that require focus in any development initiative are that of human security and sustainability.

Though, many countries have made significant advances both in GDP and in Human Development Index measures, but overall, the record of development on a world scale is open to two major criticisms:

- The benefits of development have been distributed unevenly, with income inequalities remaining persistent and sometimes increasing over time. The global numbers of extremely poor and malnourished people have remained high, and in some areas have increased, even as a global middle class has achieved relative affluence.

- There have been major negative impacts of development on the environment and on existing social structures. Many traditional societies have been devastated by development of forests, water systems, and intensive fisheries. Urban areas in developing countries commonly suffer from extreme pollution and inadequate transportation, water, and sewer infrastructure. Environmental damage, if unchecked, may undermine the achievements of development and even lead to collapse of essential ecosystems.

These problems are not minor blemishes on an overall record of success. Rather, they appear to be endemic to development as it has taken place over the past half-century, and to threaten to turn success into failure.

The straightforward view of development as an upward climb, common to all nations but with different countries at different stages, seems inadequate for the twenty-first century. The absolute gaps between rich and poor nations, and between rich and poor groups within individual countries, are widening, not narrowing.

The growing awareness of these challenges to traditional development thinking has led to the increasingly wide acceptance of a new concept – that of sustainable development. Phrases such as development which protects the environment, development which advances social justice have surrounded the introduction of what has been claimed to be a new paradigm. The new formulation has been eagerly adopted both by critics of standard development practice and by leaders of existing development institutions.

4.3.5 DEFINING SUSTAINABLE DEVELOPMENT

When the World Commission on Environment and Development presented their 1987 report, *Our Common Future*, they sought to address the problem of conflicts between environment and development goals by formulating a definition of sustainable development: “Sustainable development is development which meets the needs of the present without compromising the ability of future generations to meet their own needs”.

In the extensive discussion and use of the concept since then, there has generally been a recognition of three aspects of sustainable development:

Economic: An economically sustainable system must be able to produce goods and services on a continuing basis, to maintain manageable levels of government and external debt, and to avoid extreme sectoral imbalances which damage agricultural or industrial production.

Environmental: An environmentally sustainable system must maintain a stable resource base, avoiding over-exploitation of renewable resource systems or environmental sink functions, and depleting non-renewable resources only to the extent that investment is made in adequate substitutes. This includes maintenance of biodiversity, atmospheric stability, and other ecosystem functions not ordinarily classed as economic resources.

Social: A socially sustainable system must achieve distributional equity, adequate provision of social services including health and education, gender equity, and political accountability and participation.

Each of the three areas is commonly referred to as a *system*: economic systems, environmental systems, and social systems each have their own logic. However, it is assumed that the whole cannot function properly and is not viable and sustainable if individual component systems cannot function properly. Sustainable development is possible only if component systems as well as the total system are viable.

4.3.5.1 Sustainable Development: A Synthesis of Perspectives

Let us briefly review some of the main themes developed thus far:

- The original idea of development was based on a straight-line progression from traditional to modern mass-consumption society. Within this framework, a tension developed between the promotion of economic growth and the equitable provision of basic needs.

Development as it has proceeded over the last half-century has remained inequitable, and has had growing negative environmental impacts.

- A concept of sustainable development must remedy social inequities and environmental damage, while maintaining a sound economic base.
- The conservation of natural capital is essential for sustainable economic production and intergenerational equity. Market mechanisms do not operate effectively to conserve natural capital, but tend to deplete and degrade it.
- From an ecological perspective, both population and total resource demand must be limited in scale, and the integrity of ecosystems and diversity of species must be maintained.
- Social equity, the fulfilment of basic health and educational needs, and participatory democracy are crucial elements of development, and are interrelated with environmental sustainability.

Taken together, these principles clearly suggest new guidelines for the development process. They also require a modification of the original goal of economic growth. Economic growth, especially for those who lack essentials, is clearly needed, but must be subject to global limits and should not be the prime objective for countries already at high levels of consumption. As Alan Durning has suggested, a moderate level of consumption, together with strong social institutions and a healthy environment, represents a better ideal than ever-increasing consumption.

In pursuing these modified development goals, it will be necessary to recognize the limits of the market mechanism. During the structural adjustment phase of development policy, the virtues of free markets became an article of faith for policy-makers; this dogma will have to be revised, as the World Bank now acknowledges. While markets may be excellent under some conditions at achieving economic efficiency, they are often counterproductive in terms of sustainability. Guided markets may often be

useful tools for achieving specific environmental goals, and there is an extensive economic literature on “internalizing externalities” so as to reflect environmental costs and benefits in the market. But in a broader perspective, it is the social and institutional processes of setting social and environmental goals and norms which must guide sustainable development policy.

To bring the argument down to earth, and to get a sense of what the principles summarized at the beginning of this section mean for development, we can examine some sectoral specifics. In each major area, it becomes clear that true sustainability means a major shift from existing techniques and organization of production.

Agriculture: The need to feed an expanding population at higher per-capita levels of consumption is straining global soil and water systems. The response to this must be twofold. On the production side, current high-input techniques which are leading to serious soil degradation and water pollution and overdraft must be replaced by organic soil rebuilding, integrated pest management, and efficient irrigation. This in turn implies much greater reliance on local knowledge and participatory input into the development of agricultural techniques.

On the consumption side, both limits on population growth and greater equity and efficiency in food distribution are of central importance given probable resource limitations on production.

Energy: Both supply limits and environmental impacts, in particular the accumulation of greenhouse gases, mean that it will be necessary to accomplish a transition away from fossil fuels well before 2050.⁴¹ A non-fossil energy system would be significantly more decentralized, adapted to local conditions and taking advantage of opportunities for wind, biomass, and off-grid solar power systems. This is unlikely to occur without a major mobilization of capital resources for renewable energy development in countries now rapidly expanding their energy systems.

