INR481

NATIONAL OPEN UNIVERSITY OF NIGERIA

FACULTY OF SOCIAL SCIENCES

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3 CREDIT UNITS

COURSE TITLE: INTERNATIONAL ECONOMIC RELATIONS

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COURSE DESCRIPTION

INR481: International Economic Relations (3 Credit Units)

This course examines the nature of the International economic relations. The character of international economic order since 1945, the dominant states in the global economy, global economic order since the establishment of The Bretton Woods institutions, theories of international trade, World trade dilemmas, GATT, UNCTAAD, WTO, IMF etc Politics of foreign aid, and the relationship between donors and recipient's Economic sanctions and International Enforcements. Given this scenario, this course will examine in the first module pre-World War 2 economic management, the economic Alliances or otherwise that characterized the cold war era, the advent of the new states into the international economic system, transnational corporations and contemporary economic management.

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INTRODUCTION

INR481: International Economic Relations is a one semester course in the final year of B.sc (Hons.) degree in International and Diplomatic Studies. It is a three-unit credit course designed to enable you have a bird's eye view of the salient issues in international economic relations. This is especially in the face of increasing economic competition in the international system. The course begins with a brief introductory module, which will help you to have a good understanding of the issues at stake in the international economic system. Such issues include; Nexus between Economics and politics; Contending Perspectives on international economic relations; International Economic Management before World War II, International Economic Management since World War II; Contemporary international Economic Management. The study units are structured into modules. Each module is structured into 5 units. A unit guide comprises of instructional material. It gives you a brief of the course content, course guidelines and suggestions and steps to take while studying. You can also find self-assessment exercises for your study.

COURSE AIMS AND OBJECTIVES

The primary aim of this course is to provide students of international relations with a comprehensive knowledge of International Economic Relations. However, the course specific objectives include enabling you:

i. have a working knowledge of international Economic Relations by understanding some of the commonplace but nonetheless important organizations like transnational or multinationals, foreign aid and debt burden.;
ii. familiarize with institutional framework such as mercantilism or liberalism or capitalism;
iii. have understanding on the cross-current issues between politics and economics

The specific objectives of each study unit can be found at the beginning and you can make references to it while studying. It is necessary and helpful for you to check at the end of the unit, if your progress is consistent with the stated objectives and if you can conveniently answer the self-assessment exercises. The overall objectives of the course will be achieved, if you diligently study and complete all the units in this course.

WORKING THROUGH THE COURSE

It is advised that you carefully work through the course studying each unit in a bid to understanding the concepts and principles in international law and how the discipline evolved and has continued to develop. Knowing the theoretical debates to this study will also be very useful in having a good grasp of the course. Your questions should be noted regularly and asked at the tutorial classes. It is recommended that students also engage new ideas generated from unfolding events around the world

that International Law principles can be applied to and romance these ideas among one another and the tutorial masters.

At the end of the course, you will be expected to write a final examination.

THE COURSE MATERIAL

In this course, as in all other courses, the major components you will find are as follows:
1. Course Guide
2. Study Units
3. Textbooks
4. Assignments

STUDY UNITS

There are 25 study units in this course. They are:

MODULE 1: International Economic System at a Glance

Unit 1 Nexus between Economics and politics
Unit 2 Contending Perspectives on International Economic Relations
Unit 3 International Economic Management before World War 2
Unit 4 International Economic Management since World War 2
Unit 5 Contemporary International Economic Management

MODULE 2: The Major Strands in the Management of International Relations

Unit 1 The Western System
Unit 2 The North-South System
Unit 3 The East-West System
Unit 4 The South-South System

MODULE 3: Understanding the Role of IGOs and Transnational Corporations in the International Economic System

Unit 1 World Bank
Unit 2 International Monetary Fund
Unit 3 United Nations Conference on Trade and Development
Unit 4 World Trade Organisation
Unit 5 Transnational Corporations in International Economic Relations

MODULE 4: Developmental Issues in the International System

Unit 1 What is foreign Aid?
Unit 2 Politics of foreign Aid
Unit 3 Problems of foreign Aid
Unit 4 Debt and Development
Unit 5 Africa’s Debt crisis

As you can observe, the course begins with the basics and expands into a more elaborate, complex and detailed form. All you need to do is to follow the instructions as provided in each unit. In addition, some self-assessment exercises have been provided with which you can test your progress with the text and determine if your study is fulfilling the stated objectives. Tutor marked assignments have also been provided to aid your study. All these will assist you to be able to fully grasp knowledge of International Economic Relations.

TEXTBOOKS AND REFERENCES

At the end of each unit, you will find a list of relevant reference materials which you may yourself wish to consult as the need arises, even though I have made efforts to provide you with the most important information you need to pass this course. However, I would encourage you, as a fourth-year student to cultivate the habit of consulting as many relevant materials as you are able to within the time available to you. In particular, be sure to consult whatever material you are advised to consult before attempting any exercise.

ASSESSMENT

Two types of assessment are involved in the course: The Self-Assessment Exercises (SAEs), and the Tutor-Marked Assessment (TMA) questions. Your answers to the SAEs are not meant to be submitted, but they are also important since they give you an opportunity to assess your own understanding of the course content. Tutor–Marked Assignments (TMAs) on the other hand are to be carefully answered and kept in your assignment file for submission and marking. This will count for 30% of your total score in the course.

TUTOR–MARKED ASSIGNMENT

At the end of each unit, you will find tutor-marked assignments. There is an average of two tutor–marked assignments per unit. This will allow you to engage the course as robustly as possible. You need to submit at least four assignments of which the three with the highest marks will be recorded as part of your total course grade. This will account for 10 percent each, making a total of 30 percent. When you complete your assignments, send them including your form to your tutor for formal assessment on or before the deadline.

Self–assessment exercises are also provided in each unit. The exercises should help you to evaluate your understanding of the material so far. These are not to be submitted. You will find all answers to these within the units they are intended for.

FINAL EXAMINATION AND GRADING

There will be a final examination at the end of the course. The examination carries a total of 70 percent of the total course grade. The examination will reflect the contents of what you have learnt and the self–assessments and tutor-marked assignments. You therefore need to revise your course materials before-hand.

COURSE MARKING SCHEME

The following table sets out how the actual course marking is broken down.

ASSESSMENT	MARKS
Four assignments (the best four of the assignments submitted for marking)	Four assignments, each mark out of 10%, but highest scoring three selected, then total of 30%
Final Examination	70% of overall course score
Total	**100% course score**

COURSE OVERVIEW PRESENTATION SCHEME

Units	Title of Work	Week Activity	Assignment (End-of-Unit)
Course Guide	**International Economic Relations**		
Module 1	**International Economic System at a Glance**		
Unit 1	Nexus between Economics and Politics	Week 1	Assignment 1
Unit 2	Contending Perspectives on International Economic Relations	Week 2	Assignment 1
Unit 3	International Economic Management before World War 2	Week 3	Assignment 1
Unit 4	International Economic Management since World War 2	Week 4	Assignment 1
Unit 5	Contemporary International Economic Management	Week 5	Assignment 1
Module 2	**The Major Strands in the Management of International Relations**		
Unit 1	The Western System	Week 6	Assignment 1
Unit 2	The North-South System	Week 7	Assignment 1
Unit 3	The East-West System	Week 8	Assignment 1
Unit 4	The South-South System	Week 9	Assignment 1
Module 3	**Understanding the Role of IGOs and Transnational Corporations in the International Economic System**		
Unit 1	World Bank	Week 10	Assignment 1
Unit 2	International Monetary Fund	Week 11	Assignment 1
Unit 3	United Nations Conference on Trade and Development	Week 12	Assignment 1

Unit 4	World Trade Organisation	Week 13	Assignment 1
Unit 5	Transnational Corporations in International Economic Relations	Week 14	Assignment 1
Module 4	**Developmental Issues in the International System**		
Unit 1	What is foreign Aid?	Week 15	Assignment 1
Unit 2	Politics of foreign Aid	Week 16	Assignment 1
Unit 3	Problems of foreign Aid	Week 17	Assignment 1
Unit 4	Debt and Development	Week 18	Assignment 1
Unit 5	Africa's Debt crisis	Week 19	Assignment 1
Module 5	**Contemporary Issues in International Economic System**		
Unit 1	The Trade Issue	Week 20	Assignment 1
Unit 2	Globalization	Week 21	Assignment 1
Unit 3	Economic Regionalization	Week 22	Assignment 1
Unit 4	Africa's Rising Economic Profile	Week 23	Assignment 1
Unit 5	Global Economic and Financial Crisis	Week 24	Assignment 1

WHAT YOU WILL NEED FOR THE COURSE

This course builds on what you have learnt in the 100 Levels. It will be helpful if you try to review what you studied earlier. Second, you may need to purchase one or two texts recommended as important for your mastery of the course content. You need quality time in a study friendly environment every week. If you are computer–literate (which ideally you should be), you should be prepared to visit recommended websites. You should also cultivate the habit of visiting reputable physical libraries accessible to you.

TUTORS AND TUTORIALS

There are 15 hours of tutorials provided in support of the course. You will be notified of the dates and location of these tutorials, together with the name and phone number of your tutor as soon as you are allocated a tutorial group. Your tutor will mark and comment on your assignments, and keep a close watch on your progress. Be sure to send in your tutor marked assignments promptly, and feel free to contact your tutor in case of any difficulty with your self–assessment exercise, tutor–marked assignment or the grading of an assignment. In any case, you are advised to attend the tutorials regularly and punctually. Always take a list of such prepared questions to the tutorials and participate actively in the discussions.

TUTOR–MARKED ASSIGNMENTS (TMAs)

Usually, there are four online tutor–marked assignments in this course. Each assignment will be marked over ten percent. The best three (that is the highest three of the 10 marks) will be counted. This implies that the total mark for the best three assignments will constitute 30% of your total course work. You will be able to complete your online assignments successfully from the information and materials contained in your references, reading and study units.

FINAL EXAMINATION AND GRADING

The final examination for **INR481: International Economic Relations** will be of two hours' duration and have a value of 70% of the total course grade. The examination will consist of multiple choices and fill in–the–gaps questions which will reflect the practice exercises and tutor–marked assignments you have previously encountered. All areas of the course will be assessed. It is important that you use adequate time to revise the entire course. You may find it useful to review your tutor-marked assignments before the examination. The final examination covers information from all aspects of the course.

HOW TO GET THE MOST FROM THIS COURSE?

1. There are 25 units in this course. You are to spend one week in each unit. In distance learning, the study units replace the university lecture. This is one of the great advantages of distance learning; you can read and work through specially designed study materials at your own pace, and at a time and place that suites you best. Think of it as reading the lecture instead of listening to the lecturer. In the same way a lecturer might give you some reading to do. The study units tell you when to read and which are your text materials or recommended books. You are provided with exercises to do at appropriate points, just as a lecturer might give you in a class exercise.

2. Each of the study units follows a common format. The first item is an introduction to the subject–matter of the unit, and how a particular unit is integrated with other units and the course as a whole. Next to this is a set of learning objectives. These objectives let you know what you should be able to do, by the time you have completed the unit. These learning objectives are meant to guide your study. The moment a unit is finished, you must go back and check whether you have achieved the objectives. If this is made a habit, then you will significantly improve your chance of passing the course.

3. The main body of the unit guides you through the required reading from other sources. This will usually be either from your reference or from a reading section.

4. The following is a practical strategy for working through the course. If you run into any trouble, then put a call through your tutor or visit the study centre nearest to you. Remember that your tutor's job is to help you. When you need assistance, do not hesitate to call and ask your tutor to provide you necessary assistance.

5. Read this course guide thoroughly. It is your first assignment.

6. Organise a study schedule - Design a 'Course Overview' to guide you through the course. Note the time you are expected to spend on each unit and how the assignments relate to the units.

7. Important information; e.g. details of your tutorials and the date of the first day of the semester is available at the study centre.

8. You need to gather all the information into one place, such as your diary or a wall calendar. Whatever method you choose to use, you should decide on and write in your own dates and schedule of work for each unit.

9. Once you have created your own study schedule, do everything to stay faithful to it.

10. The major reason that students fail is that they get behind in their coursework. If you get into difficulties with your schedule, please let your tutor or course coordinator know before it is too late for help.

11. Turn to Unit 1, and read the introduction and the objectives for the unit.

12. Assemble the study materials. You will need your references for the unit you are studying

at any point in time.

13. As you work through the unit, you will know what sources to consult for further information.

14. Visit your study centre whenever you need up-to-date information.

15. Well before the relevant online TMA due dates, visit your study centre for relevant information and updates. Keep in mind that you will learn a lot by doing the assignment carefully. They have been designed to help you meet the objectives of the course and, therefore, will help you pass the examination.

16. Review the objectives for each study unit to confirm that you have achieved them. If you feel unsure about any of the objectives, review the study materials or consult your tutor. When you are confident that you have achieved a unit's objectives, you can start on the next unit. Proceed unit by unit through the course and try to space your study so that you can keep yourself on schedule.

17. After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives (listed at the beginning of each unit) and the course objectives (listed in the course guide).

CONCLUSION

This is a theory course but you will get the best out of it if you cultivate the habit of relating it to political issues in domestic and international arenas.

SUMMARY

'International Economic Relations' introduces you to general understanding of the current dynamics surrounding economic interactions among nations in the international system. All the basic course materials that you need to successfully complete the course are provided. At the end, you will be able to: Explain the concept of International Economic Relations; discuss the institutional frameworks regulating international commerce; have an understanding of the implications of international economic relations on Africa; and Familiarize with the current issues in international economic relations such as globalization and 'economic meltdowns or financial crisis.

List of Acronyms

DRC	**-**	**DEMOCRATIC REPUBLIC OF CONGO**
ELR	**-**	**EXCEPTIONAL LEAVE TO REMAIN**
EU	**-**	**EUROPEAN UNION**
GDP	**-**	**GROSS DOMESTIC PRODUCT**
ILO	**-**	**INTERNATIONAL LABOUR ORGANISATION**
NGOS	**-**	**NON-GOVERNMENTAL ORGANISATIONS**
UN	**-**	**UNITED NATIONS**
UNDP	**-**	**UNITED NATIONS DEVELOPMENT PROGRAM**
UK	**-**	**UNITED KINGDOM OF GREAT BRITAIN AND IRELAND**
USA	**-**	**UNITED STATES OF AMERICA**
WWI	**-**	**WORLD WAR I**
WWII	**-**	**WORLD WAR II**
WTO	**-**	**WORLD TRADE ORGANISATION**

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Module 1: International Economic System at a Glance

UNIT 1: CONNECTION BETWEEN ECONOMICS AND POLITICS

CONTENTS

1.1 INTRODUCTION

The major task of this unit is to throw enabling light on the connection between politics and economics for the benefit of the beginning student. This is key because an adroit understanding of the deep connections between politics and economics lays the foundations for greater understanding of other issues which will be discussed in later modules. At the end of this unit, you should be able to discuss and understand the nexus between politics and economics in the international system.

1.2 INTENDED LEARNING OUTCOMES (ILOs)

By the end of this unit, you will be able to:

- Discuss and understand the link between economics and politics.
- Understand the points at which economics and politics converge.

1.3 Historical perspectives on Economics and Politics

There is an age long link between politics and economics in international relations discourse. This interaction has continued from seventeenth century mercantilists to twentieth century Marxist to present. However, in the twentieth century politics and economics began to toe a difference pathway. A major reason for this divulgence was the theoretical heritage of modern western academe. This theoretical is hinged in liberal thought which rejected the age-old concept of a unified political and economic order replacing with two separate orders. For the liberals in economic system working under natural laws is geared toward the production, distribution and consumption of goods and services for the harmony of these natural laws are best observed when there is a dichotomy between the political and economic spheres. In contradiction politics they argued that politics or the political system, a compendium of power, influence and public decision making, is not subject to natural laws or harmony. Politics and government is only necessary for essential services such as defence law and order. Consequently, liberal theorists are of the view that the distinct separation of politics and economics is indispensable for free trade in the international system which would bring it peace and harmony.

Following these postulations, economics and political science have operated in the past nineteenth century as disciplines with regard to for their common area of interests or convergence. In this regard international political economy has been bifurcated into international politics and international economics with the scholars in each discipline focusing exclusively on their disciplines. In the post bellum era, how political and economic developments gave added impetus to this formal division of analysis. One was the creation of the Breton woods system which established commercial and financial rules for major industrial states. While in east the soviet hegemony allowed for a stable international system. The subordinate third world states could not be acquiescing to the system mapped out for them by the west. Given that prevailing scenario the distribution in the international economic system was minimized allowing international economic interaction was relegated to the level of 'low' politics.

The emergence of the cold war was also a factor which precipitated the recession of international economic relations. This was because security and issues of security were the main themes which engaged decision makers and scholars. Theories such as system analyses, decisions making theory, strategy and game theory, simulation, conflict resolution were based on the primacy of security issues. In contrast to the low politics of economic interaction, security and security related issues were seen as 'high' politics.

However, by mid-1970s this seeming comfortable demarcation of the international system was undermined by such processes as detente west Germany's Ostpolitik and the end of the Vietnam war, furthermore and more importantly, the economic consensus of the immediate past World War II era was experiencing mal-functioning, for example, the Bretton woods system had broken down in the west due to the spectacular success of west Europe and Japan. The balance of payment crises in US and the rampant energy induced inflation of the 1970s. Meanwhile, in the East, the closed communist system began to unravel as the communists found their system two restrictive for economic development and have thus turned to the west for trade and technology. The formerly sub-soviet countries of the south have attained independence with miasma of economic problems and as such have demanded a restructuring of the international relations between the developed and under-developed regions of the world. It was on the heel of this development that it was felt by scholars of the pressing need to bridge the interface between economics and politics in the international system.

The examination of the relationship between economics and politics have more often than not hinged on the impact of economic reality on politics. For example, a school of thought maintains that economic resources determine political power. Some scholars over that a proper admixture of a polity's gross national product, the quality and quantity of resources and international trade may determine military strength. Britain's early industrialization helped to harness its resources for more than a century of domination of the international economic and political system. The same pertains to the U.S.A which in the aftermath of World War 1 became an economic colossus with extensive military and political spread.

However, just as economic factors affect political outcomes; political factors also affect similarly shape economic outcomes. A common denominator of international political analyses is that often the impact of politics on international economic relations neglected by writers in the discipline. Politics may affect economic outcomes in three ways; the international political structure shapes the international economic system; political interest often determines strategic polices and international economics are inevitably political relations. For example, during the mercantilist age between the fifteen and eighteen centuries, two principal features determined economic relationship, and one was the appearance of the powerful nation states such as England, France etc. the major goal of these was the internal and external consolidation of power. A second consolidation was the extent of competition among the nearly equal states. However, there were significant limits to competition such as a common political culture which included a consensus on royal legitimacy. The scale itself was also limited by weak state administration, small armies. Consequently, inhibited by these limitations, the state diverted its energies to the economic realm which became the field for profound political conflict. Mercantilism is underpinned by pursuit of state power through the pursuit of national economic power and wealth. All international economic relations were undertaken with the aim of aiding state power. This during mercantilist age the nature of the state played steering role in determining economic interaction. The rise of Great Britain to political eminence caused the political structure to undergo change which affected the mercantilist economic system.

This brings us to the second factor through which political processes shape economic outcomes, which is that important economic policies are frequently dictated by overriding the political interests. For instance, in the nineteenth century the political system was characterized by the balance of power on the continent and by the Great

Britain's power overseas. Its strategic power off the coast of Europe allowed Great Britain to play the role of the balancer in European affairs. This mix of balancer and overseas power enabled that country to achieve a foremost economic advantage over the next of Europe. The basis of this system was free trade with Britain at its center. Thus, the political consideration of acting as a balance of power among the contending power blocs on European continent had enabled Britain to shape and internationalized a liberal economic system. However, by the turn of the century as British power declined the liberal international system, its power had created also began to give way to a new imperialist system.

We now turn to the final way through which political factors shape economic outcomes; international economic relations in and out of themselves are political relations. In this regard we look at the imperial system of the nineteenth century. Two political factors were necessary for the inception of the imperialism. One was the concomitant decline of Great Britain and the rise of the United States and Germany. Added to this, was the disruptive influence of these power reinforced by the onset of modern nationalism, ie national identity, national pride, and the quest for national self- fulfilment and power. This development led to an increasing competitive international system. Several other factors escalated the competitiveness of the international system such as; political pressures of the newly powerful capitalist class; the exploits of explorers; technological developments which enabled control of foreign dependencies and the dynamics of imperial competition. As international conflict increased, it was acted out short while both continents had been virtually divided between Europe and United States.

As the fulcrum of a new international economic system imperialism allowed European political domination thus leading to economic domination and exploitation. These political overlords through various measures instituted infrastructures and processes in their colonies which enabled economic dependency even up to the present age. This system was finally destroyed after the destructive world wars. Its eclipse led to the rise of the bipolar system in which the world was broken politically into two contending but hostile camps of East against West. This international political system shaped the post war international economic system. In the East, the Soviet Union imposed the communist economic system and sought to isolate these countries from the West. America's liberal unison shaped the economic order in the west consequently free trade was accepted economic principle to follow just as in the era of British dominance. America investment and American dollar were current. The decline and decay of the political system of the Soviet Union and its subsequent collapse in 1991 led to the predominance of western liberalism globally.

3.2. Political Concerns and Economic Policy

Apart from helping to set out the economic systems, political factors also play a lead role in orchestrating economic policies. Economic policy is the outcome of a political bargaining process in which different groups representing different interest's conflict over different preferred policy outcomes. In this regard group conflict may occur between groups over low tariff barriers and protection between energy independence and reliance on foreign sources. A pungent example was American foreign policy which in the years after world war2 tended toward engagement in the world. This was the outcome of the victory of the engagement policy subsequently fired American multilateralism and free trading system. Thus, following this viewpoint mercantilism was also the outcome of a political conflict between particularistic local powers and the rising power of the central government U.S liberalism by the support it enjoyed among powerful business and labour groups.

Consequently, over the year's economic policy is frequently shaped by political concerns. Another example of political considerations shaping economic policy is the use of trade as tool of national strategic and diplomatic policy. Embargo has remained a potent economic tool of political warfare throughout history; France applied an embargo to weaken Great Britain during the Napoleonic Wars; the League of Nations called for an embargo of Italy after the invasion of Ethiopia.

SELF ASSESSMENT EXERCISE 1

1.4 SELF ASSESSMENT EXERCISES 1

Q1. What are the factors that hinder economic growth in a given particular country?