Industry: As the scale of global industrial production increases several-

fold over current levels, which themselves represent a quadrupling over 1950 levels, it is apparent that “end-of-pipe” pollution control not be adequate. The new concept of “industrial ecology” implies the restructuring of whole industrial sectors based on a goal of reducing emissions and reusing materials at all stages of the production cycle. Corporate reform and “greening” as well as a broad cooperative effort between corporations and government will be needed to achieve goal.

Renewable Resource Systems: World fisheries, forests and water systems are severely over-stressed. With even greater demands on all systems expected in the next century, all levels of institutional management must be urgently reformed. Multilateral agreements and global funding are needed to conserve transboundary resources; national resource management systems must be shifted from goals of exploitation to conservation and sustainable harvesting; and local communities must be strongly involved in resource conservation.

Each of these areas poses challenges which are social and institutional as well as economic. It is clear that the social component of sustainability is not just an idealized goal, but a necessity for achieving the economic and ecological components. Existing institutions of all kinds, including corporations, local and national government, and transnational organizations, will have to adapt to the requirements of sustainable development if all the problems which motivated the development of concept are not to grow worse. Democratic governance, participation, and the satisfaction of basic needs are thus an essential part of a new development synthesis.

4.3.6 THE MILLENNIUM DEVELOPMENT GOALS (MDGS)

At the Millennium Summit in September 2000 the largest gathering of world leaders in history adopted the UN Millennium Declaration, committing their nations to a new global partnership to reduce extreme poverty and setting out a series of time-bound targets, with a deadline of 2015, that have become known as the Millennium Development Goals.

Eight UN Millennium Development Goals and 18 time-bound targets

Goal 1: Eradicate Extreme Poverty and Hunger

Target 1 Reduce by half the proportion of people living on less than a dollar a day

Target 2 Reduce by half the proportion of people who suffer from hunger

Goal 2: Achieve Universal Primary Education

Target 3 Ensure that all boys and girls complete a full course of primary schooling

Goal 3: Promote Gender Equality and Empower Women

Target 4 Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels by 2015

Goal 4: Reduce Child Mortality

Target 5 Reduce by two-thirds the mortality rate among children under five

Goal 5: Improve Maternal Health

Target 6 Reduce by three-quarters the maternal mortality ratio

Goal 6: Combat HIV/AIDS

Target 7 Halt and begin to reverse the spread of HIV/AIDS

Target 8 Halt and begin to reverse the incidence of malaria and other major diseases

Goal 7: Ensure Environmental Sustainability

Target 9 Integrate the principles of sustainable development into country policies and programmes; reverse loss of environmental resources

Target 10 Reduce by half the proportion of people without sustainable access to safe drinking water

Target 11 Achieve significant improvement in the lives of at least 100 million slum dwellers, by 2020

Goal 8: Achieve a Global Partnership for Development

Target 12 Develop further an open trading and financial system that is rule-based, predictable and non-discriminatory, includes a commitment to good governance, development and poverty reduction, nationally and internationally

Target 13 Address the least developed countries' special needs. This includes tariff- and quota-free access for their exports; enhanced debt relief for heavily indebted poor countries; cancellation of official bilateral debt; and more generous official development assistance for countries committed to poverty reduction

Target 14 Address the special needs of landlocked and small island developing states

Target 15 Deal comprehensively with developing countries' debt problems through national and international measures to make debt sustainable in the long term

Target 16 In cooperation with the developing countries, develop decent and productive work for youth

Target 17 In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries

Target 18 In cooperation with the private sector, make available the benefits of new technologies – especially information and communications technologies

The Millennium Development Goals (MDGs) are the world's time-bound and quantified targets for addressing extreme poverty in its many dimensions-income poverty, hunger, disease, lack of adequate shelter, and exclusion-while promoting gender equality, education, and environmental sustainability. They are also basic human rights-the rights of each person on the planet to health, education, shelter, and security.

The MDGs synthesize commitments made separately at various international conferences and summits during the 1990s. They are said to be innovative in that they explicitly recognize interdependence among growth, poverty reduction and sustainable development; they say that development rests on the foundations of democratic governance, the rule of law, respect for human rights and peace and security; they are based on time-bound and

measurable targets accompanied by indicators for monitoring progress; and they bring together, in the eighth Goal, the responsibilities of developing countries with those of developed countries, founded on a global partnership endorsed at an International Conference on Financing for Development in Monterrey, Mexico, in March 2002, and a similar conference held at the Johannesburg World Summit on Sustainable Development in August 2002.

To sum up, essentially the MDGs are just a wish list of goals based in fine ideals, but lacking means of realization – they are supposed to be realized by each national government, in part using funds made available from debt relief, with ‘advocacy, monitoring and advice’ from the UNDP, the World Bank and other international agencies. The trouble with this kind of proclamation is that it makes it look as though something serious is being done about development, when in fact governments are just carrying on as before.

4.3.7 FROM MDGS TO SDGS (SUSTAINABLE DEVELOPMENT GOALS)

2015 has been described as a landmark year for international development with big implications for global co-operation in poverty reduction. It is the European Year for Development and the end point for the Millennium Development Goals (MDGs), the eight targets agreed in 2000 to harness global efforts toward poverty reduction. Towards the end of 2015, world leaders and civil society groups will agree new targets – Sustainable Development Goals (SDGs) – with a similar fifteen year timeframe for achievement. The SDGs are an acknowledgment of the failings of the MDGs with around one billion people still living on less than a \$1.25 a day and more than 800 million people not having enough food to eat. On the plus side, as Ford argues, the MDGs “provided a focal point for governments on which to hinge their policies and overseas aid programmes to end poverty and improve the lives of poor people – as well as provide a rallying point for NGOs to hold them to account”. On the debit side, the goals failed to

adequately address human rights, economic development, environmental sustainability and gender equality.

In the light of failure of MDGs, the post-2015 development framework needs to be more than a ‘measuring rod’ for development by providing the critical awareness necessary to investigate the structural causes of poverty and inequality. Part of this process should involve the international development sector focusing more directly on the pressure points for change in the global North in key areas such as illicit financial flows, debt, unfair trade rules and corporate power. This requires naming and challenging the neoliberal economic model that underpinned the 2008 global financial crisis and has brought the world to the ‘existential crisis’ of climate change. Unless the SDGs challenge these issues head-on with the support of the development sector they are also bound to fail in meeting their targets. Development education can help to create the critical awakening needed to mobilise the public for the achievement of the SDGs.

4.3.8 LET US SUM UP

In September 2001, based upon the Millennium Declaration, the United Nations (UN) presented the Millennium Development Goals (MDGs) as a list of common goals for the world community to achieve by 2015. Since then, remarkable progress has been made towards achieving the MDGs. However, progress across all MDGs has been limited and uneven across countries. An estimated 15.5% of the world population still suffers from hunger, and many countries, particularly on the African continent, are unlikely to meet the targeted two-thirds reduction in child mortality by 2015. A variety of reasons for shortfalls in progress towards the MDGs are discussed in the literature. UN Secretary-General Ban Ki-Moon links the lack of progress to ‘unmet commitments, inadequate resources, lack of focus and accountability, and insufficient interest in sustainable development’. For others, the MDGs cannot be fully met because of how the goals were designed. As a result, towards the end of 2015, world leaders and civil society groups launched a

new set of goals – Sustainable Development Goals (SDGs) – with a similar fifteen year timeframe for achievement. The SDGs are an acknowledgment of the failings of the MDGs and to overcome these failures in the future with specific targets clearly set.

4.3.9 EXERCISE

1. Briefly state the historical background to the notion of development.
2. The concept of Human Development is broader and inclusive. Explain.
3. How do you understand the concept of Sustainable Development?
4. Explain various perspectives of sustainable development.
5. Write a note on Millennium Development Goals.
6. Critically review Millennium Development Goals.

**4.4 EMERGENCE OF GLOBAL SOUTH:
BRICS AND G20**

- V. Nagendra Rao

STRUCTURE

4.2.0 Objectives

4.2.1 Introduction

4.2.2 Emergence of Global South

4.2.3 Emerging Powers in Global South: The Important Actors

4.2.3.1 China: Global Power

4.2.3.2 India: Great Power

4.2.3.3 Brazil: Medium Global Power

4.2.3.4 South Africa: Medium Continental Power

4.3.4 Global South: Institutionalized Cooperation

4.3.4.1 G-20

4.3.4.2 IBSA

4.2.5 Global South: A Critical Review

4.2.6 Let us Sum up

4.2.7 Exercise

4.4.0 OBJECTIVES

After going through this lesson, you will be able to know:

- The emergence of new powers, the Global South, and their role in contemporary international political economy;
- The growing stature of China, India, Brazil and South Africa in global economic and political structure;
- The institutionalized cooperation between major powers of Global South with specific reference to G-20 and BRICS;
- The critique on emerging powers and their relative position in contemporary international political economy;

4.4.1 INTRODUCTION

In comparison with the era of the Cold War, we are now living in a constantly changing world. In recent years a number of emerging nations have been challenging the position of dominance of the old powers, which are dropping down the international pecking order. The traditional international order began to undergo a transformation at the beginning of the 21st century with the rise of new economic powers whose importance is still not reflected in the international political power structure. China has overtaken Japan as the world's second biggest economy, lifting hundreds of millions of people out of poverty in the process. India is reshaping its future with new entrepreneurial creativity and social policy innovation. Brazil is raising its living standards by expanding international relationships and antipoverty programmes that are emulated worldwide. A symptom of this is the debate on 'emerging power' in the study by Goldman & Sachs which coined the term in 2003 and which analyses the economic capacity of the so-called BRIC countries without stressing their military potential and/or political global influence. Beyond economic criteria, in a multi-dimensional international order, the term emerging power requires a wider and more complete definition. An emerging power is, per se, a country which finds itself in a transformation

process from one international position to a higher one: small power to medium power, medium to big, big to global.

The ‘rise of the new powers’ is a much larger phenomenon. Indonesia, Mexico, South Africa, Thailand, Turkey and other developing countries are becoming leading actors on the world stage. The 2013 UNDP’s *Human Development Report* identifies more than 40 developing countries that have done better than expected in human development in recent decades, with their progress accelerating markedly over the past 10 years. Thanks to this rise, South-South trade now accounts for 30 per cent of world merchandise trade, and the exponential growth of the middle class is occurring primarily in Asia. Developing countries today hold more than US\$5 trillion in foreign exchange reserves, which is nearly double the amount held by affluent countries. In 2007, no fewer than 85 developing countries recorded per capita income growth faster than the OECD average of 2.75 per cent. India and China have sustained average growth four times faster than the OECD countries in the present decade. The rise of the new powers can be explained by three factors: proactive developmental states; countries’ abilities to tap global markets; and social policies that emphasise human development values such as public investment in education and healthcare.

Hence, many predict that the international system—as constructed following the Second World War—will be almost unrecognizable by 2025 owing to the rise of emerging powers, a globalizing economy, an historic transfer of relative wealth and economic power from West to East, and the growing influence of nonstate actors. By 2025, the international system will be a global multipolar one with gaps in national power continuing to narrow between developed and developing countries.

In this lesson, you will study how this emergence of new powers in international arena changed the global power configurations and how it is influencing developments in contemporary international political economy.

4.4.2 EMERGENCE OF GLOBAL SOUTH

Since the 1950s, global growth dynamics have changed, with stronger growth in Asian and Latin American economies. The ratio of per capita income of the US to Asia is now close to 5:1, a dramatic reduction from 13:1 witnessed as recently as in 1950. Economic power is, thus, shifting away from the advanced Western industrial economies to the rest of the global economy, especially the fast-growing emerging economies.