1.5 SUMMARY

Our discourse in this unit has focused on the factors which have led to growing links between politics and economics in the world. We saw how interaction has continued from seventeenth century mercantilists to twentieth century Marxist to present. However, in the twentieth century politics and economics began to toe a difference pathway. A major reason for this divulgence was the theoretical heritage of modern western academe. This theoretical is hinged in liberal thought which rejected the age old concept of a unified political and economic order replacing with two separate orders. However, by mid-1970s this seeming comfortable demarcation of the international system was undermined by certain processes as détente. It was on the heel of this development that it was felt by scholars of the pressing need to bridge the interface between economics and politics in the international system.

1.6 REFERENCES/FURTHER READINGS

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1.7 ANSWERS TO SAEs 1

Q1. Answer

However, just as economic factors affect political outcomes; political factors also affect similarly shape economic outcomes. A common denominator of international political analyses is that often the impact of politics on international economic relations neglected by writers in the discipline. Politics may affect economic outcomes in three ways; the international political structure shapes the international economic system; political interest often determines strategic polices and international economics are inevitably political relations. For example, during the mercantilist age between the fifteen and eighteen centuries, two principal features determined economic relationship, and one was the appearance of the powerful nation states such as England, France etc. the major goal of these was the internal and external consolidation of power. A second consolidation was the extent of competition among the nearly equal states. However, there were significant limits to competition such as a common political culture which included a consensus on royal legitimacy. The scale itself was also limited by weak state administration, small armies. Consequently, inhibited by these limitations, the state diverted its energies to the economic realm which became the field for profound political conflict. Mercantilism is underpinned by pursuit of state power through the pursuit of national economic power and wealth. All international economic relations were undertaken with the aim of aiding state power. This during mercantilist age the nature of the state played steering role in determining economic interaction. The rise of Great Britain to political eminence caused the political structure to undergo change which affected the mercantilist economic system.

UNIT 2: CONTENDING PERSPECTIVES ON INTERNATIONAL ECONOMIC RELATIONS

CONTENTS

2.1 INTRODUCTION

The international economic system has overtime been driven by different ideologies and viewpoints. These perspectives such as liberalism, mercantilism and structuralism at one time or the order dominated international economic thinking. Even to this present age they are in varying degrees still relevant or practiced in the international economic system. This unit therefore will attempt to provide the reader with a cursory bird's eye view of the aforementioned ideologies.

2.2 INTENDED LEARNING OUTCOMES (ILOs)

By the end of this unit, you will be able to:

- State the three streams of the international economic system.
- Discuss the relationship between the three ideologists of International Economic System.

2.3 MAIN CONTENT

2.4 Contrasting Perspectives and Methodologies

The three dominant perspectives of IPE are economic liberalism, mercantilism, and structuralism. Each focus on the relationships between a variety of actors and institutions. A strict distinction between these perspectives is quite arbitrary and has been imposed by disciplinary tradition, at times making it difficult to appreciate their connections to one another. Each perspective emphasizes different values, actors, and solutions to policy problems but also overlooks some important elements highlighted by the other two perspectives. Economic liberalism (particularly neo-liberalism) is most closely associated with the study of markets. Currently, there is an increasing gap between orthodox economic liberals (OELs), who champion free markets and free trade, and heterodox interventionist liberals (HILs), who support more state regulation and trade protection to sustain markets. Increasingly, HILs have stressed that markets work best when they are embedded in (connected to) society and when the state intervenes to resolve problems that markets alone cannot handle. In fact, many HILs acknowledge that markets are the source of many of these problems. Many liberal values and ideas are the ideological foundation of the globalization campaign. They are derived from notable thinkers such as Adam Smith, David Ricardo, John Maynard Keynes, Friedrich Hayek, and Milton Friedman. The laissez-faire principle, that the state should leave the economy alone, is attributed to Adam Smith. More recently, economic liberal ideas have been associated with former president Ronald Reagan and his acolytes, who contended that economic growth is best achieved when the government severely limits its involvement (interference) in the economy. Under pure market conditions (i.e., the absence of state intervention or

social influences), people are assumed to behave “rationally”.
Mercantilism (also called economic nationalism) is most closely associated with the political philosophy of realism, which focuses on state efforts to accumulate wealth and power to protect society from physical harm or the influence of other states. In theory, the state is a legal entity and an autonomous system of institutions that governs a specific geographic territory and a “nation.” Since the mid-seventeenth century, the state has been the dominant actor in the international community based on the principle that it has the authority to exercise sovereignty (final authority) over its own affairs. States use two types of power to protect themselves. Hard power refers to tangible military and economic assets employed to compel, coerce, influence, fend off, or defeat enemies and competitors. Soft power comprises selective tools that reflect and project a country’s cultural values, beliefs, and ideals. Through the use of movies, cultural exports and exchanges, information, and diplomacy, a state can convince others that the ideas it sponsors are legitimate and should be adopted. Soft power can in many ways be more effective than hard power because it rests on persuasion and mutual exchange. For example, Nobel Peace Prize recipient Barack Obama partly regained some of the world’s support for the United States through a discourse emphasizing multilateral cooperation. Structuralism is rooted in Marxist analysis but not limited to it. It looks at IPE issues mainly in terms of how different social classes are shaped by the dominant economic structure. It is most closely associated with the methods of analysis many sociologists employ. Structuralists emphasize that markets have never existed in a social vacuum. Some combination of social, economic, and political forces establishes, regulates, and preserves them. As we will see in the case of the financial crisis, even the standards used to judge the effectiveness of market systems reflect the dominant values and beliefs of those forces.

2.4 SELF-ASSESSMENT EXERCISES 2

Q1. Briefly what do you understand by Mercantilism?

2.5 SUMMARY

Discussion in this unit has centered on the discussion of the major streams of economic ideologies of the international system. Economic liberalism (particularly neo-liberalism) is most closely associated with the study of markets; Mercantilism (also called economic nationalism) is most closely associated with the political philosophy of realism, which focuses on state efforts to accumulate wealth and power to protect society from physical harm or the influence of other states. Structuralism examines how different social classes are shaped by the dominant economic structure.

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2.7 POSSIBLE ANSWERS to SAEs 2

ANSWER

Mercantilism (also called economic nationalism) is most closely associated with t political philosophy of realism, which focuses on state efforts to accumulate wealth a power to protect society from physical harm or the influence of other states. In theo the state is a legal entity and an autonomous system of institutions that governs specific geographic territory and a "nation." Since the mid-seventeenth century, t state has been the dominant actor in the international community based on the princi that it has the authority to exercise sovereignty (final authority) over its own affai States use two types of power to protect themselves. Hard power refers to tangil military and economic assets employed to compel, coerce, influence, fend off, or def enemies and competitors. Soft power comprises selective tools that reflect and projec country's cultural values, beliefs, and ideals. Through the use of movies, cultu exports and exchanges, information, and diplomacy, a state can convince others that t ideas it sponsors are legitimate and should be adopted. Soft power can in many ways more effective than hard power because it rests on persuasion and mutual exchan For example, Nobel Peace Prize recipient Barack Obama partly regained some of world's support for the United States through a discourse emphasizing multilate cooperation.

UNIT 3: INTERNATIONAL ECONOMIC MANAGEMENT BEFORE WORLD WAR II

CONTENTS

3.1 INTRODUCTION

In the past years what led the to the Second World War, the international economic system had been largely mercantilist in outlook. This avid nationalist colouration of the system played a key role in propagating the instability of the international system as countries engaged in cutthroat competition with each other. This prevailing attitude was directly implicated as one of the causes of the Great War or the First World War. The following discussion will discuss economic system management, albeit rudimentary, of the pre-Second World War era.

3.2 INTENDED LEARNING OUTCOMES (ILOs)

By the end of this unit, you will be able to:

- Understand the processes of economic management before World War II
- Identify the rationale behind the decline of British Hegemony and World War I
- State the factors that underline the institutional framework

3.3 MAIN CONTENT

3.3.1 Global Economic Relations before World War II

4 **3.3.1 The Mercantilist Period:**

The origins of IPE are closely associated with the development of modern European states and their global markets. The modern European state gained official recognition at the 1648 Treaty of Westphalia, which marked the defeat of the Catholic Hapsburg countries by mostly Protestant countries in Northern Europe. The Peace of Westphalia upheld state sovereignty and territorial integrity by institutionalizing changes to prevent external religious and secular authorities e.g the Pope, Holy Roman Emperor, and other states from interfering in a state's internal affairs. A major factor enabling the state to establish its authority vis-à-vis internal and external forces was the development of mercantilism. Adam Smith, an eighteenth-century liberal economist who was highly critical of the mercantilists, first used the term in reference to much of the economic thought and practice in Europe from about 1500 to 1750. Mercantilists were acutely aware of the linkage between politics and economics, viewing both power and wealth as essential goals of national policy. The mercantilist states could use their wealth to build up their armed forces, hire mercenaries, and influence their enemies and allies. Thus, they accumulated gold and silver by seeking trade advantages over others in the following ways: They increased their exports and decreased their imports of manufactured goods, restricted raw material and technology exports to prevent others from developing manufacturing capabilities, and imported raw materials they needed to reduce costs for their own manufacturers.

Colonialism was central to mercantilism, because the colonies provided the metropole with raw materials and served as markets for its manufactures; thus, manufacturing in the colonies was usually prohibited. Although Smith criticized mercantilists for following beggar-thy-neighbour policies that would lead to conflict, their emphasis on national power helped establish state authority and territorial unification. The European state system in turn contributed to the development of the global political economy. Although sovereignty in principle gives states supreme authority within their own territory, there is a pecking order in which some states are more powerful than others. Some scholars have examined the role of "world powers" such as Portugal, Spain, the Netherlands, and Britain during the mercantilist period, but there is considerable debate as to whether these states were dominant enough to be hegemonic. Most hegemonic stability theorists refer to only two global hegemonic periods, both of them after the mercantilist period: under Britain in the nineteenth century and the United States in the twentieth century.

3.3.2 The Industrial Revolution and British Hegemony

Mercantilism is a preindustrial doctrine. The Industrial Revolution began in about 1780, affected only some manufactures and means of production, and initially progressed from region to region rather than involving entire countries. However, Britain became the hegemonic power in the nineteenth century as it was the first state to industrialize. By 1860 Britain accounted for about 37 percent of European industrial production, 20 percent of world industrial production, and 80 percent of newer technology industries. In view of its competitive edge, Britain shifted from mercantilist policies toward free trade: It removed most of its industrial trade restrictions by the 1830s, and in 1846 it repealed its Corn Laws, which had restricted agricultural imports. Britain's decision to liberalize agricultural trade stemmed from both domestic and external factors.

Domestically, industrial groups gained seats in the British Parliament at the expense of landed agricultural groups through legislative and demographic changes, and the agricultural elite could no longer prevent the repeal of the Corn Laws. Externally, Britain opened its markets to agricultural and raw material imports so that other countries would accept its manufactured goods. The division of labour served Britain's hegemonic interests in promoting its industrial exports. Other states oriented their production in line with Britain's preferences because it was the largest market for their exports. Moreover, Britain's policies contributed to an extended period of free trade during the nineteenth century, and the 1860 Cobden–Chevalier Treaty between Britain and France resulted in a network of treaties lowering tariffs throughout Europe.

3.3.3 The Decline of British Hegemony and World War I

The growth of trade became slower in the late nineteenth century because of depressed economic conditions, industrial protectionism on the European continent, and a decline of British hegemony. A decrease in Britain's productivity relative to the United States and Germany made it less competitive in trade and less able to serve as a market for other countries' exports. Banks and the state (including U.S. state governments) helped promote U.S. and German productivity through investment in industrial production and infrastructure such as railroads and canals, and the two countries built up their infant industries through protectionist policies that limited imports. Whereas Britain's share of world trade fell from 24 percent in 1870 to 14.1 percent in 1913, Germany's share rose from 9.7 to 12.2 percent and the U.S. share rose from 8.8 to 11.1 percent. On the eve of World War I, the United States had become the largest industrial power, accounting for about 32 percent of world industrial output. However, Britain continued to dominate in international finance. The city of London was the main centre of the international financial system, the British pound was the key international currency, and in 1913 Britain accounted for about 43 percent of the world's foreign investment. While Britain's foreign liabilities increased during World War I, the United States emerged as a net creditor; thus, financial pre-eminence finally shifted from London to New York after the war.

3.3.4 The Interwar Period:

The United States emerged from World War I as the world's largest industrial power and the only major net creditor. Although it lent about $10 billion to cash-short countries during the 1920s, some U.S. policies did not facilitate a return to an open, liberal economy. For example, the United States initially insisted that its close allies Britain and France repay all their war debts, and it imposed import barriers that made it difficult for Europeans to gain revenue from exports. The 1922 Fordney–McCumber Act raised U.S. customs duties, and when the U.S. economy moved into depression after the 1929 stock market crash, the 1930 Smoot–Hawley Act increased U.S. tariffs to their highest level in the twentieth century. European states retaliated with their own import restrictions, and world trade declined from $35 billion in 1929 to $12 billion in 1933. Hegemonic stability theorists argue that the lack of a global hegemon prevented the development of an open, stable international economy in the interwar period. Whereas Britain was the global hegemon in the nineteenth century, during the interwar period Britain was no longer able, and the United States was not yet willing, to assume the hegemon's role. Other theorists argue that domestic U.S. politics lead to the economic disarray. The U.S. Constitution gives Congress the authority to regulate foreign commerce, but as a large unwieldy body, Congress could not resist constituent demands for protectionism from special interests. Thus, U.S. tariffs increased because of domestic politics despite the growing economic power of the United States. In efforts to reverse the damage caused by the Smoot– Hawley tariff, the U.S. Congress passed the Reciprocal Trade Agreements Act (RTAA) in 1934. The RTAA delegated tariff-setting authority to the president, who could resist special interest pressures and negotiate tariff reductions more effectively than Congress. However, the RTAA reflected a conviction that the reduction oftariffs through bilateral bargaining would help restore U.S. export markets, and "protection at home remained an important goal of American trade strategy." Although the RTAA agreements resulted in a substantial reduction of some tariffs, tariff rates were so high in the early 1930s that the agreements were not sufficient to stem the forces of protectionism.

3.3.5 The Institutional Framework:

Before World War II Most IOs formed from 1815 to 1914 were designed to utilize technological innovations and promote economic regulation and commerce mainly among European states. For example, the Central Commission for the Navigation of the Rhine was formed in 1815 to gain commercial advantages from the development of the steamship, the International Telegraph Union was established in 1865 to benefit from the invention of the telegraph, and the Universal Postal Union was created in 1874 to promote speedy and efficient postal deliveries. The first financial IO, the Bank for International Settlements (BIS), was established in Basle, Switzerland in 1930 to oversee the settlement of German reparations after World War I, but its main purpose was to promote cooperation among central banks. Other than the BIS, economic IOs in the interwar period were mainly concerned with developing international standards for facilities, equipment, and installations required for the functioning of the global economy. These organizations were not able to deal with major economic problems such as the Great Depression. As economic differences increased in the 1920s–1930s, several international conferences were convened to confront the trade and financial problems. For example, a 1922 conference in Genoa, Italy, pressured central banks to manage currency exchange rates and use currencies that were convertible into gold. However, these conferences failed to resolve the problems of war reparations and debt, disorderly currency exchange conditions, and a decline in world trade. In 1936, Britain, the United States, and France finally reached an agreement that recognized international responsibility for exchange rates. This experience emphasized the need for international bodies to promote open and stable economic relations after World War II and as a result the IMF, World Bank, and GATT were formed.

3.4 SELF-ASSESSMENT EXERCISES 1

Q1. Briefly examine the Decline of British Hegemony and World War I?

3.5 SUMMARY

The unit has cursorily but penetrative examined the Mercantilist Period which is a period of intense economic nationalism; the Industrial Revolution and British Hegemony, a period in which British advancement in industry led to its domination of the international system; the Decline of British Hegemony and World War I, the Interwar Period and the Institutional Framework.

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3.7 ANSWERS to SAEs 3

The growth of trade became slower in the late nineteenth century because of depressed economic conditions, industrial protectionism on the European continent, and a decline of British hegemony. A decrease in Britain's productivity relative to the United States and Germany made it less competitive in trade and less able to serve as a market for other countries' exports. Banks and the state (including U.S. state governments) helped promote U.S. and German productivity through investment in industrial production and infrastructure such as railroads and canals, and the two countries built up their infant industries through protectionist policies that limited imports. Whereas Britain's share of world trade fell from 24 percent in 1870 to 14.1 percent in 1913, Germany's share rose from 9.7 to 12.2 percent and the U.S. share rose from 8.8 to 11.1 percent. On the eve of World War I, the United States had become the largest industrial power, accounting for about 32 percent of world industrial output. However, Britain continued to dominate in international finance. The city of London was the main centre of the international financial system, the British pound was the key international currency, and in 1913 Britain accounted for about 43 percent of the world's foreign investment. While Britain's foreign liabilities increased during World War I, the United States emerged as a net creditor; thus, financial pre-eminence finally shifted from London to New York after the war.

UNIT 4: INTERNATIONAL ECONOMIC MANAGEMENT AFTER WORLD WAR II

CONTENTS

4.1 INTRODUCTION

The previous unit examined the nature of international economic management before World-War II. It elucidated the major details of that system. In this unit we shall examine the international economic management put in place in the aftermath of World-War II. The Second World War played a major role in the collapse of the subsisting and the enthronement of new system which was to endure for many years. Furthermore, it was felt that the subsisting system was inadequate in several way as it had led to the severe worldwide economic depression which had hobbled global commerce and indirectly precipitated the war. Thus, as the war drew to an end there was a feeling in the victor's camp that an integrative economic system was indispensable for lasting peace internationally.

4.2 INTENDED LEARNING OUTCOMES (ILOs)

By the end of this unit, you will be able to:

- Discuss the international economic system that prevailed in the aftermath of the World War II
- Critically analyze the factors that disarticulated the Bretton Woods system in the in 1970s.

4.3 MAIN CONTENT

4.1 The management of international economic relations since World War I

The end of the catalytic World War II saw the destruction of the predominating international economic systems and heralding of another. The imperial system was destroyed for good and the Breton Woods system enlisted for the next two decades. The Breton Woods system is based on three coincidental conditions. The concentration of power in a few states, a cluster of important interests shared by those states and most importantly a power willing and able to assume leadership of the international system. The Breton Wood system was dominated by countries from the north represented by North America and Eastern Europe. Due to the rabid isolation of the countries of the East the small coterie of countries from the west faced no challenge to their serenity. Furthermore, they faced no challenge from the countries of the third world who were more integrated into the international economic system but lacked a voice in management largely due to political and economic weakness. The only other country outside the small coterie of countries from Western Europe and America able to offer any challenge was Japan. Unfortunately, Japan was weakened by war and thus remained largely subordinate and thus outside the management for much of the Breton Wood era. The management of the international economic system was helped by overarching agreement on key principles of administration. The key principles were capitalism and liberalism. Though there were some variances in the nature of capitalism practiced by, for instance, France and the United States nonetheless they all favoured a liberal political system and free market. Again, disagreeing on the implementation of this liberal system, it was however tacitly agreed that an open system would maximize economic welfare for all. In some quarters, in the west it was staunchly believed that international peace was better assured under a liberal international economic system. For instance, the U.S secretary of state Cordell Hull observed that;

unhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair economic competition with war. If we could get a free flow of trade –free in the sense of fewer discriminations and obstructions – so that one country would not deadly jealous of another and the living standard of all countries might rise, thereby eliminating the economic dissatisfaction that breed war, we might have a reasonable chance of lasting peace (Gardner, 1969: 9).

In this regard there was also a tacit resolve by the developed countries of the need for governmental intervention in the international economic system. This advocacy was borne out of the experience witness during the great depression when independent national goals together with failure to perceive that those national goals could not be realized without some forms of international collaboration resulted in economic and political disaster which culminated in the second world war. A major instigator of the Breton Woods system, Henry D. White noted that a lesson learned from the disaster was that: ‘the absence of a high degree of economic collaboration among the leading nations… inevitably resulted in economic warfare that will be but the prelude and instigator of military warfare on even vaster scale.

It was thus to avoid a repetition of the late conflict that countries from the west agreed to cooperate in regulating the international economic system. This front was further enhanced by the outbreak and escalation of the cold war at the end of the 1940s. It was thus felt that a strong Western Europe and Japan would better withstand pressure from the soviet bloc. This consideration furthered the willingness to compromise and share economic burdens. It was also agreed that the international economic management should be constructed to further a liberal system. To assist such a system, it was necessary for the establishment of effective international monetary system and the reduction of barriers to trade capital flows.

The removal of these subsisting and aft destructive barriers would enable a favourable economic environment for national stability and growth. By the 1970s the philosophy underlining the Bretton Woods system was beginning to unravel. This was largely due to the changes in each of the three political bases of the Breton woods system firstly states outside the development world had challenged their right to manage the system. The challenge had come from countries of the third world who left increasingly isolated from and dissatisfied with a system which shaped their economies but excluded them from an equal share of the wealth and countries of the communist bloc which sought greater participation in the international economy. Secondly, following a period of dynamic economic growth in Eastern Europe and Japan, and the concomitant internal economic problems in the United States there was increasing dissatisfaction with the prerogatives which leadership gave the United States and the way in which the United States used these prerogatives. On its part the United States was increasingly disenchanted with the cost of economic leadership. The advent of detent which led to lessened tension further undermined American leadership as Western Europe and Japan no longer felt the pressing need for American security umbrella.

Finally, by the 1970s the consensus on a liberal and limited system as the basis of Breton woods had all but collapsed. The main antagonists of the liberal system were the new states of Asia and America who felt the open system perpetuated their dependency. But even in the developed world liberalism was longer as defied as it was once. In this region liberalism one reaction was to erect new barriers to limit economic interaction and with interdependence. Open international systems in the view of many no longer maximized economic welfare and most certainly undermine national sovereignty and autonomy. Another reaction was to go beyond the idea of a limited management to new forms of international economic cooperation which would manage international dependence. It was also felt that under an open system management which would assume responsibility and prerogative formerly assumed by the state.

The isolated communist who now wished to enter the international economic system due to growing economic difficulties presented a unique challenge to liberalism. This challenge came in the form that their centrally planned state trading system is antithetical to free markets. Consequently, their migration would have to require new forms of management will be required to regulate East-West trade, investment and financial flows.

4.4 SELF-ASSESSMENT EXERCISES 4

1. Examine some event that happen after World War II?

4.5 SUMMARY

This unit has examined the nature of economic system that characterized the end of the Second World War. In the aftermath of that war imperial system was destroyed for good and the Bretton Woods system enlisted for the next two decades. We also saw that by the 1970s the philosophy underlining the Breton Woods system had begun to unravel. This was largely due to the changes in each of the three political bases of the Breton Woods system firstly states outside the development world had challenged their right to manage the system. Secondly following a period of dynamic economic growth in Eastern Europe and Japan, and the concomitant internal economic problems in the United States, here were increasing dissatisfaction with the prerogatives which leadership gave the United States and the way in which the United States used these prerogatives. Finally, by the 1970s the consensus on a liberal and limited system as the basis of Breton woods had all but collapsed.