The Asian growth miracle, however, became more conspicuous beginning in the 1980s, with the initiation of structural reforms in Asia's two largest economies – China beginning the 1980s and India beginning the 1990s. Both of these economies, in particular China, have now recorded close to 3 decades of high growth: annual real GDP growth during 1980-2014 averaged over 6 per cent for India and almost 10 per cent for China. The 1990s and 2000s also witnessed a phase of high growth with relative macroeconomic stability in the Latin American region, and the larger economies like Brazil attracted interest. Given their large initial economic size, and sustained high growth, the BRICS countries now have a combined weight of 31 per cent in global GDP (PPP basis) – up significantly from only 17 per cent in 1992 – and are hence major players in the global economy. According to the IMF estimates, the share of the BRICS is expected to increase further to 33 per cent by 2020. By 2017, the share of the BRICS will exceed that of the G7. Even in terms of market exchange rates (MER), the share of BRICS in global GDP, at about 21 per cent, is comparable to that of the US at 22 per cent and the European Union at 24 per cent.

As the growth momentum of a number of large emerging economies continued over the 2000s, and as they achieved significant weight in the global economy, the pace of relative change in global economic shares began to accelerate. Thus, the share of emerging economies in global GDP is expected to increase from about 40 per cent in 2000 to over 60 per cent by 2020 in PPP terms and from 20 to 40 per cent in MER terms. Similarly, the share of G7 countries in global GDP (PPP) is expected to fall from about 44 per cent in

2000 to about 30 per cent by 2020, with a corresponding increase in the share of BRICS from 19 per cent in 2000 to 33 per cent in 2020.

This very rapid change in economic power between the G7 on the one hand, and the BRICS on the other, over just a span of 20 years is dramatic. It is reversing the economic hegemony enjoyed by Europe and North America for over 200 years and can hence be regarded as the beginning of an epochal change. It is no wonder then, that given the relative growth dynamics over the past 2-3 decades and the projected trajectories, there is a demand for better representation of the emerging economies in the global economy and in the major global economic institutions like the IMF and the World Bank.

Growth projections for Brazil, Russia, India, and China (the BRICs) indicate they will collectively match the original G-7's share of global GDP by 2040-2050. China is poised to have more impact on the world over the next 20 years than any other country. If current trends persist, by 2025 China will have the world's second largest economy and will be a leading military power. It also could be the largest importer of natural resources and the biggest polluter. India probably will continue to enjoy relatively rapid economic growth and will strive for a multipolar world in which New Delhi is one of the poles.

Asia's economic powerhouses—China and India—are restoring the positions they held two centuries ago. China and India, for the first time since the 18th century, are set to be the largest contributors to worldwide economic growth. These two countries will likely surpass the GDP of all other economies except the US and Japan by 2025, but they will continue to lag in per capita income for decades. The years around 2025 will be characterized by the “dual identity” of these Asian giants: powerful, but many individual Chinese or Indians feeling relatively poor compared to Westerners. Growth projections for Brazil, Russia, India, and China have them collectively matching the original G-7's share of global GDP by 2040-2050. According to these same projections, the eight largest economies in 2025 will be, in descending order: the US, China, India, Japan, Germany, the UK, and France, and Russia.

A generation of globally competitive companies is emerging from the new powers, helping to further solidify their position in the global marketplace; from Brazil in agribusiness and offshore energy exploration; Russia in energy and metals; India in IT services, pharmaceuticals, and auto parts; and China in steel, home appliances, and telecommunications equipment. Of the top 100 new global corporate leaders from the non-OECD world listed in a 2006 report from The Boston Consulting Group, 84 were headquartered in Brazil, Russia, China and India.

China and India are expected in 10 years to achieve near parity with the US in two different areas: scientific and human capital (India) and government receptivity to business innovation (China). Companies in China, India, and other major developing countries have unique opportunities to be the first to develop a host of emerging technologies. This is especially the case in those instances where companies are building new infrastructure and not burdened by historical patterns of development. Such opportunities include distributed electrical power generation, development of clean water sources, and the next generation of Internet and new information technologies (such as ubiquitous computing and the Internet of Things—see the foldout). Early and significant adoption of these technologies could provide considerable economic advantage.

4.4.3 EMERGING POWERS IN SOUTH: THE IMPORTANT ACTORS

Of the many emerging powers, four are gaining attention all over the world: the two Asian powers of China and India, one Latin American power, the Brazil and one from the Africa, South Africa. Though many club Russia also along with these powers, considering the fact that it was major power for centuries with a largest empire, it cannot be bracketed with these emerging powers from developing world or ‘Global South’. They have not only raising individually but also making efforts to grow together collectively by making efforts to coordinate their policies at global level whether at WTO, Climate

Change negotiations or IMF and World Bank reforms. Apart from this, they are also creating new institutions to fasten the development of theirs and other developing countries. The following sections will elaborate on these issues.

4.4.3.1 China: Global Power

China is an emerging global power and probably a superpower of the future. In fact, it is already the USA's main economic and political rival. With 1.35 billion people, its population is more than four times that of the USA, and, according to some studies, in less than twenty years time, China could be the world's number one economy. More than a country, its dimensions are that of a state-region. On a global scale, China's population amounts to one fifth of the entire world's, its landmass is second only to Russia's, and in 2007 it substituted Japan as the world's second economic power. Moreover, China is the second global military power in terms of budget and troop numbers.

Since 1978, China has been gradually adapting to the market economy, within the political constraints of the socialist system or one-party state. The result of its economic opening up was spectacular: between 1978 and 2007, China increased its GDP fivefold and registered an average growth rate of 10 per cent, the highest rate in the world. Apart from a huge modernization project and the creation of infrastructure, its economic success is based above all on an industrial base which accounts for more than half its GDP, the export of manufactured goods (mainly textiles and electronic goods), foreign investment (Asian parent companies) and low wages compared to traditional industrialised countries.

China presents itself to the world above all as a trading power. Its main partners are the EU (principally Germany), the USA, Japan, Singapore, South Korea and Russia. These are not asymmetrical relations but mutual dependencies, given that China is also Japan's main trading partner, the second biggest trading partner of the USA, the EU and India, and Brazil's third.