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4.7 POSSIBLE ANSWERS TO SAE 4

The end of the catalytic World War II saw the destruction of the predominating international economic systems and heralding of another. The imperial system was destroyed for good and the Breton Woods system enlisted for the next two decades. The Breton Woods system is based on three coincidental conditions. The concentration of power in a few states, a cluster of important interests shared by those states and most importantly a power willing and able to assume leadership of the international system. The Breton Wood system was dominated by countries from the north represented by North America and Eastern Europe. Due to the rabid isolation of the countries of the East the small coterie of countries from the west faced no challenge to their serenity. Furthermore, they faced no challenge from the countries of the third world who were more integrated into the international economic system but lacked a voice in management largely due to political and economic weakness. The only other country outside the small coterie of countries from Western Europe and America able to offer any challenge was Japan. Unfortunately, Japan was weakened by war and thus remained largely subordinate and thus outside the management for much of the Breton Wood era. The management of the international economic system was helped by overarching agreement on key principles of administration. The key principles were capitalism and liberalism. Though there were some variances in the nature of capitalism practiced by, for instance, France and the United States nonetheless they all favoured a liberal political system and free market.

UNIT 5: THE CONTEMPORARY INTERNATIONAL ECONOMIC SYSTEM

CONTENTS

5.1 INTRODUCTION

This unit will examine contemporary international economic management techniques since the Second World War. Involved in this analysis is description of the institutions spewed by that war. The unit will also examine the situation of economic management in the aftermath of the regression of the communist threat in the 1990s.

5.2 INTENDED LEARNING OUTCOMES (ILOs)

By the end of this unit, you will be able to:

- Examine the reasons for the rise of institutional frameworks in the management of the international economic system.
- Discuss the point rational behind the collapse of the immediate post Second World War framework

5.3 MAIN CONTENT

5.3.1 The Contemporary International Political Economy

Developments since 1945 have, indeed, raised a wide variety of theoretical, practical, and policy issues. The contemporary international political economy is characterized by unprecedented levels of multinational production, cross-border financial flows, and international trade. It is also plagued by increasing political conflict as individuals, groups, classes, and countries clash over the meaning and implications of these economic transactions. The contradiction between increasing economic integration and the wealth it produces, on the one hand, and the desire for political control and national autonomy, on the other, defines much of what happens in the global political economy. For the first thirty years after World War II, the general pattern of relations among non-communist nations was set by American leadership, and this pattern continues to influence the international political economy today. In the political arena, formal and informal alliances tied virtually every major non-communist nation into an American-led network of mutual support and defence. In the economic arena, a wide-ranging set of international economic organizations—including the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade (GATT), and the International Bank for Reconstruction and Development (World Bank)—grew up under a protective American "umbrella," and often as a direct American initiative.

The world economy itself was heavily influenced by the riseof modern multinational corporations and banks, whose contemporary form is largely of U.S. origin. American plans for a reordered world economy go back to the mid-1930s. After World War I, the United States retreated into relative economic insularity. When the Great Depression hit, American political leaders virtually ignored the possibility of international economic cooperation in their attempts to stabilize the domestic economy. Yet even as the Franklin Roosevelt administration looked inward for recovery, by 1934 new American initiatives were signalling a shift in America's traditional isolation. Roosevelt's secretary of state, Cordell Hull, was a militant free trader, and in 1934 he convinced Congress to pass the Reciprocal Trade Agreements Act, which allowed the executive to negotiate tariff reductions with foreign nations. This important step toward trade liberalization and international economic cooperation was deepened as war threatened in Europe and the United States drew closer to Great Britain and France.

The seeds of the new international order, which had been planted in the 1930s, began to grow even as World War II came to an end. The Bretton Woods agreement, reached among the Allied powers in 1944, established a new series of international economic organizations that became the foundation for the post-war American-led system. As the wartime American-Soviet alliance began to shatter, a new economic order emerged in the non-communist world. At its centre were the three pillars of the Bretton Woods system: international monetary cooperation under the auspices of the IMF, international trade liberalization negotiated within the GATT, and investment in the developing countries stimulated by the World Bank. All three pillars were essentially designed by the United States and dependent on its support. As it developed, the post-war capitalist world reflected American foreign policy in many of its details. One principal concern of the United States was to build a bulwark of anti-Soviet allies; this was done with a massive inflow of American aid under the Marshall Plan and the encouragement of Western European cooperation within a new Common Market. At the same time, the United States dramatically lowered its barriers to foreign goods and American corporations began to invest heavily in foreign nations. Of course, the United States was not acting altruistically: European recovery, trade liberalization, and booming international investment helped ensure great prosperity within its own borders as well. American policies, whatever their motivation, had an undeniable impact on the international political economy.

Trade liberalization opened the huge American market to foreign producers. American overseas investment provided capital, technology, and expertise for both Europe and the developing world. American governmental economic aid, whether direct or channeled through such institutions as the World Bank, helped finance economic growth abroad. In addition, the American military umbrella allowed anti-Soviet governments in Europe, Japan, and the developing world to rely on the United States for security and to turn their attentions to encouraging economic growth. All in all, the non-communist world's unprecedented access to American markets and American capital provided a major stimulus to world economic growth, not to mention to the profits of American businesses and general prosperity withinthe United States. For over twenty-five years after World War II, the capitalist world experienced impressive levels of economic growth and development, all within a general context of international cooperation under American political, economic, and military tutelage. This period is often referred to as the Pax Americana because of its broad similarity to the British-led international economic system that operated from about 1820 until World War I, which was known as the Pax Britannica. In both instances, general political and economic peace prevailed under the leadership of an overwhelming world power—the United Kingdom in one case, the United States in the other. There were, nonetheless, major differences between the two eras.

Just as the Pax Britannica eventually ended, however, the Pax Americana gradually eroded. By the early 1970s, strains were developing in the post-war system. Between 1971 and 1975, the post-war international monetary system, which had been based on a gold-backed U.S. dollar, fell apart and was replaced by a new, improvised pattern of floating exchange rates in which the dollar's role was still strong but no longer quite so central. At the same time, pressures for trade protection from uncompetitive industries in North America and Western Europe began to mount; and, although tariff levels remained low, a variety of nontariff barriers to world trade, such as import quotas, soon proliferated. In the political arena, détente between the United States and the Soviet Union seemed to make the American security umbrella less relevant for the Japanese and Western Europeans; in the less developed countries, North-South conflict appeared more important than East-West strife. In short, during the 1970s, as American economic strength declined, the Bretton Woods institutions weakened, and the Cold War thawed, the Pax Americana drew to a close. The quickening pace of change in the Soviet Union and its allies eventually culminated in the collapse of former Soviet bloc nations in the late 1980s and early 1990s, and ultimately in the disintegration of the former Soviet Union. The end of the Cold War did not, of course, mean an end to international conflict, but it did put an end to the East-West divide that had dominated global politics for so long. To some extent, some of the former centrally planned economies, especially in Central Europe, moved successfully into the ranks of the developed nations, albeit as relatively poor ones. Others, however, became most similar to the developing nations as they struggled to overcome poverty and privation. Russia, although it shares many typical Third World problems, is unique in its mix of underdevelopment, size, and military might. Within a rapidly changing environment, the United States remains the most important country within the contemporary international political economy, but it is no longer dominant. The era of American hegemony has been replaced by a new, multilateral order based on the joint leadership of Western Europe, Japan, and the United States. Together, these countries have successfully managed—or, some would say, muddled through—the "oil shocks" of the 1970s, the debt crisis of the early 1980s, the transition to the market of the former centrally planned economies after 1989, and the currency and other financial volatility of the 1990s.

Despite greater success than many thought possible, multilateral leadership andthe liberal international order remain fragile. Conflicts of interest and economic tensions remain muted, but they could erupt at any time. As might be expected, the rise and decline of the Pax Americana and the emergence of the new, multilateral order, along with the end of the Cold War, have led to great scholarly controversy. For some analysts, America's global dominance and the East-West divide were the principal determinants of Western interests and policies and, in turn, of the liberal international economy. In this view, the decline of the United States in a post-Cold War world presages the eventual collapse of international openness. For other observers, the policies of the United States and other countries were affected in more important ways by domestic economic and political pressures; from this perspective, the decline of American hegemony is expected to have little effect on international openness. For still others, the consequences of the liberal order have fundamentally altered the interests of the United States and other countries; the internationalization of production and finance and the rise of economic interdependence have created vested interests in favour of the free flow of goods, services, and capital across national borders

5.4 SELF-ASSESSMENT EXERCISES 1

1. Explain the functions of trade liberalization?

5.5 SUMMARY

In this unit we have discussed a brief history of rise of institutional frameworks for the management of the international economic system. This process began in the post-bellum period with the formulation of the Bretton Woods institutions. The decline and eclipse of communism allowed neo-liberal influences to pull the global economy toward the much-taunted globalisation system. This has brought the West in head-long clash with conservative interests in the East.

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5.7 ANSWERS TO SAEs 5

Trade liberalization opened the huge American market to foreign producers. American overseas investment provided capital, technology, and expertise for both Europe and the developing world. American governmental economic aid, whether direct or channeled through such institutions as the World Bank, helped finance economic growth abroad. In addition, the American military umbrella allowed anti-Soviet governments in Europe, Japan, and the developing world to rely on the United States for security and to turn their attentions to encouraging economic growth. All in all, the non-communist world's unprecedented access to American markets and American capital provided a major stimulus to world economic growth, not to mention to the profits of American businesses and general prosperity withinthe United States. For over twenty-five years after World War II, the capitalist world experienced impressive levels of economic growth and development, all within a general context of international cooperation under American political, economic, and military tutelage. This period is often referred to as the Pax Americana because of its broad similarity to the British-led international economic system that operated from about 1820 until World War I, which was known as the Pax Britannica. In both instances, general political and economic peace prevailed under the leadership of an overwhelming world power—the United Kingdom in one case, the United States in the other. There were, nonetheless, major differences between the two eras.

Module 2: THE MAJOR STRANDS IN THE MANAGEMENT OF INTERNATIONAL RELATIONS

UNIT 1 THE WESTERN SYSTEM

CONTENTS

1.1 INTRODUCTION

As the Second World War began to ebb away, the representatives of forty four nations met at Breton wood, New Hampshire to create a new intentional monetary order. A major need for this meeting was to put on apparatus that could replace the international monetary system which had collapsed in the 1930s. It was also important that such an apparatus be durable enough to prevent another economic and political collapse and subsequently another military conflict. It was generally held that mere reliance on the forces of the market was unavailing and government acting in concert was assuming a pivotal role in the management of the international monetary system. The United States was a major instigator of the Bretton woods system because of the policy makers had realized that a major cause of the political and economic collapse had been a failure of American leadership. These individuals envisioned an international economic system which would exclude economic nationalism by embracing free trade and a high level of international interaction for them. This would enable a lasting peace for the international system. The American plan in concert with the British became the first publicly managed international monetary order. This plan endured for a quarter of a century in which the development countries witnessed robust economic growth.

1.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Discuss the mode of economic management in the aftermath of the Second World War.
- Enumerate the reasons for the rise and fall of the economic institutions.

1.3 MAIN CONTENT

3.3.1 The Formation of an International Economic System

Following Spero, the Bretton woods never functioned as intended by the originators. Two organizations originated with the Bretton woods system; the international monetary fund (IMF) and the international bank for reconciliation and development (IBRD, also known as the world bank). They were to be central banks of the international economic system. The Bretton woods system provided guidelines set forth the articles of agreement. The first rule was that there will be a fixed exchange rate in contrast to the floating exchange rate which was believed to have orchestrated from the problems associated with the crises of the 1930s. to actualize this all countries agreed to establish the parity of their currencies in terms of gold and to maintain exchange rates within one percent, plus or minus of parity. The IMF was to be the keeper of the rules and the main instrument of public international management. Its approval was needed for any change in exchange rates. It advised countries and extended credits to countries suffering from balance of payments problems. In order to achieve this, aim the IMF was provided with a fund, the initial quotas were 8.8 billion, contributed by member countries. These contributions were denominated in gold and in the currencies of the contributing countries. During times of budgetary deficit countries could borrow up to eighteen months and in cases up to five years from this fund.

However, despite these innovations in its original form, the Bretton woods system still placed emphasis on national and market solutions to monetary problems. For instance, national monetary reserves were to be supplemented, when necessary, by IMF credits during crises of balance of payments distortions. In the final analysis few means were handed to the IMF on how to encourage such national solutions. It was expected in 1944 that the new system would come to into operation after the return to normalcy following the devastation of the war. In order to ensure speedy post war, recover, the international bank for reconciliation and development was created. By 1947, it was recognized especially in the United States that the Bretton woods system was not performing as planned and thus the entire western system tittered on collapse. This was because the entire productive capacity of Europe had been destroyed during the war. Consequently, Europe was running huge deficits whilst the United States was amassing huge surplus.

Due to the problems, the Bretton Woods system was unable to cope as envisaged furthermore the article of agreement stated that IMF loans should be available for only current account deficits and not for reconstruction purposes. Meanwhile the IBRD had only $570 million for such purpose. Thus by 1947 both IMF and the IBRD had admitted their failure to cope with the crises. Key political issues underpinned the crises; pressure from powerful labour unions in France and Italy; British withdrawal from India and Palestine and the abandonment of its political and security commitments t Greece and turkey and seeming communist gains under soviet tutelage in east Europe. It appeared then to observers that the soviets were awaiting the collapse of Western Europe to further their political advantage.

Given the haplessness of the Bretton Woods institutions by 1947 a new system of international monetary management was born. This system was the dollar system which was hinged solely on American management.

3.3.2. Unilateral American Management

The United States was able to manage the system from 1947 to 1960. This ability largely grew from the strength of the American economy, lessons of the interwar period and security incentives. Moreover, the Europeans and Japanese wearied by the war were willing to accept American political and economic leadership in order to rebuild their societies politically and economically. In 1947 the United States began to perform this task by providing liquidity and adjustment which are two key functions necessary for a monetary system. In the nineteenth and early twentieth century's gold had served as an instrument for determining the currency value. Supplementing the use of gold in this period was the British pound based on the dominance of the British economy. By 1947 gold was insufficient to meet world financial demands and the devastation of the British economy had seriously weakened the pound. Thus, the American dollar the only currency strong enough then to meet the international demand stepped into the breach.

Apart from its strength the dollar had other attributes which rated it higher than the gold such as earning of interest, flexibility and ability to buy imports. In order to assure the world of much needed dollar supply, it was necessary that the natural economic processes had to be reversed. That is dollar has to leave the United States and become available for international use. This rather than continue to run massive surplus the United States economy had to run massive deficits. Consequently, from 1947 to about 1958 the United States government deliberately encouraged the outflow of dollars through various aid programs such as the Marshall plan amongst several others. The United States also gave out billions of dollars in grants to sixteen Western Europe countries from 1948 to 1952. Dollar liquidity was also provided through America's vast expenditures on security to curtail the growing communist threat worldwide.

As regards the provision of adjustment the United States adopted several measures which facilitated it in the short term. For instance, it neglected the Bretton woods system structure on convertibility and encouraged European and Japanese trade protectionism. In order to encourage long-term adjustment, the United States encouraged trade competiveness of European Japanese goods. By the 1950s the international economic system had recovered well enough under American influence to assure stability and progress.

3.3. 3.Multilateral Management under US Leadership

By 1958, as Europe and Japan recovered, America lost interest in running a payments deficit. In fact, it was long before the United States realized that its deficit was out of control. By 1960 that deficit had risen to 3.7 billion dollars. 1960, international speculators began to convert dollars into gold on the London market. In the followingyear there was also massive speculation on the British pound. This led to the perception that the United States was now unable to manage the system alone. Consequently, the United States was forced to join in collective management of the system. The IMF which had hitherto been dormant under American economic suzerainty began to find its voice when Europeans began to turn to it for funds to finance temporary balance- of- payments disequilibrium. Increases in the fund's quotas at the time facilitated the more active role. However, the major functions of monetary management were perfumed by multilateral elite from the major states. These forms of multilateral included, central bank cooperation, the group of ten comprising of ten composing of finance ministers and their deputies, the working party three of the organization for economic cooperation and development and a series of bilateral arrangement between the United States and other members of the group of ten which supported the multilateral management system.

To the extent that they prevented and contained currency crises the multilateral management mechanisms were a success. They also achieved major reform of international liquidity.

By the 1960s and 1970s, certain important structural changes led to the breakdown of multilateral management. One major change was the high level of monetary interdependence. This new interdependence was created first by the internationalization of banking. This new form of monetary interdependence made possible huge international capital flows. This high rate of monetary interdependence began to increasingly interfere with national economic management. The effect of this monetary system told negatively on American trade. Due to expenditure on the Vietnam war and alteration of exchange rates by other countries, the dollar became overvalued. A fact led to declining export. A second structural change which undermined the system was the rise of pluralism. Europe and Japan had recovered and were no longer content to sit back and allow the United States unrestricted domination of the system. Furthermore, the loosening of tension in the cold war helped loosen the bonds that had hitherto held the western alliance. The new pluralism thus made monetary management more difficult.

Paralysis

Given the imbroglio a paralysis in international monetary management was bound to develop from 1968 to 1971 a series of paralysis seized the system. The central banks were unable to control the large currency flows in the system. Cooperation in the group of ten detonated; America withdrew from cooperation and leadership of the system and followed domestic policies regardless of its international consequences. The United States also engaged in benign neglect of the system as it no longer sought to mobilize the system for reform as it had done in the 1960s. This was partly because it was unable to lead the system. Issues came to a head on August 15, 1971 when President Nixon without consulting the members of the international monetary system announced his new economic policy. The policy called for dollar inconvertibility into gold and 10 percent surcharge on dutiable imports. That day signalled the end of the Bretton Woods system

The Smithsonian agreement

Following the American declaration on August 15, 1971 attempts were made under American direction to develop a new multilateral monetary system. Following the series of negotiations on agreement was reached at the Smithsonian institution in Washington in December 1971. The Smithsonian agreement presented a minimum level of international monetary cooperation. American negotiators finally agreed to devalue the dollar. Despite the 10 percent US import surcharges the Europeans and Japanese did not impose countervailing duties. Thus, there were no drift into protectionism.

Smithsonian was a temporary agreement which it was hoped would give the participants' time to negotiate a long –term monetary reform. The lengthy negotiation leading to Smithsonian revealed the under currents of political conflicts bedevilling the international monetary system. Only a last-minute compromise by the American and French President had saved the negotiation. Within a year, the Smithsonian agreement had dissolved under pressure from issues such as massive currency flows.

The committee of twenty; the elusiveness of reform

In 1972, a committee on reform of the international monetary system and related issues, the committee of twenty had been established within the IMF to develop a major reform of the international monetary system. The committee was charged with developing new means of managing the quantity of the world's reserves, establishing a commonly accepted currency or currencies in which members of the system had confidence and developing new adjustment mechanisms. As expected, there was great conflict over issues such as the nature of controls on surplus and deficit countries, over the conditions of floating, over the role of gold and dollar e.t.c. Even as the committee sat the world economy went into turbulence, double digit inflation erupted and orchestrated a dramatic rise in the price of oil. This led directly to huge surplus in the oil producing states. Thus, the international monetary system must provide mechanisms for transferring earnings from oil surplus to oil deficit countries. This is the recycling problem.

Overwhelmed by the float, inflation and the monetary consequences of the oil crises the committee of twenty, in Rome, in 1974, concluded it was impossible to fashion a plan for monetary reform given the turmoil in the international system. In this regard it was replaced by an interim committee. The interim management focused on controlling problems arising from the sudden hike in oil prices. These remedies included makeshift programs such as a German loan of $2billion to Italy, a European Economic Community (EEC) facility of $3billion and a $3billion IMF facility for oil- induced deficit. Due to disagreements, it was not possible to go beyond these temporary measures to more significant recycling program. In January 1975, a general agreement was reached to establish a $25billion net with the OECD. There were still problems from monetary management problems related to the rise in the price of petroleum. These problems included debt payment, the long-term transfer of resources from oil consumers to oil producers. The shift in vast resources to oil producers who were outside the traditional management group of developed economies. This was a significant problem because these countries now processed the means to disrupt the system. Consequently, new mechanisms had to be developed to integrate the new monetary powers into the system.

The attempt to address exchange rate and reserve problems now came to the fore after 1975 when the oil crises had been received to a considerable extent. At various meetings in November 1975 in Rambouillet, France IMF meeting in September 1975 and IMF meeting in Jamaica in January 1976 the five monetary powers achieved some consensus.(38); the float was legalized but a window was left open for the fixed exchange rates for countries willing to do so; at the insistence of France it was agreed that a generalized fixed rate may be returned to at some future time; finance ministers were mandated to meet frequently to discuss policy whilst central banks must consult daily about exchange rate conditions. On reserve assets, an official price for gold was eliminated, the disposal's of one third of the IMF's supply of gold and the renewal of the fund's obligation to make and receive payments in gold. The political process of reform was fraught with difficulties. Gone are those simpler days when the United States, along with the United Kingdom could draw up a constitution for a world monetary order.

3.4. International Trade and Domestic Politics

Trade policies of many countries are usually at very centre of domestic politics. Concepts such as tariffs, quotas, and non tariff barriers are familiar issues for a broad range of economic groups in any country's domestic politics. The intricacies of trade policy are not only well known, they are also the subject of frequent and often lightly domestic political conflict majorly because it determines prosperity or depression, profit or trade policy, bankruptcy, survival or death for many industries.

Domestic politicization has been an important constraint on international management. In trade due to the presence of large number of actors and interests, unilateral management is not possible through leadership. Factors which led to the emergence of managed international system after World War II also led to the attempt to subject trade for the first time to systematic international control. Two factors were predominant in the quest for an international managed trade system; the United States belief in free trade and its willingness to lead the system.

The Havana Charter

The conflict between domestic politics and international management arose with the Havana charter which was intended towards a new order for the international economic system. In 1945, the United States had presented a plan for a multilateral commercial convention which would regulate and reduce restrictions on international trade. The convention offered rules for all aspect of international trade- tariffs, preferences, quantitative restrictions, subsidies, international trade agreements. It also provided for an international trade organization to oversee the system. Discussion began in 1946 on American initiative on how to implement a new trading order.

The result was a long and delayed international negotiation which did not end until 1947. The Havana charter was a compromise which ended up pleasing everyone and satisfying no one. The domestic conflict in America politics finally put paid to the ambitions of the charter. In 1950 president Truman finally decided against submitting the charter to congress where it faced inevitable defeat.

Multilateral Management under US Leadership

The end of ITO signalled the end of many rules of the Havana charter but the consensus on the need for the establishment of an international trading order remained. It was embodied in GATT (General Agreement on Tariffs and Trade) which had been drawn up in 1947 to provide a procedural base and to establish guiding principles for the tariff negotiations the being held in Geneva.

Because the Havana charter was never ratified, GATT which was meant to be temporary became by default the expression of the international consensus on trade. The major rule for implementing free trade was the GATT principle of non-discrimination. GATT also established an international commercial code with rules on such important issues as dumping and subsidies. The most important rule prohibited the use of quantitative restriction such as quota except for balance of payments reasons. GATT also provided the framework for multilateral trade negotiations. Thus from a temporary treaty GATT became not only an established commercial code but also an international organization with a secretariat and a director general to oversee the implementation of GATT rules and to carry out preparatory work for international trade conferences. Finally, America also moved in to head the new trading system.The system worked as quotas and exchange rate barriers were eliminated. However by 1968, structural changes were leading to the resurgence of domestic political challenges to international management of trade and the system appeared to be failing.

Paralysis and Drift

After 1967, there were no new multilateral trade negotiation leading states to adopt policies which eroded the system of leadership and the norms of cooperation. These problems include the attempt of the six and later the nine European states to build a common economic and political unit. Although custom unions had been permitted by GATT yet by the late 1960s it had appeared as if Europe was moving against multilateralism. A good example was the community's agricultural policy (CAP) which blocked imports into the community. Despite its protectionist impact the EEC had been unwilling to make any major revision in CAP. The expansion of the preferential trading arrangements explicitly outlawed by GATT rule of non-discrimination was also a problem. The enlargement of the EEC to include the United Kingdom, Denmark and Ireland increased the size of the agricultural protectionist system and the preferential system.

1.4 SELF-ASSESSMENT EXERCISE 1

Discuss your understanding of USA unilateral management of economic ideology?

1.5 SUMMARY

Our discussions in this unit have revolved around the setting up of Bretton woods institutions and the IBRD. The unit also noted that by 1947, it was recognized especially in the United States that the Bretton woods system was not performing as planned and thus the entire western system verged on collapse. This was because the entire productive capacity of Europe had been destroyed during the war. Given this scenario a new system of international monetary management was born. This system was the dollar system which was hinged solely on American management. It worked for a while before it too under stress began to encounter serious distortions.

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1.7 POSSIBLE ANSWERS TO SAEs 1

The United States was able to manage the system from 1947 to 1960. This ability largely grew from the strength of the American economy, lessons of the interwar period and security incentives. Moreover, the Europeans and Japanese wearied by the war were willing to accept American political and economic leadership in order to rebuild their societies politically and economically. In 1947 the United States began to perform this task by providing liquidity and adjustment which are two key functions necessary for a monetary system. In the nineteenth and early twentieth century's gold had served as an instrument for determining the currency value. Supplementing the use of gold in this period was the British pound based on the dominance of the British economy. By 1947 gold was insufficient to meet world financial demands and the devastation of the British economy had seriously weakened the pound. Thus, the American dollar the only currency strong enough then to meet the international demand stepped into the breach.

Apart from its strength the dollar had other attributes which rated it higher than the gold such as earning of interest, flexibility and ability to buy imports. In order to assure the world of much needed dollar supply, it was necessary that the natural economic processes had to be reversed. That is dollar has to leave the United States and become available for international use. This rather than continue to run massive surplus the United States economy had to run massive deficits. Consequently, from 1947 to about 1958 the United States government deliberately encouraged the outflow of dollars through various aid programs such as the Marshall plan amongst several others. The United States also gave out billions of dollars in grants to sixteen Western Europe countries from 1948 to 1952. Dollar liquidity was also provided through America's vast expenditures on security to curtail the growing communist threat worldwide.

UNIT 2: THE NORTH-SOUTH SYSTEM

CONTENTS

2.1 INTRODUCTION

Management problems of the North-South system are quite different from those of the Western system. For the system of the market economies, the dilemma is whether it is possible to achieve the necessary international political capability to manage mutually beneficial international economic relationships. In the North-South system of dependence, the management dilemma is whether it is possible to achieve the necessary international political capability to create a system which is mutually beneficial for all.

2.2 INTENDING LEARNING OUTCOMES (ILOs)

By the end of this unit, you will be able to:

- Discuss the History of North-South economic interaction China and account for its interaction with the west.
- Account for the imbalances in the economic relationship between North and South
- Understand the economic implication and benefit of relationship between South and North.

2.3 MAIN CONTENT

2.3.1 The North-South System

The management problems of the north-south system are quite different from those of the western system of dependence the management dilemma is whether it is possible to achieve the necessary international political capability to create a system which is mutually beneficial for all. In this regard the policy of the north has been to maintain the system of independence whereas the policy of the south has been to change in liberal school, the Marxist-medical school and the structuralize school of thought through looking at following economic ideologies:

The liberals:

For liberal theorists' continuous contact with the developed market economics is an important means of promoting development; trade according to liberal analysis acts as an engine of growth. Specialization according to comparative advantage and international trade increases income foreign aid from developed market economics is also believed to help fill resource gaps in underdeveloped countries by providing capital, technology and education.

Marxist:

For Marxists theorist equitable distribution of benefits cannot occur within the international capitalist system. Southern countries are poor and exploited because of their history as subordinate elements in the world capitalist system and units' condition will persist for as long as they remain part of that system. furthermore, foreign investment further hinders and distorts southern development often by controlling the most dynamic local industries and expropriating the economic surplus of these sectors via negotiation of profits. royalty sues and licenses

The Structuralists:

Just like Marxists, structuralists have argued that the international market perpetuates backwardness and dependency in the south and encourages dominance by the north. Gunner Myrdal one of the foremost structuralists observed that the market tends to favor the already well-endowed and thwart the underdeveloped the structural bias of the international market according to this school, rests in large port on the inequalities of the international trading system.

2.3.2 TRADE STRATEGY

In the post-World War II, the independent southern states fought to include their interests in the post war international trading order. The economic development of the south was not a major concern of wartime and post-war economic planning. the Havana charter recognized in some degree the special problems of underdeveloped countries .in this regard the south had access to the major decision –making bodies of the ITO. The abrupt end of the Havana charter ended the integration of the concerns of less developed countries in the regulation of international trade. The GATT which replaced it made no provisions for the interests of the under developing countries. Consequently, isolated from the management system they then sought to insulate themselves from adverse conditions of the international market.

By the late 1950s it was becoming clear that the southern strategy of isolation from the international trading system was a failure it led neither to development nor to independence and may have actually aggravated the negative impact of international trade on the south .in cheatingly dissatisfied with the operation of the international market and with the exclusion from management and often unable or unwilling to carry out domestic reforms to further economic development the country of the south began to look for a new trade strategy factors such as worsening economic situation ,negative effects of import substitution and balance of payments crisis aided this search

The southern strategy of the 1960s was one of unity and confrontation .the first southern demand was for an international conference on trade and development and the first attempt to unite the south behind such a demand came at the bell gate conference of nonaligned countries in September 1961.faced with this unity and the southern numerical control of the general Assembly the north gave way .this decision had been forced on it by the Cairo conference of 1962 at which for the first time several American states has joined the Aston and African nations in a unified southern attempt to formulate a joint policy and a joint demand on the developed countries southern unity and numerical strength in the United Nations thus succeeded in calling the first UNCTAD in Geneva in 1964. The permanent secretariat and its secretary general had reinforced the perception of common interest by providing a doctrine which defines what is needed is redistribution of world resources to help the south.

Although the UNCTAD had achieved some success yet it encountered important limitation, difficulty in maintaining southern unity, the united front of opposition from the developed countries and most importantly the inability of the southern strategy to pressure the north.

1. **3.3 The multinational corporation**

The level of globalization in the world today has heightened. the problems of managing the multi nationals in developing economies. This is primarily because multinational corporations have far greater power in the south than in the north and it would appear also that the costs of multinational power have been for greater in the underdeveloped world than in the developed world than in the developed world

The importance of foreign investment in the south varies from country to country .in some states it is relatively insignificant where as in others it plays a key role. It is known that multinational corporations have tended to concentrate a few underdeveloped countries. The power of multinational corporations grows out of their structural position within the relatively small and underdeveloped economies of many southern states more importantly foreign investment dominates key industries in southern states. This include the extractive industry and manufacturing

Power: Local Government

A major governmental problem in the global south has been the multinational ability to intervene in the domestic political process of the host state to further corporate as opposed to host government interests. Multinational corporations are potentially able to use their resources in both legal and illegal political activities in host countries. Tactics such as public relations activities campaign contributions bribery and economic boycott are available to the corporation in their ability to intervene in domestic polices multinational corporations are, in one sense, no different from national corporations; the problem they pose is not in the area of foreign investment but in their ability as private corporations to influence government. Thus, due to their powerful positions within third world economics and vis-à-vis third world governments multinational corporations can affect economic efficiency and welfare and influence politics in southern host countries.

Efficiency, Growth and Welfare

Proponents argue that foreign investment has a positive impact on southern economic development one of the most important contributions is capital. A second crucial resource gap filled by multinational as argued is technology. For them foreign investment also improves the quality of labour in the south. However these viewpoints have been contested by critics who vote that multinationals do not bring as much foreign capital as suggested since their financing is usually done through host country finance. There is also the contention that foreign investment actually leads to an outflow of capital .Another criticism is that profits only represents a small point of the effective return to the parent as a large point of the real return comes from licensing fees and royalties paid by the subsidiary to the parent for the use of technology controlled by parent in sum multinational accused of fostering a distributed an undesirable enclaves which do not contribute to the development of the larger economy.

Management of foreign investment

Despite the apparent enthusiasm of the underdeveloped countries for the attempt by the United Nations centre on transitional corporations to develop on international code of conduct little can be expected of such efforts. The real efforts to control the national level or prep has as in the attempt of the an clean

The most publicized southern attempts to manage multinational corporations have been nationalization of local subsidiaries. Further there has been the enactment in recent years of new bureaucratic system of control is the use of inducement such as tax advantages or exemption from import restrictions in order to encourage companies to invest in new fields or to use new technologies. Another technique of control is government support of state. owned industry in many industries with high barriers to entry, government-owned enterprise is the only visible national alternative to foreign investment.

Oil and Cartel Power

In 1973 southern oil-exporting states dramatically reversed a system of dependency and increased not only their economic rewards but also their political power. consequently it appeared as if the organization of petroleum exporting countries became the new hope of the underdeveloped countries. The international oil system which was overturned by Opel had been dominated from the earliest days by consortium of international oil companies known as the seven sisters. they included standard oil of new jersey now known as Exxon, standard oil of California, Mobil, Gulf and Texaco (American), British petroleum and British royal Dutch-shell (Anglo-Dutch).The ability of this oil oligopoly to manage the price of the oil to their advantage was facilitated by the nature of demand for oil .The demand for petroleum is highly inelastic at least in the short run .This is due to the fact that there are no readily available substitutes and also because it is difficult to decrease consumption on increase in the price of oil the dominance of the seven sisters was backed by political intervention from the industry as well as from their home government an extreme example of such of such intervention took place in Iran in the early 1950s .due to nationalization of the Anglo-Iranian oil company by the government of Muhammad Mossadegh was overthrown by the CIA .

Forces of Change

A number of important changes eventually relieved the producing states from dependence on the seven states. These changes include the entry of new firm thus increasing competition the formation of OPEC in 1960 which improved slightly the bargaining position of the producing countries and the increased dependence of the developed world on imported oil a situation that was accentuated by the declining political influence of these countries government in the oil- producing regions

The major changes in the system began in 1970. In the 1970s the oil producing states- especially the Arab oil producers –developed a strong bargaining position vis-à-vis both the companies and producing states. Favourable international economic and political conditions plus internal co-operation enabled the first to take control of prices and then to assume actual ownership of oil investment. The catalyst of future change was the Libyan government action against the oil companies in 1970. This had begun when the radical government of Colonel Muammar Gaddaffi demanded on increase in the posted price of and the tax of Libyan oil. The Libyan settlement was a harbinger of things to come as oil producers where now aware fully that government revenue could be raised not only by increasing exports but also instead by increasing price.

In December 1970 OPEC countries met in Caracas and passed resolutions calling for an increase in the posted price of oil and in host country income taxes on that oil. Negotiations between OPEC and the oil companies began in Teheran, Iran in January 1971.The outcome was on increase in government royalties and taxes from 50 percent to 55 percent. In April 1971 a similar agreement but with higher price, was reached with Libya at Tripoli 1972 in Geneva an agreement was negotiated which provided for an increase in the posted price of oil and a continuing adjustment to account for exchange rate changes. Despite two more negotiations in 1972 to discuss nationalization and in 1973 to discuss a second adjustment of prices to reflect monetary changes, the country remained dissatisfied.

The conditions creating discontent also created the possibility for alleviating that discontent. The fourth Arab-Israel war had begun on October 6 just two days before the Vienna talks began on December 23 OPEC unilaterally raised the price of person Gulf oil to 111.65 to take effect January 1964.The actions of OPEC showed that hence forth on issues of price the producers would not negotiate with the companies or with the consuming states they possessed the power to dictate terms unilaterally. Since 1973 oil prices have been determined by the OPEC members acting as a producers' cartel.

The success of the oil producers led to revolution in the thinking of southern new material producers. Suddenly it seemed that producer cartels could bring the end of dependence. Producer organization in copper, bauxite, iron one, bananas and coffee were either formed or took on new life after October 1973.the third world issued a call for producer associations .in April 1974 at a special season of the United Nations General Assembly. The less developed countries demanded the establishment of a new international economic order which was to include Northern support for the functioning and the aims of producer association. In December 1974 the third world pressed through the general assembly a charter of economic rights and duties of states which included an article on the right of the south to form producer associations and the duty of the north to respect that right by refraining from applying economic and political measures that would limit it.

2.4 SELF-ASSESSMENT EXERCISES 2

Q1. Examine the nature of trade strategy?

2.5 SUMMARY

The unit discussed aid, trade strategy, the Multinational Corporation and oil in the economic interaction and relationship between North and South hemispheres. Even though these issues sprung up generations ago yet one finds that even to the present time they still bear remarkable salience in the North-South economic relations.

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2.7 POSSIBLE ANSWERS TO SAES 2

In the post-World War II, the independent southern states fought to include their interests in the post war international trading order. The economic development of the south was not a major concern of wartime and post-war economic planning. the Havana charter recognized in some degree the special problems of underdeveloped countries .in this regard the south had access to the major decision –making bodies of the ITO. The abrupt end of the Havana charter ended the integration of the concerns of less developed countries in the regulation of international trade. The GATT which replaced it made no provisions for the interests of the under developing countries. Consequently, isolated from the management system they then sought to insulate themselves from adverse conditions of the international market.

By the late 1950s it was becoming clear that the southern strategy of isolation from the international trading system was a failure it led neither to development nor to independence and may have actually aggravated the negative impact of international trade on the south .in cheatingly dissatisfied with the operation of the international market and with the exclusion from management and often unable or unwilling to carry out domestic reforms to further economic development the country of the south began to look for a new trade strategy factors such as worsening economic situation ,negative effects of import substitution and balance of payments crisis aided this search

UNIT 3: THE EAST-WEST SYSTEM

CONTENTS

3.1 INTRODUCTION

In the post-war peace orchestrated by the allied military victory, it was felt that the aftermath peace would rely heavily on post-war international economic prosperity. Thus, Soviet participation in the international economic order would encourage harmony and trade with the Soviet Union would create demand for U.S products thereby encouraging prosperity. However, the optimistic view was shortly undermined by post-war disagreements between the U.S and the Soviet Union.

3.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Explain the success of East and West Economic Relation
- Understand the politics that led to change in the East
- Examine the forces for change in the west.

3.3 MAIN CONTENT

3.3.1 East-West Economic Relations

It was not part of the plans of economic reconstitution in the past-World War II period that the east would not be part of the post war system from the time of the Russian revolution until the early 1930s, when the collapse of world trade led to a collapse of trade with the west, the society union carried on an important trade relationship with the developed countries and with the United States in particular. In fact, US-society economic interaction revived during the war years through US –lend 4lease assistance

The participation of Eastern Europe in the post war economic order was not questioned by western planners. The countries of Eastern Europe had been closely integrated with the west in the inter war period. Despite these past economic relationship between the capitalist countries of the west and the communist of the east became one of independence and for most of the post war era of confrontation. the world war led to an effort on both sides to separate the economics of east and west and to use that separation as a tool of political confrontation. The Soviet Union together with the new communist states of Eastern Europe created a separate economic system. As Joseph Stalin put it

The disintegration of the single, all-embracing world war market must be regarded as the most important economic sequel of the Second World War and of its economic consequences. China and European people's democratic broke away from the capitalist system together with the Soviet Union formed a united and powerful socialist camp confronting the camp of capitalism (Spero, 1980)

The creation of a separate eastern economic system was part of the Soviet Union post-war policy of dominance Eastern Europe. The Soviet Union ideological purpose was to advance world revolution and the spread of communism. According to Marxist theoreticians the formation of a separate eastern economic blitz would deepen the crisis of world capitalism and speed its inevitable demise. The denial of eastern markets would decently rate the west's economic problem unsolved since the great depression and reinforced by the war station started that denying the eastern export possibilities, create idle industrial capacity and to the inevitable internal economic and political collapse of capitalism. There was also the military strategy of preventing Eastern Europe from falling into the orbit of the hostage western powers. Thus, through wartime diplomacy, military occupation and coup d'état, the Soviet Union established communist satellite regimes in all the states of Eastern Europe. The Soviet Union refused to join the new international economic institutions created by the west and prevented these satellites which were eligible and which evidenced on interest from participating in western institutions.

3.3.2 Forces of Change in the East

The decline of political and economic forces in the Soviet Union and Eastern Europe led to decrease in political conflict with the West. Some of these factors included the Soviet nuclear parity with the United States which allowed the Soviets to view the West with more confidence. Another factor was the problem of Russian agriculture. Unable or unwilling to subject their people to increasing pressure without courting political risks the Soviet Union after 1960 decided to meet shortfalls with international purchases. Another factor was the issue of the intractable problem of

Eastern technology. In the East there was little incentive for plant managers to experiment with new technologies. Thus, by the mid-1960s it became increasingly apparent that the East would have to turn to the West to sort out its most serious problems.

3.3.3 Forces of Change in the West

An economic interest in opening relations with the East developed in the United States in the late 1960s and early 1970s at the time of economic crisis in the West. Changing international economic conditions fostered a domestic political consensus favouring increased trade with the East. As Western Europe and Japan became powerful competitors and threatened US position in Western markets, American businessmen began to look to the East. The communist state looked attractive not only as untapped markets but also because of the new interest of the communist countries in purchasing technology in large quantities from the West.

3.4 SELF-ASSESSMENT EXERCISES 3

Describe the nature of East and West Economic Relation you know?

3.5 SUMMARY

This unit examined the processes that led to the rise of the Eastern economic bloc as a force in the international economic system. In order to circumvent this bloc, the West had launched a sustained economic warfare on the Eastern bloc primarily to obstruct the rise of communism. However, within a short while economic dictation forced the cooperation of the two blocs until the latter-day demise of the Eastern bloc.

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3.7 ANSWERS TO SAEs 3

It was not part of the plans of economic reconstitution in the past-World War II period that the east would not be part of the post war system from the time of the Russian revolution until the early 1930s, when the collapse of world trade led to a collapse of trade with the west, the society union carried on an important trade relationship with the developed countries and with the United States in particular. In fact, US-society economic interaction revived during the war years through US –lend –lease assistance

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UNIT 4: THE SOUTH-SOUTH SYSTEM

CONTENTS

4.1 INTRODUCTION

The South herein refers to the developing countries as per the country groupings in the International Yearbook of Industrial Statistics 2007, UNIDO. For example, the Non-aligned Action Programme for Economic Cooperation among Developing Countries in 1972 and the Lima Declaration which was a call for change made in March 1975 when the Second General Conference of the United Nations Industrial Development Organization (UNIDO), meeting in Lima, issued a Declaration and World Plan of Action for the redistribution of world industry so that developing countries would generate 25 per cent of world industry by the year 2000.

4.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Understand the key argument behind South-South cooperation.
- Explain the impact of South-South cooperation on its development
- Examine the global features for South- South integration

4.3 MAIN CONTENT

4.3.1 The South and the South in cooperation

The rationale for industrial development, trade and hence growth and poverty alleviation through SSC relates to declining real prices for, and loss of, market shares by commodity dependent DCs (Developing Countries) in general, and least developed countries (LDCs) in particular. With the exception of hydrocarbons, and certain industrial raw materials, prices for commodities have been on a long-term downward trend and remain at historically low levels despite more recent demand-induced upward changes. The case for SSC in industrial development for economic growth also stems from the regionalism in trade that is characterized by preferential RTAs. When countries of a RTA have similar natural resources, in the absence of policy interventions, they may achieve little diversity in their resource endowments and hence experience limited opportunities for advancing up the manufacturing value added (MVA) ladder.

A wide spectrum of initiatives among DCs, continuing on from those of the 1970s and 1980s, is needed in pursuit of using trade and SSC as responses to the challenge of sustainable industrial development. A division of labour that spurs South-South trade-induced economic and industrial complementation, in terms of the Akamatsu (1962) 'flying geese' paradigm, would seem beneficial. However, SSC cannot take place in isolation from the progressive integration of the global economy under the auspices of multilateral trade agreements that set the 'rules of the game'. A profile of South-South trade that is emerging, irrespective of the current economic crisis, indicates windows of opportunity for converting relatively static comparative advantages into dynamic competitive advantages through membership in RTAs. Economic growth in a number of Asian countries bears testimony to poverty alleviation being growth-centric, with export trade acting as the engine of growth. The success of Asian countries in using export dynamic manufacturing for growth and poverty alleviation is inherent to the way those countries have addressed a number of critical issues. An attempt is made in this unit to capture key issues regarding SSC in industrial development.