Although it maintains cordial and proper relations with its trading partners, China doesn't have powerful strategic allies in the world and, due to its political regime and continental dimension, has deliberately opted to follow a solitary path, of peaceful co-existence.

China's growth has been impressive compared to the rest of the world, but lost in the admiration is the fact that the growth rate has slowed down to around seven per cent—down more than four percentage points due to recession and financial crisis in the world economy. Thus, in the recent period China has been using a lot more investment in order to grow significantly more slowly than in the past.

China's response to this changing growth dynamic is partly external and partly internal. On the external side, it is no coincidence that this period of excess capacity at home is the moment at which China launched expensive new initiatives, such as the Asian Infrastructure Investment Bank (AIIB), the BRICS Bank, and the 'One Belt, One Road' initiative in order to strengthen infrastructure both on the westward land route from China through Central Asia and on the southerly maritime routes from China through Southeast Asia and on to South Asia, Africa, and Europe.

The domestic response to China's over-capacity problem is a set of reforms that emerged from the Third Party Plenum in November 2013. Together, these form a coherent set of measures that would rein in wasteful investment, increase innovation and productivity growth, and enhance consumption.

China's rise is so serious that it has been seen in many quarters as a setback for the United States. The U.S. government contributed to this narrative through its efforts to discourage allies from joining the new AIIB. In the end, major American allies, such as the United Kingdom, Australia, and South Korea, did join the Chinese initiative, and Japan is seriously considering becoming a member.

In short, China is the world's most important rising power. In two

decades, China has moved from the periphery to the centre of the international system. Every day and everywhere, China figures prominently in global attention. Wherever one turns, China is in the news – gobbling up resources, soaking up investment, expanding its overseas footprint, asserting itself in its Asian neighbourhood, being the sought-after suitor in global governance diplomacy, sailing its navy into new waters, broadening its global media exposure and cultural presence, and managing a mega-economy that is the engine of global growth. China’s global impact is increasingly felt on every continent, in most international institutions, and on many global issues.

4.4.3.2 India: Great Power

India is China’s main competitor in Asia and an emerging power on a global scale. Unlike China, the West perceives India first and foremost as a nuclear power rather than an economic player and, at the same time, as a bulwark for democracy in Asia, though this perception is changing and India is also considered as one of the fastest growing economies with its impressive growth rates despite the global economic recession. In 2007, India became the world’s third largest economy, ahead of Germany and Japan, and behind the whole of the EU block. By reaching this status, the predictions that India would overtake Germany’s GDP around the year 2020 and would be competing a few years later with China and the USA were realised a decade earlier than anticipated.

China and India together are the principal military force in the world, contribute 21 per cent of the world’s GDP and account for 40 per cent of the world’s population. The relationship between the two countries swings between competition and cooperation. On the one hand, they represent different political models and compete for leadership in Asia and the world. On the other, China is India’s second biggest trading partner and, since 2005, both countries have maintained a bilateral political dialogue, committing themselves to creating a strategic association based on the five co-existence principles jointly defined in 1954.

Today the Indian economy is growing spectacularly: an average of eight per cent in the last five years, close to that of China. But it is also different to China, experiencing growth without employment, because the services industry – which includes communication and computing technologies – the main economic pillar of the Indian economy and responsible for 55 per cent of its GDP – is not labour intensive. Although it accounts for less than 20 per cent of the GDP, 60 per cent of India's labour force is still concentrated in agriculture, mostly in the rural areas which are the worst affected by the poverty.

India's extra-regional relations during the Cold War were centred on close co-operation with the Soviet Union and participation in the Non-Aligned Movement (NAM). The end of a bi-polar world has meant a substantial reorientation of its foreign policy towards the USA which today is a main strategic ally in Asia. A sign of this was the signing in 2005 of the Civil-Nuclear Agreement between India and the USA which, from Washington's point of view, went some way to promoting India in Asia as a political and cultural counterweight to China. On the other hand, the summit which China and India held in January 2008 and the bilateral commitment to advance their association shows that India is trying to counterbalance its relationship with the USA by securing closer ties with its powerful neighbour.

The EU, Russia and Japan make up the second circle of Indian foreign and economic policy. And further in the distance comes India's cooperation with Brazil and South Africa. These three countries formed IBSA in 2003, a forum for dialogue to promote three-way co-operation and increase the influence of the three emerging powers within the World Trade Organization (WTO) and the United Nations. Unlike other initiatives from the South, IBSA is based on shared values: the trinity of democracy, development and peace.

Compared with China, India has two great soft power resources: its democratic model and its control of the English language which aids the diffusion of its culture and its international influence. From the Western point of view, India's great advantage lies in its sixty years of uninterrupted

democracy in a country with numerous ethnic groups and religions, something which can be seen as a significant achievement in a highly diversified and divided society of different ethnic groups, castes, languages, cultures and religions. Seen in this light, India serves as an example that democracy is possible even in the most adverse circumstances and in spite of enormous inequalities and differences which persist.

Whilst China has chosen a solitary path without international allies, India has become the USA's main international partner. It shares the USA and the EU's commitment to democracy, has cultural affinities through the English language, and a relatively open market economy. Its newfound cooperation with the USA and its strategic alliance with the EU reflect a certain recognition of India's growing international role.

4.4.3.3 Brazil: Medium Global Power

On account of its landmass, population and GDP, Brazil makes up the third great emerging power. In quantitative terms (population, territory, GDP and military force) Brazil is the main regional power in Latin America. It is different to India and China in not having a nuclear arsenal, and in its more modest growth rate, it has emerged on the global scene through the channels of diplomacy and international negotiation.

In the last five years, Brazil has profiled itself as a creator of international agendas and ground rules, mainly at the heart of the WTO and the United Nations. Along with India, the EU and the USA, Brazil belongs to the main negotiating core of the WTO's Development Round. It aspires, as does India, to obtain a permanent seat on the UN Security Council and has made different proposals (amongst others to fight world hunger) in the framework of the United Nations.

More than India, Brazil acts as a spokesperson for the interests of the South vis-a-vis the North and as a promoter of South-South alliances. Whilst India can consider itself an emerging global power on account of its population, Brazil sees itself as a medium sized power, not so much because

of its size but – following the example set by Canada – because of the role it plays as an international and regional mediator. Striking examples of its capacity to define consensus and strategic alliances are the creation of the G20 in the framework of the WTO, the ISBA forum for dialogue and its participation in the G4 (also made up by Germany, Japan and India) to press their claim to be included as permanent members of the Security Council.

In a similar way to India, Brazil is another example that demonstrates that “multicultural democracy” can co-exist with great inequality, high poverty levels, and violence. But unlike India, Brazil suffers no regional or international conflict. Indeed it has, under the Lula government, assumed a greater role of responsibility as mediator between neighbouring countries (Bolivia, Ecuador, Peru, Venezuela) and since 2004 holds the military command of the United Nations mission in Haiti (MINUSTAH). Its international and regional integration comes in the form of cooperation and integration (in the framework of Mercosur and Latin America), although the ultimate objective of Brazilian diplomacy is to influence the international agenda.

4.4.3.4 SOUTH AFRICA: MEDIUM CONTINENTAL POWER

Conscious of its limitations in terms of size and resources, South Africa does not aim to become a global power or to belong to the BRIC group but instead is perceived as a geographical medium sized power, politically centred in Africa. Even so, in the African continent, South Africa is the only player with a certain level of influence on the international stage and enjoys a notable influence in resolving regional conflicts. As a consolidated democratic market economy, post-Apartheid South Africa can consider itself an anchor of stability in Africa, a priority that, at the same time, is where its foreign policy is directed.

It’s worth remembering that in terms of GDP and military force, South Africa is a regional power. But because of its negative historical inheritance, South Africa eschews hegemonic aspirations in Africa and expresses its

regional policy above all through multilateral organisms, principally the African Union and other regional forums. In this way, South Africa has become one of the main promoters of regional integration and is the principal architect of NEPAD (New Partnership for Africa's Development) which was born in the context of the African renaissance and has the backing of the G8.

In this multilateral framework, South Africa has begun, since the end of Apartheid in 1994, to assume the role of Africa's international spokesperson, one example amongst others being its recent election to a non-permanent seat on the UN Security Council. Under the government of President Thabo Mbeki, South Africa also has begun to exercise an active role in the resolution of various conflicts in its own backyard. Its principle tool of power being mediation and negotiation, South Africa can be considered a medium sized power and an important pacifying force in the region.

Just like Brazil and India, South Africa is also faced with numerous internal problems, the principal one being the HIV/AIDS epidemic which affects one in five South Africans and which has reduced life expectancy in the country to 54 years. In the context of these internal limitations, South Africa is not a great power, nor does it aim to be, but the fact that it is the main economic and military power of Sub-Saharan Africa grants it a leadership role inside and outside the continent. Taking into account the fact that Africa is home to the highest number of fragile states (although not of the greatest international risk), South Africa is an important anchor of stability and as such an emerging power on the international stage.

4.4.4 GLOBAL SOUTH: INSTITUTIONALIZED COOPERATION

The emergence of new powers has been recognized widely by the international community and started responding in various ways to accommodate these powers. One serious proposal is to change the quotas in IMF and World Bank to accommodate changing realities and provide more voice to these new powers. Similarly, the developed world, particularly the

US, EU and Japan, has also recognised the importance of coordination with these new powers to resolve global powers. This resulted in the establishment of G-20 groups which is becoming the major economic powerhouse, gradually replacing the G-7 which was dominated throughout the Cold War period. Apart from this the emerging powers are coordinating their policies and efforts to protect the interests of the global south in various platforms such as WTO and climate change negotiations. Most recently, the emerging powers created new institutions to channelling their energies to alter the rules of global political economy; the BRICS and IBSA are a few examples for this.

4.4.4.1 G-20

G-20 is the best example to understand how the global power dynamics have changed with the emergence of new powers. The G20 has its origins as a forum for finance ministers in the late 1990s in response to the instability in the global financial system. The role of the G20 has continued to grow and formally replaced the G8 as the preeminent site for executive level deliberation in 2009. The G20 has been formally assigned duties for the management of the global economy, although there are those who would like to see it venture into other issues, such as international security.

The G20 includes 19 countries and the European Union (EU). The creation of the G20 was announced by the finance ministers of the 'Group of Seven' (or Eight, if Russia is included, so also called G8) leading industrial nations in Washington on 25 September 1999. The nineteen countries are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States. As earlier stated, the European Union was also included.

George W. Bush, the former U.S. President, hosted the first ever meeting of G20 leaders, creating the summit in Washington on 14-15 November 2008 to coordinate a global response to the recession. The US felt that the time had surely come to hear out leaders of 'emerging' nations or in

some cases “re-emerging” ones, as many nations including India, Turkey, Mexico, Brazil and Saudi Arabia would be heirs to great civilizational heritage.

Communiqué issued at the end of the Rio+ Summit, Los Cabos (Mexico), June 20, 2012 reflects the stand of these emerging powers on issues like Climate Change, Food Security, IMF Reforms, Removal of Poverty, Growth, Generation of Employment, and Un-earthling of Black Money etc. All these points were on the agenda of G-20 Summit that took place in Los Cabos, Mexico. G-20 resolved to promote growth and jobs. They committed to act together to strengthen recovery and address financial market tensions. For low income countries, G-20 intensifies its efforts to create a more conducive environment for development, including supporting infrastructure investment. It is supporting economic stabilization and the global recovery. Strong, sustainable and balanced growth remained the top priority of the G20.