Trade Agreements and Vertical Specialization

A select group of factors indicate the deepening integration of the world economy. These are in turn framed by a global rule-based trading system that is increasingly articulated through RTAs. SSC is therefore contextualized by the separation of stages of production and vertical specialization in value chains and their geographic distribution in the economic space. The factors are: with increasing globalization, the growth of financial capitalism has outpaced world output growth; growth of vertical intra-industry trade (VIIT) has outperformed that of foreign direct investment (FDI); global trade is dominated by multinational enterprises (MNEs) such that 70-75 per cent of world imports and exports occur within, or between, the organizational boundaries of MNEs; and growth of FDI (at least regarding the twin peaks of FDI in 2000 and 2007 [UNCTAD (2008)]) outpaced that of world trade growth. These dynamic changes have been cradled by the proliferation of RTAs — growing cumulatively from 25 (1975) through 50 (1982) to 214 (2006). The framework of 158 RTAs covering goods and services and the 43 RTAs covering services that cradle SSC is expanding at such a pace that by 2010 approximately 400 RTAs could conform the global economic landscape. Notwithstanding the issues of compatibility between RTAs and the multi-lateral trading system rules of the World Trade Organization (WTO), such a framework of RTAs could first enable DCs to increasingly make RTAs central to commercial and industrial policies (as intermediate manufactures and industrial services dominate international trade).

Secondly, the increasing sophistication in the design of RTAs involving liberalization, and not restricted to geographically near partner countries, would enable DCs greater degrees of freedom and flexibility, given shrinkages in ‘policy space’, in shifting towards preferential agreements that provide new trade opportunities within the context of SSC. In other words, increasingly, countries are exploiting RTAs as policy vehicles for gaining access to strategic markets rather than strictly as policy instruments for ‘near abroad’ regional integration. The crucial outcomes of the operations of the global factory are in terms of shares of vertical specializations in world trade, which have been increasing. The South accounted for some 25 per cent of global MVA in 2004 compared to some 14 per cent in 1980 [UNIDO (2006)].

Within this overall dynamic, key players of the South are increasingly important in trade in intermediate goods. Vertical specialization has increased from about 15 per cent (1970) to about 20 per cent (1990) of world trade, and within the value chain, represented by automotive and transport equipment, there are significant opportunities for DCs to upgrade their industrial manufacturing sectors. These sectors, and others, referred to in terms of export dynamic products hold the potential for DCs to integrate their economies more efficiently into the global economy.

Opportunities and Challenges

The increasing specialization in world trade and globalization presents opportunities for greater SSC along a number of fronts, including complementarity in using comparative advantage, as well as preferential agreements for industrial structural change, and hence ultimately for socio-economic development. However, a number of serious challenges remain. For one, the benefits of liberalization need to be nested in low transaction costs of doing business. Secondly, the current state of the Doha Round carries implications for the proliferation of RTAs—and their complexity—as they may bypass the multilateral trade negotiations. New opportunities for SSC would need to address a number of key issues.

Employment insensitivity to growth

Changes triggered by liberalized South-South trade are likely to change production patterns. The emerging pattern of production increasingly demands mobility of labour that is equipped with enhanced skills and technical knowledge. However, free movement of labour across manufacturing activities hinges on a number of interrelated factors. Knowledge and skill flows are more efficient when facilitated by worker mobility to industries that are similar to their industry of origin as measured by input-output flows between industries. It is thus contended that workers are conduits through which knowledge is transferred across firms. This in turn leads to significant increases to total factor productivity and hence wage gains.

At the efficient production frontier, it is generally assumed that high employment and high growth environment workers with accumulated knowledge and skills can usefully be deployed, without transaction or friction costs, from declining industries to rising industries, in a way that leads to optimal allocation of labour. In contrast, in high unemployment and slow growth environments, even workers with accumulated knowledge and skills may face limited labour mobility, and employment might be insensitive to growth. In the absence of specific policies that reduce the transaction costs of deploying labour to correct system failures, labour is unlikely to respond to the changing facets of production systems as elaborated above.

4.3.2 Technology, knowledge, skills, information, innovation, R&D and networking driven industrialization to reshape comparative advantage-based production.

A recent study points to empirical evidence regarding preferential trade liberalization in MERCOSUR countries that favours a reshaping of manufacturing production according to regional comparative advantage in labour and technologically-skilled labour during 1985-1998. Drawing on this experience, a number of inferences can be made and implications drawn for SSC in trade, which may suggest comparative advantage based on reshaping of industrial production, given the policy incentives, ceteris paribus, namely: - Industries that use agricultural inputs intensively tend to locate in countries with a large endowment of arable land; - Labour-intensive industries tend to locate in countries that are relatively labour abundant (in terms of productivity-adjusted cost of labour); - Industries that intensively use skilled workforce tend to locate in countries relatively well endowed with technologically-skilled labour; and - Industries which rely highly on industrial intermediate inputs tend to locate in countries with a large or 'thick' industrial base thus ensuring better access to relevant and broad-based suppliers. However, increasingly, industrialization patterns are driven less by comparative advantages of resource endowments and more by knowledge, technology, skills, research and development (R&D), revealed technological advantage and innovation-intensity skills that are networked to convert static comparative advantages into dynamic competitiveness within RTAs.

4.3.3 Global integration as a prerequisite for enhanced South-South trade

Manufactured exports in South-South trade have increased significantly from 58 per cent in 1990 to 64 per cent in 2001 [Economic Analysis Unit (2004)]. One of the fastest growing export products in South-South trade between 1990 and 2001, accounting for around half of manufactured exports is office and telecommunication equipment growing at an average annual rate of 18 per cent during 1990-2001, followed by automotive products (17 per cent), and machinery and transport equipment (16 per cent). The manufacture of all these products is spatially distributed and therefore, by definition, benefits significantly from global connectivity. While global integration is critical for keeping DCs connected to the new industrial realities, there appear mixed research findings on global integration with respect to the sources of creating improvements in domestic capability. Building advanced domestic capabilities constitutes the key to learning, innovation and competitiveness. In this regard, FDI is generally expected to bring in advanced skills, know-how and technology that can be transferred to the host country by setting up training facilities, inter alia. Notably, during their developmental path, countries such as the Republic of Korea and Taiwan, Province of China, have developed advanced indigenous capabilities despite—but also precisely because of— restricting initially the entry of foreign firms through low modal neutrality. A policy array of licensing and tapping experiential knowledge from local employees serving in MNEs and domestic capabilities developed from local initiatives to facilitate learning and innovation became the basis for the development of local firms. However, the shrinking policy space presents challenges to other DCs in replicating the policy successes of the 1970s and 1980s.

FDI, joint ventures, licensing, original equipment manufacturing, original design manufacturing, original brand manufacturing, subcontracting, imports of capital goods, franchising, management contracts, marketing contract, technical service contract, turnkey contracts, overseas training, overseas acquisition of equity investments, strategic partnership or alliances for technology, contracts for R&D to other companies, research grant consortia, bilateral cooperative technology agreements, buying technology embedded in products, material sub-assembly or process are various channels of technology transfer and adaptation dependent on domestic capacities and capabilities. Modal neutrality refers to investment policies that leave the decision on the best way(s) to serve foreign market(s), in terms of entry mode, up to the investor (high modal neutrality) rather than the host government (low modal neutrality). Related to this concept are contestability which refers to the legal ability of foreign as well as domestic investors to compete for the same input factors of production and policy coherence which signifies the degree to which development objectives, the FDI regime and interpretation of that regime, in its regulatory form, has internal consistency across business functions, at different levels of Government and in different places in the country.

Efficient means of private sector acquisition of technology

The issue remains that while there are many sources of technology in the South, due to lack of widespread and 'deep' capital and financial markets, manufacturers in the South are generally unable to access financing easily for acquiring, or developing, technologies. Most technology financing is done through the private effort of entrepreneurs. This implies policy conditions that recognize the importance of deepening the capital and financial markets of DCs and enabling them to intermediate between entrepreneurs and the market.

4.4 SELF-ASSESSMENT EXERCISES (SAEs) 4

How do you analyze the South-South economic relation towards enhancing global economic framework?

4.5 SUMMARY

This unit has dealt with the issues concerned in South-South cooperation such as Trade Agreements and Vertical Specialization; the Opportunities and Challenges; Employment insensitivity to growth and Technology, knowledge, skills, information, innovation, R&D and networking driven industrialization to reshape comparative advantage-based production.

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4.7 POSSIBLE ANSWERS TO SAEs 4

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Module 3: UNDERSTANDING THE ROLE OF IGOS AND TRANSNATIONAL CORPORATIONS IN THE INTERNATIONAL ECONOMIC SYSTEM

UNIT 1: THE WORLD BANK

CONTENTS

1.1 INTRODUCTION

In this unit we shall examine the events leading to the formation and the present activities of the World Bank. The World Bank has gradually grown into a colossus of international finance that simply cannot be ignored. This is more especial in the global south where its financial power is sorely needed for developmental projects. Asides this, the World Bank also provides loans at very attractive rates. However, the organisation has had severe criticisms trailing its activities especially also in the global south; this unit will examine all the processes of the organisation

1.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Explain the activities, successes and failures of the World Bank
- Identify areas of weakness and strength of the World Bank
- Examine the politics behind the operation of the world bank towards promoting Global economy

1.3 MAIN CONTENT

1.3.1. World Bank

Like the International Monetary Fund, the World Bank is a product of the Bretton Woods system. Originally called the International Bank for Reconstruction and Development (IBRD), it commenced operations in 1946 with a membership of 38 states, including the United States, Britain, and France. The initial task for the Bank was to provide loans to the shattered economies of Europe. During the 1950s and 1960s, as Europe began to recover from the Second World War, the Bank turned its attention to Africa, Asia, and Latin America, offering loans, guarantees, technical assistance, investment advice, and political risk management to middle-income countries seeking to modernize and develop. Over the past decade this commitment has extended to East European countries as well. The Bank now has a membership of more than 180 states and is headquartered in Washington, DC. It is one of the key agencies of the United Nations.
Since the 1950s, four specialised organisations have been created to assist the Bank in its work. In 1956, the World Bank created the International Finance Corporation (IFC). This agency offers loans to private developers (mainly multinational corporations) as a way of attracting other private investment capital. The International Development Association (IDA) was the second of the specialised institutions created by the Bank. It came into being in 1960 to offer long-term, interest-free loans to the poorest countries in the world. In 1966, the International Centre for the Settlement of Investment Disputes (ICSID) was set up to mediate disputes between governments and investors. In 1988, the Multilateral Investment Guarantee Agency (MIGA) was formed to insure private investments against expropriation, coups, and other forms of political risk. In principle, the main goal of the World Bank is laudable. It seeks to reduce the level of poverty in the Third World. The Bank tries to live up to this lofty ideal by targeting projects likely to stimulate economic growth and raise the standard of living of the recipient country. Generally, the Bank concentrates its efforts on large infrastructure projects such as dams, roads, telecommunications networks, ports, and bridges. But the IDA is involved in more modest projects such as water purification, sanitation, health, family planning, agricultural production, and the training of educators. It is important to note, however, that the Bank lends only a proportion of the funds required for particular projects. The remainder must be raised from private investors, taxation, and capital markets. The Bank itself is funded from a number of sources. It borrows fromcommercial institutions and it receives interest on its loans and investments. The Bank also sells bonds to pension funds, insurance companies, and multinational corporations.

The most steady source of income, however, has been the annual contributions of its member countries. The United States is the largest donor, contributing more than US$50 billion to the Bank since 1945. The day-to-day running of the bank is handled by an Executive Board consisting of 22 directors. Five of these are appointed by the largest donor countries (the United States, Japan, Germany, Britain, and France) and the rest are elected by the member countries. Above the executive directors are the President and the Board of Governors. The Board includes a representative from each of the member countries. Voting power is proportional to contributions made. This gives the United States the largest number of votes. The President of the Bank is appointed by the executive directors, generally for a five-year period. The World Bank has many critics. At one extreme are those who see it as a 'wolf in sheep's clothing'. From this vantage-point, the Bank is primarily an institution for opening up Third World markets for the First World rather than being devoted to reducing world poverty.

Today, indebtedness in the Third World is approaching US$2 trillion. Some countries now have a lower per capita income than they did before becoming involved with the Bank. In the early 1980s an estimated 130 million people were living in poverty, but by the beginning of the 1990s the figure had risen to an estimated 180 million people. These are grim statistics, especially given the enormous sums of money that have already been loaned. One of the interesting things about these figures is that they are used by critics on both the left and the right of the political spectrum. The left highlights the growing poverty in order to mount a case for the cancellation of Third World debt and a redistribution of wealth from the rich to the poor countries. Those on the right use the same statistics to discredit the Bank and to push for its abolition, believing that economic prosperity can only come about when the market is left to itself.

Writers have been critical of the Bank's 'large project' mentality, arguing that it has failed to consider local issues such as the environment and the role of women in development. The Bank has attempted to address some of these issues in recent years. For example, it has funded projects specifically designed to improve the position of women in Third World countries. One of the most controversial projects in recent years has been the Bank's involvement in a US$160 million loan to resettle nearly 58,000Han Chinese and Chinese Muslim farmers into traditional Tibetan territory. The Tibetan community-in-exile argues that if the Bank grants such a loan, it will be supporting a policy of ethnic cleansing. However one views this particular case, it highlights the main problem for the World Bank. It is an institution that exists to serve the interests of states. As such, its commercial decisions will often prejudice the needs of non-state groups. It is likely, therefore, that the Bank will always be mired in controversy. It will never be able to live up to its cosmopolitan ideals as long as it remains subordinate to the most powerful states in the international system, particularly the United States.

1.4 SELF-ASSESSMENT EXERCISES (SAEs) 1

Briefly describe the function of World Bank in shaping the fortune of global economy?

1.5 SUMMARY

The World Bank had originally been programmed to finance the devastating carnage occasioned by the Second World War however with time its terms of reference have changed to encompass developmental activities in undeveloped countries. It is a fact that these activities have been studded with many mishaps which has brought due opprobrium on the Bank yet, despite this, one still has the sense that the organisation will continue to have relevance in the coming years.

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1.7 POSSIBLE ANSWERS TO SAEs 1

Like the International Monetary Fund, the World Bank is a product of the Bretton Woods system. Originally called the International Bank for Reconstruction and Development (IBRD), it commenced operations in 1946 with a membership of 38 states, including the United States, Britain, and France. The initial task for the Bank was to provide loans to the shattered economies of Europe. During the 1950s and 1960s, as Europe began to recover from the Second World War, the Bank turned its attention to Africa, Asia, and Latin America, offering loans, guarantees, technical assistance, investment advice, and political risk management to middle-income countries seeking to modernize and develop. Over the past decade this commitment has extended to East European countries as well. The Bank now has a membership of more than 180 states and is headquartered in Washington, DC. It is one of the key agencies of the United Nations.

UNIT 2 INTERNATIONAL MONETARY FUND

CONTENTS

2.1 INTRODUCTION

The International Monetary Fund (IMF) is one of the second major developmental financial institutions set up at the nadir of the Second World War. Unlike the World Bank whose term of reference was the financing of infrastructural regeneration the IMF was mandated to stabilize the value of money and to promote international trade. These goals were pertinent because the Second World War had largely stemmed from a depression in trade in the late 1920s which had allowed fascist and anti-system governments to come to power in Europe. Consequently, in the post-war period it was hoped that such catastrophe can be overcome through the agency of the IMF.

2.2 INTENDING LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Discuss the factors responsible for the setting up of the IMF
- Understand the present tasks of the IMF
- Examine the politics behind the operation of IMF

2.3 MAIN CONTENT

2.3.1 International Monetary Fund (IMF)

The Great Depression of the 1930s had an enormous impact on the advanced industrialised states. In the United States and Europe agricultural prices fell, unemployment skyrocketed, banks closed leaving people penniless, factories stood idle, and international trade collapsed. Indeed, the onset of the Depression was one of the main reasons why so many ordinary Germans were willing to follow Hitler into war in 1939. At the same time, the outbreak of war in Europe proved to be a key factor in the United States' economic recovery. Increases in the level of production needed to fight the war stimulated economic growth, put people back to work, and money into circulation. One of the important questions confronting American policymakers, however, was how to maintain the new level of economic activity after the war. Would the international economy dramatically slow down again? Would high tariffs continue to be a feature of the international economic landscape? Would high levels of unemployment return? The purpose of the Bretton Woods Conference was primarily to ensure that these things did not happen. The 1944 Conferencehad two main goals: to stabilise the value of money and to promote international trade. Along with the World Bank, the International Monetary Fund (IMF) was created to facilitate both these goals. Article 1 of the IMF's

Charter states that its purpose is to:

- promote international monetary cooperation;
- facilitate the expansion and balanced growth of international trade;
- promote and maintain high levels of employment;
- promote exchange stability and avoid competitive exchange rate depreciation;
- eliminate foreign exchange restrictions;
- offer resources to countries to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity;
- shorten the duration and lessen the degree of disequilibrium in the international balance of payments of its members.

The original mandate of the IMF was achieved primarily by linking the world's currencies to the American dollar. Members were required to fix the value of their currencies in relation to the dollar. Changes beyond 1 per cent had to be discussed with the other members of the Fund and agreed to by them. Investors, manufacturers, and states benefited enormously from what was called the par value system. Not only did it give them a clear idea of the actual value of different currencies, it also helped to bring a degree of predictability to the international economy. The par value system lasted until the early 1970s, when the US decided it could no longer afford to allow countries to convert their US dollars into gold. It is customary to talk about the collapse of the Bretton Woods system in the early 1970s. This is not quite correct. In fact, the IMF survived because the need for monetary stability became more crucial in the absence of fixed exchange rates. None the less, the role of the IMF has changed since the 1970s. True, it continues to promote monetary stability and trade, but increasingly its role is to assist countries that are in the midst of financial crisis. Indeed, it has become something of an economic crisis management institution. It offers financial and technical assistance to countries experiencing monetary problems and remains a lender of last resort. This gives the IMF enormous power to determine the economic fate of countries experiencing balance-of payment problems. If, for example, a member country has continuing economic problems, the IMF will initiate Structural Adjustment Programmes (SAPs). These macroeconomic reforms can includedebt reduction strategies, privatisation policies, and cuts in public spending. Unfortunately, these strategies generally impact on the poor most severely. It is for this reason that SAPs are regarded as particularly iniquitous by some observers.

Today, the IMF has more critics than friends. Some economists suggest that the world economy would function better without it, and that many of its SAPs exacerbate crises rather than alleviate them. Others suggest that while it is an imperfect institution, it is better at maintaining economic stability than many governments. Whatever the truth, there is little evidence to suggest that the IMF is heading for the institutional scrap-heap. There have been muted calls for a new Bretton Woods conference, but this message has not yet filtered up to policymakers and government officials. At the same time, it is hard to imagine how the global economy could function effectively without some institutional guidance. The challenge is to ensure that a balance is struck between good economic management and human needs. In striking this balance, the IMF appears to have a long way to go.

2.4 SELF-ASSESSMENT EXERCISES (SAEs) 2

Discuss the rational behind the establishment of IMF?

2.5 SUMMARY

The Great Depression of the 1930s had an enormous impact on the international economic system. Indeed, the onset of the Depression was one of the main reasons why so many ordinary Germans were willing to follow Hitler into war in 1939. The IMF was formed essentially to stabilize the value of money and to promote international trade. Since the 1970s the role of the IMF has changed to assisting countries in financial distress.

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2.7 ANSWERS TO SAEs 1

The Great Depression of the 1930s had an enormous impact on the advanced industrialised states. In the United States and Europe agricultural prices fell, unemployment skyrocketed, banks closed leaving people penniless, factories stood idle, and international trade collapsed. Indeed, the onset of the Depression was one of the main reasons why so many ordinary Germans were willing to follow Hitler into war in 1939.

UNIT 3: THE UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD)

CONTENTS

3.1 INTRODUCTION

UNCTAD is the principal organ of the United Nations General Assembly dealing with trade, investment, and development issues. One of the specialised agencies of the United Nations it has succeeded largely in bringing out greater global consensus on trade and development. The ability of the UNCTAD to engineer greater and more even spread of trade benefits in the post-war period is arguably one of the reasons behind a relative world peace. This unit examines the role the UNCTAD has played in global politics since its formation.

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3.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Identify the process for the establishment of the UNCTAD
- State the achievements of the UNCTAD
- Discuss the politics behind the operation of UNCTAD

3.3 MAIN CONTENT

3.3.1 The United Nations conference on trade and development

UNCTAD's goals are essentially to: maximize the trade, investment and development opportunities of developing countries and assist them in their efforts to integrate into the world economy on an equitable basis. The primary objective of UNCTAD is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology. The conference ordinarily meets once in four years; the permanent secretariat is in Geneva.

One of the principal achievements of UNCTAD has been to conceive and implement the Generalised System of Preferences (GSP). It was argued in UNCTAD that to promote exports of manufactured goods from developing countries, it would be necessary to offer special tariff concessions to such exports. Accepting this argument, the developed countries formulated the GSP scheme under which manufacturers' exports and some agricultural goods from the developing countries enter duty-free or at reduced rates in the developed countries. Since imports of such items from other developed countries are subject to the normal rates of duties, imports of the same items from developing countries would enjoy a competitive advantage. The creation of UNCTAD in 1964 was based on concerns of developing countries over the international market, multi-national corporations, and great disparity between developed nations and developing nations. The United Nations Conference on Trade and Development was established to provide a forum where the developing countries could discuss the problems relating to their economic development. The organisation grew from the view that existing institutions like GATT (now replaced by the World Trade Organization, WTO), the International Monetary Fund (IMF), and World Bank were not properly organized to handle the particular problems of developing countries. Later, in the 1970s and 1980s, UNCTAD was closely associated with the idea of a New International Economic Order (NIEO).

The first UNCTAD conference took place in Geneva in 1964, the second in New Delhi in 1968, the third in Santiago in 1972, fourth in Nairobi in 1976, the fifth in Manila in 1979, the sixth in Belgrade in 1983, the seventh in Geneva in 1987, the eighth in Cartagena in

1992, the ninth at Johannesburg (South Africa) in 1996, the tenth in Bangkok (Thailand) in 2000, the eleventh in São Paulo (Brazil) in 2004, the twelfth in Accra in 2008 and the thirteenth in Doha (Qatar) in 2012.

Currently, UNCTAD has 194 member states and is headquartered in Geneva, Switzerland. UNCTAD has 400 staff members and a bi-annual (2010–2011) regular budget of $138 million in core expenditures and $72 million in extra-budgetary technical assistance funds. It is a member of the United Nations Development Group. There are non-governmental organizations participating in the activities of UNCTAD.

As of October 2012, 194 states are UNCTAD members: all UN members and the Holy See. UNCTAD members are divided into four lists, the division being based on United Nations Regional Groups with six members unassigned: Armenia, Kiribati, Nauru, South Sudan, Tajikistan, Tuvalu. List A consists mostly of countries in the African and Asia-Pacific Groups of the UN. List B consists of countries of the Western European and Others Group. List C consists of countries of the Group of Latin American and Caribbean States (GRULAC). List D consists of countries of the Eastern European Group.