Several landmark reforms of International Financial Institutions were initiated at the behest of the G20 which heightened the expectation for bringing about fundamental changes in the functioning of the global institutions and in the global governance structure. Select mid-level emerging countries have been encouraging the major emerging countries to work within the G20 process, to gradually reshape the system of global economic governance from the inside. The goal of these states is advancing a reform “from the inside” agenda, of moving the world from a US/G7-centered system to one in which the emerging countries have more say in reform proposals, e.g. the proposal of reform in the lending norms of the international financial institutions floated by Indonesia, advocacy for, and implementing, institutional changes that further broaden the number of states that are actually consulted in global summitry, taken up by South Korea and South Africa etc.

4.4.4.2 BRICS

The BRICS, a bloc comprising Brazil, Russia, India, China, and South Africa, has in its short existence rapidly expanded its diplomatic activities,

advocated a larger voice in global economic and security forums for its members, and created brand new financial institutions. The member countries share a desire for the world to accord them a larger role.

The conversion of the “BRICs” from an idea, originally coined in two early-2000s Goldman Sachs papers, into an institution began with the meeting of the then leaders of China, India, and Russia (Hu Jintao, Manmohan Singh, and Vladimir Putin) on the margins of the 2008 Group of 8 (G8) meeting in St. Petersburg. The following year, the first summit of “BRICs” countries, excluding South Africa, took place in Russia. In 2010, at a foreign ministers’ meeting, the initial four agreed to invite the African nation; by its 2011 summit, the five-country organization—with the “S” now standing for South Africa—acquired its present shape.

The growing economic might of BRICS countries, their significance as one of the main driving forces of global economic development, their substantial population and abundant natural resources form the foundation of their influence on the international scene. In 2013, BRICS accounted for about 27 percent of the global GDP (in terms of the purchasing power parity of their national currencies). The total BRICS population is 2.88 billion (42 percent of the entire global population), and the five countries cover 26 percent of the planet’s land. The Table below shows the economic status of the each of the BRICS members in 2016.

GDP of BRICS (US Dollar in billions)

Worldwide Rank	Country	GDP (2016)
2	China	11,218
7	India	2,256
9	Brazil	1,799
12	Russia	1,281
33	South Africa	294

Functioning of the BRICS

In the early days, at least if assessed by their joint statements issued at summits, the BRICS focused on highlighting the need for emerging powers to have a greater voice in global governance.

In the wake of the global financial crisis, the 2009 joint statement contained strong declarations on the importance of coordinating financial policy through the G20. But it also made several specific points about the need to reform international financial institutions to create “greater voice and representation” for emerging economies, including a more transparent process for leadership selection. These statements also addressed the longstanding traditions in which the World Bank’s president has been an American, the IMF’s Managing Director a European, and the developed Western economies have had the most weight in the voting and quota shares.

The third summit’s joint statement (2011) included the phrase that “China and Russia reiterate the importance they attach to the status of India, Brazil, and South Africa in international affairs, and understand their aspiration to play a greater role in the UN.” That said, neither China nor Russia appear to have actually done much to help their BRICS compatriots join them as permanent members of the Security Council. By the fourth summit, held in New Delhi in 2012, the collective arrived at the phrase that echoes in many subsequent communications: the BRICS represents “43 percent of the world’s population,” signalling clearly their concern for more representation in global institutions.

With each passing year, the BRICS diplomatic calendar has expanded, with a host of interactions to both coordinate policy positions as well as expand official and people-to-people dialogue, generally on non-contentious topics. What began with summit-level gatherings and, separately, meetings of foreign ministers, now includes meetings during the year for finance ministers and central bank governors, national security advisors, science and technology ministers, agriculture ministers, environment ministers, disaster response authorities, health ministers, labor ministers, a Business Council, a Think

Tanks Council, a Parliamentary Forum, a Culture Festival, and a “Friendship Cities and Local Governments Cooperation Forum.” In turn, the joint statements have ballooned to reflect all this activity: last year’s ran twenty-seven pages, and in 2015, a bloated forty-three.

New Development Bank

The five countries have rapidly used the BRICS format to signal to the world that the old twentieth-century institutions have to change. And in 2012, they took that signal from word to action. Of all the BRICS’s collective efforts, the creation of its own modestly named “New Development Bank”, along with a Contingent Reserves Arrangement, is the most significant. These institutions represent the organization’s pivot to action after long-pending IMF and World Bank reforms failed to materialize between 2010 and 2015. Much has been written about the creation of the China-led Asian Infrastructure Investment Bank—perhaps because it has signed up more members, or perhaps simply because the “China rising” storyline garners more eyeballs. But the NDB emerged from the same impulse for representation and voice, in this case in the operations of development finance.

Today, the NDB is fully operational. Each of the five countries has contributed an equal share of the \$50 billion initially subscribed capital, and each has an equal voice. The bank’s headquarters are in Shanghai; its first president is K.V. Kamath, a former CEO of India’s ICICI Bank; and the governance structure emphasizes equal and rotating representation. In April 2017, just under five years after the idea of the NDB came out of the Delhi summit, the bank signed its first development loan agreement in Brazil.

The \$100 billion Contingent Reserve Arrangement, agreed to at the 2014 summit in Brazil, provides emergency lending in the case of a liquidity crisis. It, too, was created specifically as an institutional alternative to the IMF, as the Indian government’s press statement about its founding explicitly noted.

India-China Tensions Strain BRICS Unity

Differences between China and India underline that not much binds the five members except that they are large and non-Western. It's hard, thus, for the BRICS to maintain a unified agenda beyond noncontroversial subjects when two of the organization's five members have a history of conflict that still flares occasionally into the outrightly adversarial. At times New Delhi and Beijing have made common cause to advocate for global governance reform—as they have done with the BRICS—but this too has its limits. To this day, China remains the sole P5 member to not explicitly endorse India's bid for UN Security Council permanent membership.