3.4 SELF-ASSESSMENT EXERCISES (SAEs) 3

What is the achievement of UNCTAD towards promoting economy of developing countries?

3.5 SUMMARY

This unit examined the goal of the UNCTAD's which include the maximization of trade, investment and development opportunities of developing countries. Its primary objective is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology. The unit also noted that in its life time it has been able to conceive and implement the Generalised System of Preferences (GSP).

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3.7 ANSWERS TO SAEs 3

One of the principal achievements of UNCTAD has been to conceive and implement the Generalised System of Preferences (GSP). It was argued in UNCTAD that to promote exports of manufactured goods from developing countries, it would be necessary to offer special tariff concessions to such exports. Accepting this argument, the developed countries formulated the GSP scheme under which manufacturers' exports and some agricultural goods from the developing countries enter duty-free or at reduced rates in the developed countries. Since imports of such items from other developed countries are subject to the normal rates of duties, imports of the same items from developing countries would enjoy a competitive advantage. The creation of UNCTAD in 1964 was based on concerns of developing countries over the international market, multi-national corporations, and great disparity between developed nations and developing nations. The United Nations Conference on Trade and Development was established to provide a forum where the developing countries could discuss the problems relating to their economic development. The organisation grew from the view that existing institutions like GATT (now replaced by the World Trade Organization, WTO), the International Monetary Fund (IMF), and World Bank were not properly organized to handle the particular problems of developing countries. Later, in the 1970s and 1980s, UNCTAD was closely associated with the idea of a New International Economic Order (NIEO).

UNIT 4: WORLD TRADE ORGANISATION (WTO)

CONTENTS

4.1 INTRODUCTION

The World Trade Organisation was an organisation set up to coordinate the international trade system in order to prevent conflict. In recent times the WTO has gone to great lengths to orchestrate a trade system acceptable to a large proportion of the global community. In this unit we will examine the formation of the WTO and its effects on trade and development.

4.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Discuss the reasons behind the setting up of the World Trade Organisation.
- Understand the extent to which the WTO has achieved their objectives
- Identify the areas of weakness and strength of WTO

4.3 MAIN CONTENT

4.3.1 World Trade Organisation (WTO)

The WTO came into existence on 1 January 1995, as one result of the agreement reached in the seven-year-long Uruguay round of multilateral trade negotiations that was completed the previous year. Its history, however, extends much further back, at least to the proposed International Trade Organisation (ITO) that was designed in the mid1940s alongside the other Bretton Woods Institutions, the International Monetary Fund (IMF) and the World Bank. The ITO was never approved, and part of its intended purpose was served instead by the General Agreement on Tariffs and Trade (GATT), which had been agreed upon originally as only a temporary measure pending approval of the ITO. The GATT sponsored a series of rounds of trade negotiations, the Uruguay round being the most recent. Early rounds were primarily intended to reduce tariffs, the most successful of these being the Kennedy Round that was completed in 1967. It was followed by the Tokyo Round, begun in 1974 and completed in 1979. Unlike GATT, the WTO is a formal organisation that is not restricted to promoting trade liberalisation solely in manufactured goods.

The institutional structure of the WTO contains three components: a revised GATT, the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Intellectual Property Issues (TRIPS). These components collectively enable the WTO to fulfil four important functions in international trade. First, it constitutes a forum for the exchange of information, consultation, and negotiation among its 135 member states. At the highestlevel, the trade ministers from the member countries meet every two years to discuss trade policies. Members also communicate through ongoing working groups on particular issue-areas such as the environment or competition policy. In addition, members of the WTO are obliged to notify it whenever they engage in policies in a variety of areas that might be trade restricting. Technical regulation, for example, must be notified to the WTO Secretariat with sufficient lead-time for exporters to adapt to the new rules. Second, the WTO constrains the trade policy actions of member states. Underlying the entire WTO and its GATT predecessor is the single principle of non-discrimination: that economic welfare is greatest if policies do not discriminate among suppliers and among demanders of economic goods and services.

The WTO spells out in some detail a long list of constraints on member state behaviour – things that they either must do or must not do in order to be viewed as cooperating. Many of these constraints appeared as provisions of the original GATT agreement of 1947, which took the form of a treaty and consisted of 35 Articles of Agreement. These Articles have been revised, extended, and supplemented with additional agreements in the rounds of negotiation that have occurred since then. For example, the WTO requires countries to commit not to raise tariffs above levels that they negotiate on entry or in multilateral trading rounds. These levels are called tariff bindings. It also constrains states from imposing a variety of non-tariff barriers to trade. Third, the WTO specifies and permits a list of exceptions from the constraints for prescribed reasons and with prescribed means. Complex agreements among national governments must permit a fair amount of flexibility. Any rules that are adopted will inevitably be subject to interpretation, and the effect of these rules on the economy can never be known with certainty. Therefore, international trade agreements typically include some sort of escape clause that allows the parties to back partially out of the agreement in the event that it proves to be more injurious than expected. The WTO specifies in great detail the criteria that states must follow in order to avoid the constraints without penalty. Finally, the WTO offers a mechanism for the settlement of disputes among member states. Agreements are worthless without enforcement, because states may depart from them whenever they perceive it to be in their interest to do so. When one country believes that another country is violating any aspect of a trade agreement, the complaining country first requests consultation with the alleged offender, and the two seek to resolve the dispute on their own. If consultation fails, then the complaining country requests establishment of a panel, consisting of three persons with appropriate expertise from states not party to the dispute. This panel assesses the evidence in the context of its interpretation of the WTO rules and issues a report. The report is automatically accepted unless all WTO members decide against its adoption, or if one of the parties to the dispute appeals. The WTO has established an Appellate Body composed of seven members, of whom three will serve on any given case. It also issues a report that must be accepted except by a unanimous decision to reject it by member states. Once this process is completed, states are expected to implement any recommendations of the panel report. If they do not, then complaining countries are entitled to compensation from them, or to use suspension of trade concessions against them. Concessions that the offended country had previously made to the offending party can be withdrawn. In practice, this means that selected trade barriers will be raised against (and only against) the offending country. In short, the WTO represents a major attempt to provide a more institutionalised and regulatory system for the conduct of international trade.

The scope and extent of regulation have increased with the inclusion of new issues and more detailed and obligatory substantive regulations. It remains to be seen how effective the new organisation will be. On the one hand, its membership has increased dramatically over the last decade, and many observers have welcomed the formal entry of China after years of negotiation. On the other hand, the organisation also faces some difficult challenges in the years ahead. This became clear in 1999 when member states met in

Seattle to kick start a new round of trade talks designed to increase free trade and reduce barriers to international trade. Preliminary talks in Geneva revealed such a sharp division among the participants that it proved impossible to create an agenda for the meetings. In other words, the members were so divided that they could not even agree on what ought to be discussed. For example, the United States wants Europe to cut its subsidies of farm products so that it can sell more products to Europe. The Europeans are refusing, since free trade between US and European agriculture would devastate Europe’s farmers. Developing countries want to be excused from further liberalisation of their trade policies. Labour unions in advanced industrial countries want to set minimum labour standards in the Third World, which would make the Third World a less attractive investment. The Third World wants to do without the labour unions’ solicitude. Further trade liberalisation depends upon whether member states can negotiate fruitfully on aglobal basis, or whether they will focus more on regional forms of cooperation.

4.4 SELF-ASSESSMENT EXERCISES (SAEs) 4

1. What is origin of WTO and its impact to global economy?

4.5 SUMMARY

The WTO is not restricted to promoting trade liberalisation solely in manufactured goods with three components: a revised GATT, the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Intellectual Property Issues (TRIPS). These components collectively enable the WTO to fulfil important functions in international trade. Despite its successes the organisation is still marked by challenges especially with regards to consensus.

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4.7 POSSIBLE ANSWERS TO SAEs 4

The WTO came into existence on 1 January 1995, as one result of the agreement reached in the seven-year-long Uruguay round of multilateral trade negotiations that was completed the previous year. Its history, however, extends much further back, at least to the proposed International Trade Organisation (ITO) that was designed in the mid1940s alongside the other Bretton Woods Institutions, the International Monetary Fund (IMF) and the World Bank. The ITO was never approved, and part of its intended purpose was served instead by the General Agreement on Tariffs and Trade (GATT), which had been agreed upon originally as only a temporary measure pending approval of the ITO. The GATT sponsored a series of rounds of trade negotiations, the Uruguay round being the most recent. Early rounds were primarily intended to reduce tariffs, the most successful of these being the Kennedy Round that was completed in 1967. It was followed by the Tokyo Round, begun in 1974 and completed in 1979. Unlike GATT, the WTO is a formal organisation that is not restricted to promoting trade liberalisation solely in manufactured goods

UNIT 5: TRANSNATIONAL CORPORATIONS IN INTERNATIONAL ECONOMIC RELATIONS

CONTENTS

5.1 INTRODUCTION

In the previous units we examined the processes and behaviour of inter-governmental organisations with regard to their activities in the international economic system. We saw the impact these organisations have had on the system since their advert in the post-war era, we also noted the challenges which continue to dog their heels. In this unit we shall examine another organisation which has a longer history than the aforementioned organisations- the Multinationals. As independent organisations they are largely unregulated and thus able to permeate the international economic more totally than other organisations.

5.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Discuss the history and activities of Multinational organisations
- Understand the impact of Multinationals on global politics
- Identify the politics behind the establishment of Multinational Organisation.

5.3 MAIN CONTENT

5.3.1 Multinational Corporation (MNC) and their activities

Sometimes called multinational enterprises (MNEs) or transnational corporations

(TNCs), these are powerful actors that carry out commercial activities for profit in more than one country. Increasingly, they view the world as a single economic entity and their impact on the global economy is immense. Indeed, there is almost no area of human life that is not influenced in some way by these giant firms. For example, the largest 500 corporations control more than two-thirds of world trade, much of which takes place between their own subsidiary firms. Moreover, the largest 100 corporations are estimated to account for about one-third of global foreign direct investment (FDI). Although there are more than 53,000 MNCs worldwide (and approximately 450,000 affiliate and subsidiary firms), most of the top 500 corporations have their headquarters in OECD member states.

The term 'multinational corporation' is misleading in a couple of ways. First, it implies a level of internationalisation of management and stock ownership that does not exist. Second, most MNC activity takes place within the territorial borders of the sovereign state and not between 'nations'. A more satisfactory designation would probably be 'global business enterprise'. MNCs are not new. For example, the Hudson Bay Company and the British East India Company began operating during the first wave of colonial expansion over 300 years ago. Of course, the character of MNCs has changed dramatically since then. The Industrial Revolution, advances in technology and communications, and new management techniques have been particularly important. For example, in the early 1900s Henry Ford's new production-line methods enabled him to vastly increase the number of automobiles he could manufacture in a single year. By 1911, he had constructed an assembly plant in Europe and established Ford as a major player in the emerging worldwide automobile industry. While multinational corporations have a long history, it was not until the Bretton Woods Conference (1944) laid the foundation for an international economic order based on the principles of free trade that they began to expand their commercial activities on a grand scale. This had a lot to do with the position of the United States in the post-1945 order, and especially the strength of the American dollar.

MNCs are, without doubt, the most controversial of all non-state actors. In the eyes of many critics they are predators, accused of toppling elected governments, exploiting under-developed countries, engaging in illegal activities, ignoring human rights, and wilfully damaging the environment. There is certainly ample evidence to support some of these accusations. During the 1970s, for example, ITT and Anaconda Copper (with the help of the CIA) were accused of overthrowing the democratically elected socialist government of Salvador Allende in order to retrieve their nationalised assets. Union Carbide's factory in Bhopal India caused the death of nearly 4000 people and injured almost half a million. Royal Dutch Shell was one of very few MNCs to remain in South Africa during the apartheid years, despite calls from the international community and some nongovernmental organisations to abandon its commercial interests there. Moreover, the OK Tedi mine in New Guinea, operated by BHP, has done significant environmental damage to the Fly River system and irretrievably altered the lives of the local inhabitants. At the same time, defenders of multinational corporations portray them as engines of progress, innovative in research and development, a modernising force in international relations, and the best hope for overcoming the chronic under-development and poverty in the Third World.

It is difficult to evaluate these positions. Much depends on the ideological predisposition of the critic. With the exception of the newly industrialising countries (NICs), there has been little discernible improvement in the living standards of people in the Third World. Indeed, there is evidence to suggest that global inequality is growing significantly. True, many MNCs operating in the Third World have setup hospitals, schools, and other valuable infrastructure. Some of them also provide employment, professional training, health care, and educational opportunities for their employees. But it is equally true that others impact heavily on the local culture, employ child labour, damage the environment, and often engage in corrupt practices. None the less, there is some indication that multinational corporations are beginning to realise that they must act more responsibly in the communities in which they operate, and that it is in their own interest to do so. In so far as the search for new markets and consumers is becoming more important for multinational corporations than extracting resources, it is not in their interest to place their reputations at risk by engaging in practices that could besmirch their global image.

5.4 SELF-ASSESSMENT EXERCISE (SAE) 5

1. What do you understand about Multi National Cooperations in promoting global economy?

5.5 SUMMARY

Multinationals have been operating for a long time for example, the Hudson Bay Company and the British East India Company began operating over 300 years ago. The Industrial Revolution, advances in technology and communications, and new management techniques have been particularly important. For example, in the early 1900s Henry Ford's new production-line methods enabled him to vastly increase the number of automobiles he could manufacture in a single year.Today the largest 500 corporations control more than two-thirds of world trade, much of which takes place between their own subsidiary firms. Multinationals have been drivers of economic growth and transformation especially in the undeveloped world where they have been in the forefront of the provision of basic infrastructure. Concomitantly they have been behind some of the most amoral behaviours in the region primarily due to weak regulations. Nigeria's experience with the Anglo-Saxon oil giant, Shell is a critical example of this behaviour.

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5.7 POSSIBLE ANSWERS TO SAEs 5

The term 'multinational corporation' is misleading in a couple of ways. First, it implies a level of internationalization of management and stock ownership that does not exist. Second, most MNC activity takes place within the territorial borders of the sovereign state and not between 'nations. A more satisfactory designation would probably be 'global business enterprise'. MNCs are not new. For example, the Hudson Bay Company and the British East India Company began operating during the first wave of colonial expansion over 300 years ago. Of course, the character of MNCs has changed dramatically since then. The Industrial Revolution, advances in technology and communications, and new management techniques have been particularly important. For example, in the early 1900s Henry Ford's new production-line methods enabled him to vastly increase the number of automobiles he could manufacture in a single year. By 1911, he had constructed an assembly plant in Europe and established Ford as a major player in the emerging worldwide automobile industry. While multinational corporations have a long history, it was not until the Bretton Woods Conference (1944) laid the foundation for an international economic order based on the principles of free trade that they began to expand their commercial activities on a grand scale. This had a lot to do with the position of the United States in the post-1945 order, and especially the strength of the American dollar

MODULE 4: DEVELOPMENTAL ISSUES IN THE INTERNATIONAL ECONOMIC SYSTEM

UNIT 1: FOREIGN AID

CONTENTS

1.1 INTRODUCTION

In this unit we shall look at foreign aid as an important concept in international economic relations more so as it relates to the undeveloped world. This is because this sphere of globe due to the peculiar developmental challenges confronting it is most disposed to the politics associated with foreign aid. As we shall soon see foreign aid has both its fervent supporters and critics each backing up its case with tenable reasons.

1.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Define the meaning of the concept Foreign Aid
- Discuss the perspectives associated with foreign aid

- Identify the major criticisms against foreign aid

1.3 MAIN CONTENT

1.3.1 Foreign Aid

There is a longstanding debate over the desirability and effectiveness of foreign aid from rich to poor states. Supporters of foreign aid programmes argue that aid is necessary to help capital-poor countries acquire new skills and technology. Foreign technical assistance spreads the benefits of scientific research, most of which is conducted by the wealthiest states in the world. In addition, government-to-government loans and United Nations multilateral assistance finance numerous development projects at lending rates below commercial levels. The largest lender, the World Bank, has followed a policy of giving seed money for major projects in order to attract private or local government investment for ventures that do not fit commercial criteria. Aid funds are often used to help establish leading sectors of the economy that can then, through links to less developed sectors, pull the development process along. Finally, former colonies argue that rich states have a moral obligation to assist the poor wherever the coloniser's industrial wealth was created with Third World resources. Even when the demand for restitution is difficult to justify, simple compassion calls for the rich to take some responsibility for relieving the burdens of global poverty.

Critics of foreign aid have put forward a number of reasons to explain why it has not been effective in promoting development. In the first place, the amounts are pitiful in light of the magnitude of the problem. Only a handful of states have managed to achieve the international standards declared by the United Nations, which hovers around 1 per cent of the gross domestic product (GDP) of advanced industrialised states. The United States, once the world leader in global aid, is now in fourth place after Japan, Germany, and France in terms of absolute amounts. Expressed as a percentage of its GDP, with 0.1 per cent of American GDP allocated to Overseas Development Assistance, the United States is well at the bottom of all industrialised donors. Furthermore, much of its foreign aid is in the form of military goods that contribute nothing to economic prosperity. More than half the amount of money in US foreign aid dispensed since the Second World War has been in the form of military aid. By supporting the power of the armed forces in many poorer states and encouraging the military to play an active political role, these security-assistance dollars have served to undermine democracy and economic development.

One reason for the extensive debate over aid is that so many diverse objectives drive its allocation that it is hard to evaluate how effective it is. While economic growth is clearly not the sole objective of foreignassistance, it is one of the few areas where empirical evidence permits evaluation. Growth is also important because without growth it is difficult, if not impossible, to achieve all the other goals – security, human rights, democracy – attributed to aid. In many less developed countries, there is a negative correlation between aid flows and growth performance. Africa, for example, receives ten times more aid per capita than Latin America or East Asia and yet performs far worse by most or all economic measures. There are several explanations, but one point is clear. By removing a hard budget constraint, aid inflows to a country can impede the formation of a domestic consensus on the need for difficult economic reforms. Research suggests that countries with high inflation tend to implement more complete reforms and then enjoy higher average growth rates than countries that just muddle along at medium inflation rates. What happens is that aid flows are often cut off in countries with very high inflation rates but continue in countries with medium inflation rates. These aid flows protect countries from the full costs of bad economic policies, often preventing the onset of deeper problems and the important policy learning experience that is often critical to successful economic reform. Countries often have to 'hit bottom' to get a domestic consensus on the need for economic reforms. Of course, allowing countries to collapse economically is hardly an acceptable policy recommendation. To complicate the issue further, it is also important to note that in some cases aid has actually helped develop a consensus in favour of market reforms. For example, in Poland in 1989 the promise of foreign aid as something that the reform government could deliver was critical to its election and the undertaking of market reforms. Both the timing and the role of aid flows in the implementation of policy reforms are still being widely debated. But what we do know is that financial aid to countries where there is no consensus at all in favour of reform has a negative impact. How and why has so much aid continued to flow under such conditions?

Conditionality, which is how aid is appropriated for the most part, is usually applied ex ante; that is, borrowing countries must meet certain conditions to be eligible for a loan and then must continue to meet those conditions along the way as aid is disbursed. But despite a marked increase in conditional lending in the past decade, and also an increase in the number of conditions on each loan, conditionality has not been particularly effective in attaining borrower compliance. The higher number of conditions actually seems to decrease borrower ownership of reforms. It creates a vicious cycle: weak compliance with conditions prompts donors to impose more conditions; increased conditions make it yet harder for the recipient to comply, thus increasing the incentive not to comply; and so on. On the donor side, meanwhile, the incentive structure rewards continued lending rather than halting financial flows in response to breaches in compliance. Ultimately, multilateral institutions are lending institutions, and they must lend to remain operational. So the average loan officer at the World Bank has a greater incentive to disburse loans on time than to enforce strict compliance from the recipients of those loans. As a result, many countries continue to receive loans even though they have bad records at both compliance and policy reform.

1.4 SELF-ASSESSMENT EXERCISES (SAEs) 1

Discuss the reasons behind critics of foreign Aid?

1.5 SUMMARY

The unit reviewed foreign aid and its muti-faceted problems. Some writers are of the view for example that foreign aid helps to boost economic expansion and growth while others condemn foreign aid as helping to keep backward countries further impoverished. One reason for the extensive debate over aid is that so many diverse objectives drive its allocation that it is hard to evaluate how effective it is. However, it is clear for all this that financial aid to countries where there is no consensus at all in favour of reform has a negative impact.

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1.7 ANSWERS TO SAEs 1

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UNIT 2: FOREIGN DIRECT INVESTMENT (FDI)

CONTENTS

2.1 INTRODUCTION

In this unit we shall examine the concept of foreign direct investment and its impact on the international economic system. The reader must understand that FDI has grown into a concept of relative importance given the intensity of globalisation and the concomitant urge for economic development by the global south. These twinprocesses have colluded effectively in pushing FDI to the front burner of developmental discourse perhaps since the 1990s.

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2.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Understand the processes attached to FDI
- Discuss the connection between FDI and development
- Identify area of power control on FDI

2.3 MAIN CONTENT

2.3.1 Foreign Direct Investment (FDI)

This is the transfer of capital, personnel, know-how, and technology from one country to another for the purpose of establishing or acquiring income-generating assets. There are two main types of FDI. The first is fixed asset investment, in which the investing company maintains a significant level of physical control over the asset (such as a manufacturing plant) during the life of the investment. The second is portfolio investment – the acquisition of shares and stocks located in foreign countries. FDI is not a new phenomenon. Indeed, it was an important component in European colonialism. Yet over the last 20 years, levels of FDI have increased dramatically.

In 1999 foreign direct investment reached an all-time high of US$865 billion, while total cross-border flows of short- and long-term investment have more than doubled between 1995 and 1999. In addition, FDI spreads across a wide range of industries and firms. Traditional resource extraction firms have been joined in overseas locations by consumer-product firms, by manufacturing firms, and by companies in the service and information industries. Indeed, investment in primary sector industries (such as mining and oil) is a shrinking portion of foreign direct investment. When firms invest abroad, they do so for a variety of reasons: to gain access to resources or raw materials; to reduce costs; to expand markets; to follow their customers; or to compete with other firms. Most FDI comes from companies based in the OECD region. Between 1960 and 1991, for example, over 85 per cent of all FDI came from the United States, the United Kingdom, Japan, Germany, France, the Netherlands, and Canada. During the same period, however, the US share of total FDI shrank from 65 per cent to around 16 per cent of the world total, while Japan's share increased from just 2 per cent to 21 per cent. This partly explains the debate during the 1980s concerning the relative decline of US hegemony. Since the 1970s, the Third World's share of FDI has diminished. In 1994, for example, Africa received 1.4 per cent of global FDI, the Middle East and the transition economies of Eastern Europe received 1.6 per cent, and Latin America received 11 per cent. Asia, on the other hand, received around 20 per cent of global FDI, a figure that reflects the economic rise of the newly industrialising countries (NICs). Of course, since the Asian financial crisis of 1997–98 this figure has been significantly reduced.