To sum up, “BRICS” as a shorthand nicely encapsulates the rise of emerging markets around the world. But it's less clear whether this grouping also provides durable common interests for a multilateral organization, especially given the vast economic differences among the five. China and Russia, of course, enjoy two of the five permanent seats on the UN Security Council (P5), so they already participate in global security governance in a qualitatively different manner than their BRICS peers. Additionally, the pair—particularly China under Xi Jinping, and Vladimir Putin's Russia—represent authoritarian systems of government, not democracies. For this reason, India, Brazil, and South Africa have their own separate trilateral consultation known as the “IBSA Dialogue Forum.”

The new bank is being described as a challenge to the IMF and the World Bank, that is, a challenge to American global financial power.

4.4.5 GLOBAL SOUTH: A CRITICAL REVIEW

Though many recognised the emergence of new powers from developing countries and how the global power structure is getting altered with the rise of the Global South, still many are sceptical about revolutionary changes to existing global order. According them, one needs much more nuanced approach to assess the consequences of rising new powers in contemporary international political economy.

Achin Vanaik, raises the following questions measure this rise of new powers. Does the selective rise of some countries means that the weight and power of the South as a whole will rise up? That is to say, are these Emerging Powers going to take the lead in altering existing patterns of global governance in way that will benefit all the Southern countries and their populations? Or will such selective elevation of some nations lead primarily to greater social and class differentiations within the major countries of the South and to a greater distance between them and the rest of the developing countries? If so, will this not mean a 'North' emerging within the South? Will the new 'North' of various elite dominated regimes somehow be able to work together against the older North to shift power relations significantly toward itself? Or will it individual country components be more preoccupied with prioritising their relations with the power centres of the North and with the existing governing institutions that serves their interests, than with forging ever closer relations with each other?

The answers to the above questions do not indicate any drastic changes to existing power structure of international political economy. For many scholars, the rise of new powers has created a new economic order but this has still not led to a new political order. None of the four countries amounts to a risk either for regional or world stability. China, India, Brazil and South Africa, far from questioning the international order, actively take part in it and are clamouring for greater participation. However, and accepting the existing ground rules, they are quite rightly demanding a fairer distribution of power reflecting a multi-polar world and their rising position in the international pecking order.

Rather than being a 'web' of multipolar powers, this new world order will rather be a 'hub-and-spokes' arrangement, with the US at the centre and joined by separate spokes to all other powers including the other members of the quintet. It is noticeable already that, despite the efforts of the major powers on the circumference to move towards each other and to form different groupings excluding the US, they all continue to give priority to their bilateral

relationship with the US unless the latter forces by its own behaviour (e.g. with respect to Russia over the issue of Ukraine) any of them to break from this informal quintet. This is an arrangement from which the US benefits greatly and will seek to sustain for as long as possible.

Many see the rise of G20 with scepticism. Despite broadening of the elite group G-8 to include emerging economies, the exclusivity of the G20 is questioned by some as it permanently excludes 173 countries. With no representation of low income economies and significant under representation of Africa (South Africa is the only African member country), the representational legitimacy is also questioned. Allegations of ‘plurilateralism of the big’, by which the vast majority of nations lose voice and influence on matters that affect them crucially, is also levelled against the group along with the charges of undermining the existing system of multilateral cooperation in institutions such as IMF, the World Bank and the UN.

According to these critics, one should not over-estimate the strength of the emerging powers in the midst of a Western economic crisis. Any change in the balance of power must be judged in relative terms before assessing its potential impact on the international order. And each emerging power faces its own major domestic challenges even as their collective economic gravitational pull is strengthening. Hence, there should be no illusions that emerging powers of the South behaving as they currently do can provide the desired source of resistance to global economic structure that is dominated by the developed countries. BRICS, IBSA, are groupings that aim to create more favoured positions for their member countries in the existing institutions of global governance such as the WB/IMF/WTO and the UNSC. Nevertheless, should the authority of the US be seriously weakened, this would create conditions in which Southern powers would see much greater virtue in cooperating more with each other and in exploring alternative economic arrangements of a more progressive kind.

4.4.6 LET US SUM UP

There is a widespread perception that power is shifting in global politics and that emerging powers are assuming a more prominent, active and important role. On this account the global system is increasingly characterized by a diffusion of power, to countries including emerging and regional powers; by a diffusion of preferences, with many more voices demanding to be heard both globally and within states as a result of globalization and democratization; and by a diffusion of ideas and values, with a reopening of the big questions of social, economic and political organization that were supposedly resolved with the end of the Cold War and the liberal ascendancy. There is a strong argument that we are witnessing the most powerful set of challenges yet to the global order that the United States sought to construct within its own camp during the Cold War and to globalize in the post-Cold War period. Many of these challenges also raise questions about the longer-term position of the Anglo-American and European global order that rose to dominance in the middle of the nineteenth century and around which so many conceptions and practices of power-political order, of the international legal system and of global economic governance have since been constructed.

Due to the emergence of the new powers from Global South, long-standing distinction between advanced and developing countries, particularly for rising economic powers, was blurring. The advanced countries were still the richest countries in terms of per capita income, but their economies were no longer the largest, the fastest-growing, or the most dynamic. Rising economic powers were exerting greater influence in global trade and financial policies and in the multilateral institutions that have underpinned the global economy since World War II. Although the growing participation of these new powers in global government will modify some aspects of the established order, it seems unlikely that these emerging powers will question the established political and economic model. None of the four powers project themselves to the world through ideological influence or by offering

alternative development models. Seen in this light, they are conservative emerging powers.

4.4.7 EXERCISE

1. How economic power is shifting away from the advanced Western industrial economies to the emerging economies in contemporary international political economy.
2. Write a note emerging powers, China, India, Brazil and South Africa.
3. Analyse the institutional cooperation of emerging powers with specific reference to G-20, IBSA and BRICS.
4. Do you agree with view that the elite emerging powers in reality undermining the interests of the vast number of underdeveloped countries.
5. Critically review the impact of emerging powers with regard to global economic and power structure.
6. The emerging powers are conservative powers. How far you agree with this?

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