FDI became a major issue during the 1970s, when the assets of a number of large American corporations were nationalised by left-wing governments. In the most famous case, Salvador Allende, the democratically elected President of Chile, nationalised the assets of ITT and Anaconda Copper. The fact that Allende was a socialist made the expropriation of US company assets a cold war foreign policy issue. The result was the overthrow and death of Allende by a military opposition (covertly supported by the United States) and the rise to power of Augusto Pinochet, a ruthless military dictator. Not surprisingly, both companies were immediately de-nationalised. One of the consequences of this and similar incidences elsewhere was the realisation among corporate CEOs that sound FDI needed high-quality political risk analysis.

There is a debate in the literature whether FDI is, in fact, a conduit for wealth extraction rather than for domestic development. Some observers argue that FDI creates jobs, increases the revenue and tax bases of the host government, facilitates the transfer of technology and human capital, and ultimately promotes development, economic growth, and prosperity. Opponents, on the other hand, argue that FDI serves to extract more national wealth than it contributes to the host country. They claim that FDI maintains the host country in a dependent situation. Second, it creates a skewed or uneven pattern of economic development. When the investment period comes to an end, for example, it can leave the local workforce in a precarious economic position. Third, to attract FDI, host countries increasingly compete with one another and can end up offering such favourable deals and incentives that they ultimately lose more revenue than they generate. Finally, there are environmental and health issues as well. For example, multinational corporations (MNCs) sometimes export heavy polluting technologies or 'dirty industries' that are highly regulated in the home country. Despite the criticisms, FDI has grown into an important aspect of a host country's economic development plans and it seems likely to grow in the future. For example, in 1996 foreign direct investment in the developing world was more than US$129 billion, with US firms alone accounting for US$28 billion. By contrast, official development flows in that year amounted to US$40 billion, and the entire foreign aid budget of the United States was only US$12 billion. Increasingly, therefore, contact between the industrialised world and the Third World is taking the form of foreign direct investment.

2.4 SELF-ASSESSMENT EXERCISES (SAEs) 2

1. What are the major issues of concern of foreign Direct Investment in the early 1990s?

2.5 SUMMARY

There are two main types of FDI. The first is fixed asset investment, in which the investing company maintains a significant level of physical control over the asset (such as a manufacturing plant) during the life of the investment. The second is portfolio investment – the acquisition of shares and stocks located in foreign countries. There is a debate in the literature whether FDI is, in fact, a conduit for wealth extraction rather than for domestic development. But no matter the extent or the depth of argument over the morality of FDI it may likely remain long a preferred means of quick economic development.

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2.7 POSSIBLE ANSWERS TO SAEs 2

In 1999 foreign direct investment reached an all-time high of US$865 billion, while total cross-border flows of short- and long-term investment have more than doubled between 1995 and 1999. In addition, FDI spreads across a wide range of industries and firms. Traditional resource extraction firms have been joined in overseas locations by consumer-product firms, by manufacturing firms, and by companies in the service and information industries. Indeed, investment in primary sector industries (such as mining and oil) is a shrinking portion of foreign direct investment. When firms invest abroad, they do so for a variety of reasons: to gain access to resources or raw materials; to reduce costs; to expand markets; to follow their customers; or to compete with other firms. Most FDI comes from companies based in the OECD region. Between 1960 and 1991, for example, over 85 per cent of all FDI came from the United States, the United Kingdom, Japan, Germany, France, the Netherlands, and Canada. During the same period, however, the US share of total FDI shrank from 65 per cent to around 16 per cent of the world total, while Japan's share increased from just 2 per cent to 21 per cent. This partly explains the debate during the 1980s concerning the relative decline of US hegemony. Since the 1970s, the Third World's share of FDI has diminished. In 1994, for example, Africa received 1.4 per cent of global FDI, the Middle East and the transition economies of Eastern Europe received 1.6 per cent, and Latin America received 11 per cent. Asia, on the other hand, received around 20 per cent of global FDI, a figure that reflects the economic rise of the newly industrialising countries (NICs). Of course, since the Asian financial crisis of 1997–98 this figure has been significantly reduced.

UNIT 3: DEBT AND DEVELOPMENT

CONTENTS

3.1 INTRODUCTION

In this unit we shall briefly examine the impact of debt on the growth and development of developing polities such as Nigeria's. Borrowing in itself is not inimical to development however when the loan becomes a cog on the finances of a state it assumes the character of a burden. The history of debt in the third world has assumed momentous proportions in recent times because of its near asphyxiating hold on development. In this unit we will discuss the current conditions of debt and development globally.

3.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- State the impact of debt on development
- Examine the various categories of Debts
- Examine the implication of debt to the National Economic growth.

3.3 MAIN CONTENT

3.3.1 Debt and Development

The high debt burdens suffered by many developing countries that have seen their debts written down over recent years were not the consequence of high levels of borrowing. A number of reasons for the accumulation of these debts have been adduced. i. The high debt burdens have resulted from poor economic growth.

The idea that developing countries borrowed too much is characterised in the discussion over 'odious debts'. An odious debt is a moral category that has come to take on pseudo economic meaning. Lists have been drawn up by Western NGOs and campaign groups determining the moral character of particular African governments over time. Debt taken on by governments deemed to be illegitimate are said to be odious. The notion is that developing countries have had access to too much cash, and have frivolously run up debts like global shopaholics developing countries have been unable to control their urges and have recklessly borrowed vast sums with little thought about how they could afford to pay their bills. This is not a small quibble, but is an argument that has consequences for the ability of countries such as Ghana or Nigeria to raise funds for much needed infrastructure development. According to debt relief campaigners and Western donors, if countries have simply borrowed too much in the past, the best course of action is to forgive their sins out of compassion for the poor and to ensure that it doesn't happen again. This is the logic of debt relief, to cut developing countries off from their supply of credit. This view of the developing world as addicts to debt is to be found not only within the governments of the G8, but from their critics also.

ii. Many loans simply propped up dictators or went to projects that failed because of corruption and poor lender advice.

It has been argued that debt has either been pushed upon developing countries or has been taken out by dictatorial or incompetent regimes. These are dangerous assumptions that paint a contemptuous picture of developing countries. Namely that developing countries are unable to govern their own affairs – they lack the sophistication and expertise needed; the governments and officials of developing countries are corrupt and cannot be trusted; and that the failure of development is a consequence of vast sums going to waste. But above all, the most damaging charge levelled by the critics is that developing countries have had access to too much cash.

iii. Much of the debt of poor countries arose through the reckless or self-interested lending by the rich world.

High levels of debt are presented as the consequence of the unscrupulous practice of pushing loans on developing countries that did not need them. In reality, the group of countries that has been placed under the HIPC (Heavily Indebted Poor Countries) banner are separated from the rest of the developing world in that development assistance, in the form of loans or grants, has been the main source of external funding available to them. Arguing that debt is a problem for these countries has the effect of cutting them off from a much-needed source of cash for infrastructure developments.

3.3.2. Debt Burden

Heavy debt burdens and poor economic performance are certainly linked. It does not follow that high borrowing is the cause of Ghana's economic problems or even the cause of a high debt burden. The view that a high level of borrowing is the cause of an unsustainable debt burden may be common sense, but it is not a line of thinking that is much used to understand the government debt of developed nations in the industrialised West, and it is a line of thinking that tells us little about the causes of the lack of development in poor countries. Whilst most involved in the discussion of the debt of developing economies understand the importance of the distinction between debt stock and debt burdens, the distinction is never the less slippery. The idea that the debt problems of developing countries has resulted from nothing more than an increase in the stock of external debt ignores the importance of the role played by another factor, the growth of an economy.

The level of debt stock of a country is the $ value of amounts owed to external creditors that are guaranteed by the government of the country. This is an absolute amount which tells us little about the economic situation. The level of debt burden, in contrast, is a relationship of factors. The debt burden which a country suffers is the function not just of the level of debt, but also of the level of economic activity of a country. The level of debt burden of a country is also a relationship over time. Comparing debt stock to gross domestic product is not sufficient. The rate of change of these two variables is an important factor to consider.

The result of a modest level of growth of 3% is that the debt burden stabilises, the result of a higher level of growth is that the debt burden today would be lower than that of 1970. As a consequence of debt forgiveness Ghana's debt burden for example is expected to fall to below 20% of GDP in 2007. With a modest growth rate Ghana would have been on its way to realise this goal without the need for debt relief or debt cancellation. As an aside, a 3% rate of growth would mean that Ghana today would be three times wealthier than it is now. This does not demonstrate that the growth in the debt burden is due to the growth in debt. This is a simplistic assumption that is used to argue that the debt burden is the consequence of high levels of borrowing; here we see the importance of the elision of debt and debt burden. The moral simplification of the debate concerning debt implies that the debt burden of developing economies can be understood as comparable to the debt burden of individual consumers – i.e., that the more you borrow the more you owe, the harder it becomes to service your debts.

3.4 SELF-ASSESSMENT EXERCISES (SAEs) 3

In your own opinion what is the implication for debt burden to a given particular country?

3.5 SUMMARY

In this unit we noted that debt burdens have stemmed from poor economic growth which was the lot of the third world some decades ago. We also noted that some critics have observed that the crisis began because the developing world was exposed to too much cash. This situation led thus to gross mismanagement of resources and consequently the debt crisis

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3.7 ANSWERS TO SAEs 3

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UNIT 4: THE DEBT CRISIS

CONTENTS

4.1 INTRODUCTION

In this final Unit on the activities of development issues we shall examine a critical aspect of these issues-the debt crisis. The economic aspect of debt which a large number of developing states had accumulated beginning from the 1970s had from the 19902 become an albatross of some sort about their necks. The servicing of the debts alone began to consume such a sizable lump of the Gross National Products that barely nothing was left to drive the development necessary for lifting these states out of poverty. The persistence of this anomaly led to the now famous debt crisis.

4.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to
:

- Examine the circumstances which led to the debt crisis
- Explain the ways in which it affected development negatively

- Identify politics of debt management and economic crisis in global perspective

4.3 MAIN CONTENT

4.3.1 The debt crisis

A situation in which a state has to spend much of its earnings from trade on servicing its external debts rather than on economic and social development is one of the most crippling problems for Third World countries (or more accurately, the vast majority of their citizens). The origins of the debt trap for poor states lie in the formation of the Organisation of Petroleum-Exporting Countries (OPEC) in 1973 and the dramatic rise in oil prices that year. The OPEC states deposited their new oil wealth in Western banks. Since idle money loses against inflation (which was rising rapidly at the time), the banks needed to find countries to take loans. Many states in Eastern Europe and the Third World borrowed huge sums of money in the expectation that interest rates would remain stable. The expectation was shattered by two trends in the global economy over the next 20 years. First, the fixed exchange rate system that had been established after the Second World War collapsed, and states began to use interest rates to stabilise their exchange rates. Second, interest rates rose in the 1980s in response to trade and budget deficits in the United States. This triggered a recession in many industrialised states, thereby reducing export markets for poor states. As their export earnings fell, debt repayment obligations rose, leaving much of Africa and Latin America in a state of financial bankruptcy.

In the recession the price of raw materials, on which many poorer states depend for earning foreign exchange, collapsed. Debts incurred were so large that they needed new loans to finance them. Between 1982 and 1990 US$927 billion were advanced to poor states but US$1,345 billion were remitted in debt service alone. The debtor states began the 1990s 60 per cent more in debt than they were in 1982. Sub-Saharan Africa's debt more than doubled in this period. When the issue of debt remission or debt forgiveness is raised, Western banks have argued that it would create what economists call 'moral hazard' – failing to honour debts would simply encourage poor states to continue borrowing in the expectation that they would never have to repay their debts. On the other hand, some commentators argue that moral hazard should cut both ways. Overborrowing is overlanding, and creditors should pay their share of the costs of mistakes made in the 1970s. By 1997 Third World debt totaled over US$2.2 trillion. The same year US$250 billion was repaid in interest and loan principal. The debt trap represents a continuing humanitarian disaster for some 700 million of the world's poorest people. During the last decade the world's most heavily indebted continent, Africa, has experienced falling life expectancies, falling incomes, falling investment levels, and rising infant and maternal mortality rates.

In October 1996 the first real attempt was made to deal with the problem when the World Bank and the International Monetary Fund (IMF) won agreement from their Boards of Governors for the establishment of the Highly Indebted Poor Country (HIPC) Initiative. At its launch, the policy offered the promise of poor countries achieving a 'robust exit' from the burden of unsustainable debts, campaigning groups and non-governmental organisations (NGOs) welcomed this policy as the first comprehensive approach to debt write-offs with an enormous potential for poverty reduction. The Initiative is open to the poorest countries, viz. those that are:

1. Eligible only for highly concessional assistance such as from the World Bank's International Development Association (IDA) and the IMF's Poverty Reduction and Growth Facility (formerly called Enhanced Structural Adjustment Facility);

2. Face an unsustainable debt situation even after the full application of traditional debt relief mechanisms; and 3. Have a proven track record in implementing strategies focused on reducing poverty and building the foundation for sustainable economic growth.

The HIPC debt initiative is the first debt reduction mechanism that promises to deal with the ongoing debt trap in a comprehensive and concerted way. It is designed to tackle not only commercial debt and debt owed by HIPCs to bilateral creditors, but also – and this is new – debt owed to multilateral creditors: the World Bank, the IMF, and the regional development banks. The central aim of the HIPC initiative is to enable highly indebted poor countries, whose debt burdens are too high to be dealt with by traditional debt reduction mechanisms, to achieve a sustainable debt level within a period of six years. During this six-year period, a country must implement a World Bank/IMF supported structural adjustment programme. At the 'decision point', which marks the end of the first three years, creditors re-examine the country's debt problem and determine whether it can exit the HIPC scheme or, if it cannot, how much debt relief it will need to reach a sustainable level of debt at its 'completion point', three years down the line.

What is a sustainable level of debt? This has been defined by the World Bank/IMF as a level at which a country is able to meet its current and future debt repayment obligations in full without compromising economic growth and without resorting to rescheduling or building up arrears in the future. In the HIPC scheme, a country undergoes a Debt Sustainability Analysis (DSA), on the basis of which it is decided exactly how much debt relief is needed for the country to fulfil the sustainability targets of the initiative: a debt burden within the range of 200–250 per cent of the country's annual exports and a debt service of 20–25 per cent of annual exports. The cost (and therefore debt relief provided) under the scheme is approximately US$30 billion, to be divided in half between bilateral and multilateral creditors. With regard to its implications for overall debt reduction, a rough estimate suggests that after HIPC and traditional debt relief, the value of public debt in the 33 countries likely to qualify – presently estimated at about US$90 billion – would be reduced by about half.

4.4 SELF-ASSESSMENT EXERCISES (SAEs)

During recession period does poor countries really on their foreign exchange?

4.5 SUMMARY

In the 1970s, in the aftermath of the oil crisis, many states in Eastern Europe and the Third World borrowed huge sums of money in the expectation that interest rates would remain stable. It did not. Debts incurred were so large that they needed new loans to finance them. Between 1982 and 1990 US$927 billion were advanced to poor states but US$1,345 billion were remitted in debt service alone. The debtor states began the 1990s 60 per cent more in debt than they were in 1982. The enormity of the debt thus began to militate against their development. Due to this development there was the need to relieve these countries from this shackles this led to the World Bank initiative. The central aim of the HIPC initiative is to enable highly indebted poor countries, whose debt burdens are too high to be dealt with by traditional debt reduction mechanisms, to achieve a sustainable debt level within a period of six years.

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4.7 POSSIBLE ANSWERS TO SAEs 4

In the recession the price of raw materials, on which many poorer states depend for earning foreign exchange, collapsed. Debts incurred were so large that they needed new loans to finance them. Between 1982 and 1990 US$927 billion were advanced to poor states but US$1,345 billion were remitted in debt service alone. The debtor states began the 1990s 60 per cent more in debt than they were in 1982. Sub-Saharan Africa's debt more than doubled in this period. When the issue of debt remission or debt forgiveness is raised, Western banks have argued that it would create what economists call 'moral hazard' – failing to honour debts would simply encourage poor states to continue borrowing in the expectation that they would never have to repay their debts. On the other hand, some commentators argue that moral hazard should cut both ways. Overborrowing is overlanding, and creditors should pay their share of the costs of mistakes made in the 1970s. By 1997 Third World debt totaled over US$2.2 trillion. The same year US$250 billion was repaid in interest and loan principal. The debt trap represents a continuing humanitarian disaster for some 700 million of the world's poorest people. During the last decade the world's most heavily indebted continent, Africa, has experienced falling life expectancies, falling incomes, falling investment levels, and rising infant and maternal mortality rates.

Module 5: CONTEMPORARY ISSUES IN INTERNATIONAL ECONOMIC SYSTEM

Unit 1 The Trade Issue
Unit 2 Globalization
Unit 3 Economic Regionalization
Unit 4 Africa's Rising Economic Profile
Unit 5 Global Economic and Financial Crisis

UNIT 1 THE UNITED NATIONS AND THE INTERNATIONAL COURT OF JUSTICE

CONTENTS

1.1 Introduction
1.2 Intended Learning Outcomes (ILOs)
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    1.3.1 International Trade Issues
    1.3.2 Tariffs decreasing, regulations increasing
1.4 Self-Assessment Exercises (SAEs) 1
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1.1 INTRODUCTION

Depending on who you listen to, trade is either the great destroyer of communities, the environment and developing countries, or the unblemished saviour of all the above.In reality, there is no simple relationship between trade, environment and development. Depending on the sector, the country, the markets and the prevailing policies, trade and trade liberalization may be good or bad for the environment and development. They will usually be both at once - good in some ways, bad in others.

1.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Understand the major issues involved in global trade
- Identify the causes of disputes in trade
- Examine the politics behind international trade

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1.3 MAIN CONTENT

1.3.1 Issues in trade

Over the past few decades, changes in the production of trade-able goods and services have caused an in-depth re-visitation of the traditional analysis regarding the opening up of international trade. Since the establishment of the GATT in 1947, itself a product of 19th and early 20th century economic thinking, a new landscape has gradually replaced the world of the past, marked by fifty years of regulation that began at the end of World War II. A clear-cut answer is needed to the question regarding the differences between these two worlds: technology has had a major impact on the location of manufacturing systems. An unavoidable driving force behind the globalisation of trade, technological evolution has reshuffled the cards of international trade to a degree that traditional thinkers such as Smith or Ricardo could not even have dreamt of. The practical implementation of their theories came up against the continued existence of distance asan obstacle to trade for a very long time. But new technologies, such as the container or the Internet in the field of logistics and of communication, have introduced huge factors that have slashed the cost of distance, thus improving the efficiency of trading and the international division of labour the world over.One example of these countless innovations is the replacement of piston-engine planes by jet-engine planes, which has cut the cost of transport fifty-fold over the past fifty years. It costs less today to ship a container from Marseilles to Shanghai than it does to shift it to Avignon. Constant progress in information and communication technology like the widespread use of personal computers and Smartphones, have also contributed to rapid change in the world's production and consumption patterns.

The trend towards a reduction in the cost of distance in international trade has de facto literally eliminated a traditional paradigm whereby foreigners are "distant" from us, in a geographical or geopolitical situation which allegedly hampers trade. This argument is now obsolete. In actual fact, the opening up of trade and the development of value chains have had such a major impact on the location of goods and services that it is no longer as easy as it used to be to gauge the added value of a product (whether we are talking about goods or services) whose component parts come from all around the world. A worldwide average import content of exports has shot up from 20% twenty years ago to 40% today and it looks set to hit the 60% mark in twenty years' time. What conclusions should we draw from this evolution if not that capitalism will soon end up killing mercantilism whose ideological residue occasionally continues to hamper our thinking? It is not that the old ideas of commercial heritage, which did indeed preside over the conception and regulation of world trade, were always wrong to discredit imports in favour of exports. But clinging to that way of thinking today means missing out on reality which requires that imports account for almost half of a country's exports. In other words, wishing to revive the distance hurdle by restricting trade through an increase in the taxation of foreign inputs would be tantamount quite simply to shooting oneself in the foot

1.3.2 Tariffs decreasing, regulations increasing

The system being more flexible and mobility having increased, customs duties are no longer as powerful a curb on a producer because he can simply decide to set up elsewhere. This observation partly explains the massive cut in the global level of customs duties since the start of the GATT. The trade weighted average customs duty today is below 5%. Administrative constraints and immobilisation at the border, the reduction of which was the subject of a major deal at the WTO's ministerial conference in Bali in late 2013, represent on average a cost that is twice as high as the cost of customs duties. Remaining obstacles in the way of trade now have far less to do with customs duties or with the administrative cost of border crossing, which the Bali agreement, still to be ratified, is going to reduce in the future, than they do with regulatory differences in such varied spheres as health, safety and the environment. The application of the precautionary principle to international trade raises new problems which are clearly at variance with the ideological neutrality governing the establishment of obstacles of mercantilism world. In this new landscape, it is no longer a matter for partners simply to reduce costs and to optimise gains they have to ensure that potentially politically loaded standards are addressed. Reference to the precautionary principle at this juncture subjects the regulation of trade to a risk management rationale in accordance with a moral or cultural partner that marks a radical break with the neutrality required by international trade based on the traditional approach. Without even considering such heated debates as those surrounding GMOs or data privacy, the differences between the use and conception of diesel in Europe and in the United States perfectly reflect the weight of collective preferences. For reasons that have as much to do with protecting the environment as they do with the organisation of transport, the Americans eschew diesel engines for their cars in favour of petrol engines. The Europeans, on the contrary, prefer diesel-engine cars, yet they levy taxes on diesel that are totally non-existent in the United States. The difference in regulations points to a radically different world from the previous system, which was marked by a shared intellectual approach whose aim was quite simply to ultimately abolish all customs duties.

The approach based on regulatory restriction, on the other hand, comes up against an increase in standards and in the level of protection to match increasing level of development. In the food sector alone, compliance with certain standards becomes a priority requirement when supply or production is handled upstream. The formation of collective preferences is closely linked to rising income. The more advanced a country is, the more cautious it becomes, adopting regulations which can, de facto and without it being the main reason, stand in the way of trade. Now, short of being totally cynical, it is impossible to think of eliminating regulations solely on the strength of the benefits deriving from the opening up of trade. What now matters is to reduce the difference between sets of regulations. For instance, no European commissioner would ever defend a differentiation in the maximum level of pesticides permitted in imported flowers for the benefit of less developed countries, in the name of a trade policy designed to foster development. The maximum level of pesticides permitted, a level set by Europe and checked at the border, will not change depending on the origin of the import. In other words, we can no longer differentiate. And the reality, which most trade negotiators take good care to avoid mentioning too clearly so far, is the end of differentiated treatment. The essential conclusion of this process is that with tariffs already low and with an increasingly binding regulatory environment, there is less and less room for negotiating by mutual concession.

1.4 SELF-ASSESSMENT EXERCISES (SAEs) 1

How do you perceive the issue of International Trade transaction?

1.5 SUMMARY

The unit examined the establishment of the GATT system which had been set up to help moderate trade relations among nations. The unit also examined the impact of technology on trade. In this wise the unit noted that technology has definitely played a huge role in accelerating the rate of economic interchanges in the world. Finally, the unit noted that customs duties was falling however there was a concomitant raise in administrative constraints and immobilisation.

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1.7 ANSWERS TO SAES 1

Over the past few decades, changes in the production of trade-able goods and services have caused an in-depth re-visitation of the traditional analysis regarding the opening up of international trade. Since the establishment of the GATT in 1947, itself a product of 19th and early 20th century economic thinking, a new landscape has gradually replaced the world of the past, marked by fifty years of regulation that began at the end of World War II. A clear-cut answer is needed to the question regarding the differences between these two worlds: technology has had a major impact on the location of manufacturing systems. An unavoidable driving force behind the globalisation of trade, technological evolution has reshuffled the cards of international trade to a degree that traditional thinkers such as Smith or Ricardo could not even have dreamt of. The practical implementation of their theories came up against the continued existence of distance asan obstacle to trade for a very long time. But new technologies, such as the container or the Internet in the field of logistics and of communication, have introduced huge factors that have slashed the cost of distance, thus improving the efficiency of trading and the international division of labour the world over.One example of these countless innovations is the replacement of piston-engine planes by jet-engine planes, which has cut the cost of transport fifty-fold over the past fifty years. It costs less today to ship a container from Marseilles to Shanghai than it does to shift it to Avignon. Constant progress in information and communication technology like the widespread use of personal computers and Smartphones, have also contributed to rapid change in the world's production and consumption patterns.

UNIT 2: GLOBALIZATION

CONTENTS

2.1 INTRODUCTION

Globalization is continuing process which could not be avoided by every nation in this world where the globalization trends contribute big impact toward society life and toward the development of retail industry. The impact of globalization toward society can be seen on the changing in several aspects such as economic, politic and legal, social and culture, and technology as well. This unit will examine trends which have led to the raise of this phenomenon. It will also examine some of its characteristics and drawbacks especially as it affects the developing world.

2.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Discuss the concept of globalisation
- State the key issues involved in globalization
- Identify areas of politics in operating globalisation

2.3 MAIN CONTENT

2.3.1 Globalization and the world economy

This is a term that refers to the acceleration and intensification of mechanisms, processes, and activities that are allegedly promoting globalinterdependence and perhaps, ultimately, global political and economic integration. It is, therefore, a revolutionary concept, involving the de-territorialisation of social, political, economic, and cultural life. It would be a mistake, however, to view globalisation deterministically. Just as there are powerful forces of integration at work through the shrinkage of distance on a global scale, so there are forces of disintegration as well.

Globalisation has certain identifiable characteristics, although there is no consensus in the field about any of them! In the first place, it involves a growing consciousness of the world as a single place. This is reflected in phrases such as ‘the global village’ and ‘the global economy’. Few places are more than a day’s travel away and communication across territorial borders is now almost instantaneous. In 1980 there were about 1 million international travellers per day. In 2000 more than 3 million people crossed territorial borders as tourists each day. Second, new information and communications technology have improved access to overseas markets and streamlined both the production and distribution of goods and the trade in foreign exchange. Third, human beings are becoming more and more dependent upon one another as problems such as global warming, the international drugs trade, and terrorism can only be managed through greater cooperation at a supranational level. Fourth, some observers argue that globalisation is erasing cultural differences. Sociologists, for example, like to talk about the Coca-Colaisation or McDonaldisation of global culture. Finally, some observers claim that the sovereign state's capacity for independent political action is weakened by globalisation. This is especially true in the area of economic policy. The idea of a domestic economy hemmed in by well-defined borders and managed by the state is now obsolete.

Today, domestic economic policy is subject to global market forces. The state has little effective influence or control over these forces. Any state that tries to exert its influence risks disinvestment capital flight, and recession. In short, globalisation involves a radical transformation of existing economic and political structures in international relations. It involves an aspiration to think and act globally and an acknowledgement that humanity cannot effectively be ordered along geographical lines. To talk about globalisation, then, is not only to embark on a description of the present, but involves a comprehension of the forces shaping the future. In this sense it is a multifaceted, complex, and dynamic concept. The causes of globalisation are many. Among the most important are liberal capitalism and the revolution in information and communications technologies. Liberal capitalism simply refers to theconjunction of liberal values (freedom, human rights, individualism, and democracy) with an economic system based on the market. This world view is widely held to have triumphed over communism and the idea of a planned economy, resulting in an international environment conducive to the free movement of capital and goods.

There is no agreement among scholars as to the origins of globalisation. It has been dated as far back as the dawn of Western civilisation. Some look to the origins of the modern state system for signs of globalisation, while others speak about the significance of the laying of the first transatlantic telegraph cable in the mid-nineteenth century. Nevertheless, what distinguish globalisation today is the intensity and the speed at which these changes are occurring. This is easily demonstrated by the rapid increase in the number of non-governmental organisations. At the beginning of the twentieth century there were around 170 in existence. Today the figure stands at around 5,500. Interestingly, around 1980 the figure stood at close to 2,500. That represents a 100 per cent increase in 20 years. There is no doubt, then, that the 1980s were a crucial turning point in the history of this concept. Evaluations of globalisation vary enormously. For some, it is a code word for American hegemony and the liberation of multinational corporations from effective control and regulation. This is a complaint which has accompanied the rise of 'anti-globalisation' movements in recent years. For others, it is a potential force for prosperity and greater equality through the expansion of capitalism. Some liberal activists have interpreted it as a vehicle for the promotion of universal human rights and world peace, while some cultural specialists view it as a pernicious force threatening the survival of local cultures and ways of life. It is true that not everybody benefits from globalisation.

To take full advantage of globalisation requires both capital and access to technology. Many states in the international system have neither. A large proportion of the world's population, for example, does not have access to the telephone. Being 'on the net' is not something which makes a lot of sense to those living in the poorest parts of the Third World. In other words, globalisation may not be global after all. At best, its spread and impact are uneven. From the perspective of the OECD countries, there are many unresolved issues with respect to globalisation. Among them is its relationship to democracy. If globalisation is indeed weakening the ability of states to make autonomous economic and political decisions, then one might argue that globalisation is a dangerously anti-democratic force.

2.3.2 Globalization's characteristics

In order to better understand the globalization process, it is necessary to introduce its main features: multidimensional character - manifests itself in many aspects of social life, in economy, in politics and also in culture. In globalization process, there are different actions, conducted at the same time; complexity - globalization consists of a huge number of sub-processes, spread all over the world, which create the exact structure. There are four main processes in the world economy: the decrease of USA's domination, financial market development, globalization of companies' activity, ecological problems; integration - connecting activities run on different levels: economies, markets, and companies by trade, agreement and investment connections; international dependence - the development of a particular entity depends on its activities run abroad and their success. This dependence can become a one-way dependence on a stronger foreign partner; connection with the progress of science, technology and organization -economies modernization, development of new production branches, increase of high qualified labour and new technology play a crucial role in the long-lasting globalization process.

At the same time, globalization accelerates the technological progress; compression of time and space - the "world shrinking" phenomenon is the result of science and technology development. It is seen in the labour migration, products coming from all over the world, possibility in taking part in world's events (Television, Internet) and in the fast products' and services' delivery processes; dialectical character - clashing of processes and opinions which have opposing character: globalization - regionalism, integration - de-integration; multilevel character - the world economy is the highest level in the hierarchy, economy's branches, markets, companies, assets, products and services are lower in this hierarchy; international range - extension of activities to the international and worldwide level.

Some scientists list also other distinctive features of globalization, which are presented below: the creation of a global financial market - as the result of liquidation of obstacles and difficulties in capital flows; institutionalization of foreign trade - foreign trade is controlled by such institutions like: World Trade Organization (WTO), General

Agreement on Tariffs and Trade (GATT), International Bank for Reconstruction and Development (IBRD) and International Monetary Fund (IMF); Mac-Donaldization - global unification of needs according to some products and services, especially in the food industry, electronics and car branches; sudden increase of Foreign Direct Investments FDI flows - in 1990's their growth exceeded 4 times the growth of world export; domination of transnational corporations in the global economy – which are the main entities of the globalization process; geographical disjunction of the value added chain in the global scale – setting the part of chain (production of part of final product) in the place where the ratio of expenditures to effects is the most favourable; creation of knowledge based economy - huge capital investments in Research and Development (R&D) activities; creation of the fourth economic sector - traditionally, the economy was divided into three sectors: agriculture, industry and services.

Nowadays services are divided into further two sectors: traditional services and intellectual services. The tasks of intellectual services are: information processes, Research and Development (R&D) and information management. They all create the new discipline, which is The Knowledge Management; redefinition of the term "country" - decreasing roles of countries as the result of growing roles of integration associations and international organizations.

2.4 SELF-ASSESSMENT EXERCISES (SAEs) 2

Identify and discuss the major features of globalization?

2.5 SUMMARY

The unit noted that there are four main processes in the world economy viz the decrease of USA's domination, financial market development, globalization of companies' activity, and ecological problems.

2.6 REFERENCES/FURTHER READINGS

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2.7 POSSIBLE ANSWERS TO SAEs 2

Globalisation has certain identifiable characteristics, although there is no consensus in the field about any of them! In the first place, it involves a growing consciousness of the world as a single place. This is reflected in phrases such as 'the global village' and 'the global economy'. Few places are more than a day's travel away and communication across territorial borders is now almost instantaneous. In 1980 there were about 1 million international travellers per day. In 2000 more than 3 million people crossed territorial borders as tourists each day. Second, new information and communications technology have improved access to overseas markets and streamlined both the production and distribution of goods and the trade in foreign exchange. Third, human beings are becoming more and more dependent upon one another as problems such as global warming, the international drugs trade, and terrorism can only be managed through greater cooperation at a supranational level. Fourth, some observers argue that globalisation is erasing cultural differences. Sociologists, for example, like to talk about the Coca-Colaisation or McDonaldisation of global culture. Finally, some observers claim that the sovereign state's capacity for independent political action is weakened by globalisation. This is especially true in the area of economic policy. The idea of a domestic economy hemmed in by well-defined borders and managed by the state is now obsolete.

UNIT 3: ECONOMIC REGIONALIZATION

CONTENTS

3.7 Answers to SAEs 3

3.1 INTRODUCTION

Regionalism is in fashion. It seems that every month brings news of yet another agreement among a group of countries, or between one group and another, to strengthen their economic links, particularly by removing barriers to trade and investment among themselves. This is certainly not the first time in history that regionalism has been on the march. There were widespread attempts at regional trading arrangements in the 1960s, which largely failed. Before that, in the 1930s there was a major fragmentation of the world trading system into competing blocs, which in the standard view succeeded only too well. This unit seeks to address certain big questions regarding the current regionalism such as the relationship between regionalism and a multilateral system or the usefulness of regionalism to world economy.

3.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Understand what regionalism is about
- Explain the various regional groupings in the world today
- Identify the nature of regional grouping in different parts of the world.

3.3 MAIN CONTENT

3.3.1 Regionalism in global economy

This term refers to intensifying political and/or economic processes of cooperation among states and other actors in particular geographic regions, although it is most often discussed in the context of trade flows. At least since the beginning of the 1980s, the world economy has become more and more tripolar, with more than 85 per cent of world trade concentrated in three regions: East Asia, Western Europe, and North America. At the same time, these are also areas in which attempts to engage in some regional integration have taken place. The deepening and the expansion of the European economic integration, increasing interdependence among three North American countries (US, Canada, Mexico) as well as the transformation of the Association of Southeast Asian Nations (ASEAN) into a more economy-oriented association since the 1980s are examples of this. In contrast, other regions have been successively losing their share of the world market, so that at the end of the twentieth century they represent approximately one-tenth of the world trade volume. Essentially, a region is a spatial concept. It is defined by a combination of geographical proximity, density of interactions, shared institutional frameworks, and common cultural identities.

Regions can be identified empirically by relying on data on mutual interactions such as trade flows, similarities of actor attributes, and shared values and experiences. But one should also bear in mind that regions are dynamic entities. They are not so much measurable building-blocks of the international order as spatially defined cultural, economic, and political constructions whose nature and functions are transformed over time. The term 'regionalism' captures these dynamic aspects of regional cooperation defined as the growth of social and economic interaction and of regional identity and consciousness. Regionalism results from the increasing flow of goods, people, and ideas within a spatial entity which thus becomes more integrated and cohesive. Regionalism can develop 'from below' (i.e. from the decisions by companies to invest and by people to move within a region) or 'from above' (i.e. from political, state-based efforts to create cohesive regional units and common policies for them).

Practically everyone writing today on regionalism argues that it is growing strongly in almost every part of the world. This trend, sometimes depicted as the 'second coming' of regionalism (the first one took place in the 1960s), has been explained by several, often disparate, factors. The alleged decline of US material hegemony, the end of the cold war, the rise of the Asia-Pacific region, and the export-led reorientation of development strategies in the Third World have all fostered a more decentralised international system. This has, in turn, enhanced the autonomy of regions and their dominant actors. The standard arguments on the rise of regionalism mention, at a minimum, the establishment of the North American Free Trade Agreement (NAFTA), the deepening integration in the European Union, and the growing economic interdependence in East Asia. Regional cooperation may also be promoted as a counterweight to the uneven globalisation of the world economy. Finally, regionalism may be a reaction against dominant states that try to co-opt local actors by granting special privileges to them. The main debate about regionalism is whether it is leading to a more polarised or a more cooperative world economy and world order. While the proliferation of regional trade agreements has raisedconcerns about their implications for the multilateral trading system, most observers argue that these two systems have not been contradictory.

However, the relationship between regionalism and a multilateral system is a complex one, and it is becoming more complex as the number and the scope of regional initiatives increase. Ensuring that regionalism and multilateralism grow together (open regionalism)– and not apart (closed regionalism) – is perhaps the most urgent issue facing trade 116 policymakers today. Well-structured regional integration arrangements may be helpful to the strengthening of an open world economy for three main reasons. First, regional arrangements can enhance the awareness of interdependence between trading partners, thereby enhancing the acceptance of international rules on the part of national governments and interest groups. Second, regional arrangements in general face similar challenges to those faced by the multilateral trading system. Therefore, the problems and solutions experienced during regional negotiations will be useful in overcoming similar difficulties that arise in the multilateral processes. Finally, increasing inter-regional cooperation mechanisms can serve as a building-block for the strengthening of multilateralism.

3.3.2. Regional integration groupings

In the 20th century there was a strong dynamics of integration processes, in the singular regions of the world, what is identified, by many scientists, with a trial to find a new way of economy development. Nowadays, integration activity is tied with liberalization of economic relations, and they are not treated, like a necessary evil any more, but like a necessary condition of farther economic development. T. Sporek identifies this activity with a desire to create the free trade zone, where customs and quantitative limits in a group of countries, would be abolished. This view seems to be real especially, when observing a significant progress of commercial agreements, since the beginning of the nineties. A special attention needs a fact, that highest rise of numbers of commercial agreements, was in the West Hemisphere, and areas of Asia and Pacific. A structure of the modern world economy is very complex. It comes from growing number of subjects, building it, and more complicated relations between them. In the last century, a new subject of the world economy appeared – integration grouping. It is defined, as 'significantly different, on the surrounding background (for example, in the world economy, and in international economic relations), relatively uniform, new economic organism, including two or more countries (national economies).

A process of integration joins members of groupings, and, it is a mutual adaptation of structures of singular economies. These international groupings have a regional character. It means, that, it is built by countries, which belong to a common geographical region, often neighbour to each other, and they are characterized, by a similar level of economic development though, it is not a necessary condition. It is worth to stress, that integration groupings can have a dual character: formal (institutionalized) and informal. Formal integration groupings have right organization structures, and authorities. Their role is a stimulation and continuation of integration processes, in the institutional way. Formalized integration groupings are for example: European Union, NAFTA and ASEAN. Informal groupings are deprived of formal structures, which would initiate and dynamize, integration processes. They can be formed by countries, tied with strong economic relations, for instance commercial, capital or productive ones. An example can be existing but not formalized, relations between Canada, the USA and Mexico before NAFTA was formed Integrative activity is observed in all continents.

It is worth to notice, that each of integration stages is difficult to reach. It needs, not only a rational attitude to economic matters, but also, a strong political will. The lowest stage – the free trade zone – is supposed to be the most attractive form of the integration process. It is one basic reason of such an attitude. It needs only elimination of quantitative and qualitative barriers, in trade sales, without a need to resign with economic independence of the national economy. Majority of integration processes is limited to the free trade zone examples are organizations, for instance EFTA, COMESA and ANZCERTA. Majority of organizations stay at beginning stages of the free trade zone or the customs union. They also have ambitious integration projects, but for now, do not feel like getting rid of their independence. At the same time, a new phenomenon is perceived, which was not met before. The target of integration groupings is not only liquidation of economic barriers, to increase trade, but also cooperation with scientific, technical and financial character. It is, such called new regionalization, which an essence is widening of integration areas, besides building economic groupings, also to ecology, culture or social matters. Development of the modern world economy, for which, an increase of the global economic interrelationship is characteristic, appoints, a phenomenon of regionalization, sometimes having a form of integration.

Globalization and regional integration in the world economy, like economic interrelationship, are not a new phenomenon and they existed before Yet, a range and course of these processes in the last decade of the 20th century, contains many new qualitative elements. Regionalization, which somehow is a synonym of different integration forms, takes a form less or more close and institutionalized relations, is characterized by inter weaving economic, commercial, technical and financial cooperation. In the common meaning, international economic integration is understood, as a process of a merge of national economies. Yet, this merge does not mean to add economic potentials, but creation new economic organism with different characteristics. In the last years, we can observe a notable boom of the integration processes in various regions of the world. Such called new regionalism, became one of the main elements of development of the world economy, on a present stage. Modern integration initiatives differ from the previous ones. They involve much more countries have a wider range and different forms. Old groupings try to boom their activity, and, at the same time, new regional agreements are signed. Outside and internal conditions of economic cooperation processes, in particular countries, are also different. Change of political conditions, the end of the cold war and democratic changes, as well as abandon the model directed to inside to the model directed outside, was effective to make agreements in many countries. New conditions resulted in appearing of various forms of integration, and creating integration agreements in different regions of the world, on new rules. Actual processes are an example of integration of countries with diversified potential and big differences in development level. Countries with lower development level, try to integrate with countries, which are main centres of the world economy.

'New regionalization is characterized by widening the integration field, besides creation commercial blocks for such branches as: ecology, culture, social and political matters, and at the same time, sensitizing for global transformations. It is not only about defence, against results of global changes, but rather about facilitating of adaptations, which can be realized on particular countries level. It is admitted, that in regions, there are core and periphery areas. Areas out of the core, not having chances to integrate with UE and TRIADA, are less politically stable, and economically active, but they are conscience of their unprofitable situation, and want to stop a tendency to marginalization. Such called semi – peripheries of Europe, which creates East Europe, are in the indirect position, leading to the integration with the core, so with European Union. A new stage of integration is often determined as, an open regionalism, what means, that its target is not a creation of close commercial blocks, but only increase of the free trade area. International regional cooperation is treated as a factor to strengthen of democratic and political stabilization, and to ensure economic progress and life improvement. In the literature of the subject, a lot of place is sacrificed to research of mutual relations between two tendencies, characteristic for modern economy, especially growing up, at the same time, processes of globalization and international regionalization. These relations are perceived in different way. On one side, it is shown, that the process of globalization and regionalization, strengthen mutually, on the other one, there is not lack of their opposition.

J. Mayal interprets processes of globalization and regionalization in a very interesting way. He thinks that both trends are not opposite, but symbiotic, and appear in the world at the same time, fulfilling each other. By him, a development of regionalization was an answer to globalization process, like globalization itself, and powers, which stimulate it, were a consequence of competition in the world. By J. Kleer, a base of these two processes, are mechanisms tied with profits of scale (it is called like that in economy). A deciding role in these processes played three phenomena: a violent acceleration of technical progress, informatics revolution, and a fast development of work efficiency per worker. Although, a core of globalization are similar, or even the same reasons, members of these processes, targets and rules setting both of them, are different. Targets of globalization do not have to be the same, as targets of the regional integration.

Some are common, others can be different. Processes of the world globalization are directed by requirements of competition, and searching by economic subject, the most effective forms and localization of economic activity, and its chart differing it from integration, is spontaneity. While, activity for regionalism, is mainly limited by needs of cooperation, not only economic, but also political and social, and contain many branches (for instance, environment protection or work conditions). Regional cooperation's target is resolving differences and contradictions between economies and works to compensate their development chances.

3.4 SELF-ASSESSMENT EXERCISES (SAEs) 3

In your own word describe the concept of regionalism in global politics perspective?

3.5 SUMMARY

This unit principally examined the prevalence of regional groupings since the end of the Cold War. The breakdown of nations into regional groupings has accentuated the globalisation phenomenon. Regionalism cuts across economic, political and social, and even military cooperation.
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3.7 ANSWERS TO SAEs 3

Regions can be identified empirically by relying on data on mutual interactions such as trade flows, similarities of actor attributes, and shared values and experiences. But one should also bear in mind that regions are dynamic entities. They are not so much measurable building-blocks of the international order as spatially defined cultural, economic, and political constructions whose nature and functions are transformed over time. The term 'regionalism' captures these dynamic aspects of regional cooperation defined as the growth of social and economic interaction and of regional identity and consciousness. Regionalism results from the increasing flow of goods, people, and ideas within a spatial entity which thus becomes more integrated and cohesive. Regionalism can develop 'from below' (i.e. from the decisions by companies to invest and by people to move within a region) or 'from above' (i.e. from political, state-based efforts to create cohesive regional units and common policies for them).

UNIT 4: AFRICA'S RISING ECONOMIC PROFILE

CONTENTS

4.1 INTRODUCTION

Africa's macroeconomic prospects Africa's gross domestic product (GDP) growth is expected to strengthen to 4.5% in 2015 and 5% in 2016 after subdued expansion in 2013 (3.5%) and 2014 (3.9%). The 2014 growth was about one percentage point lower than predicted in last year's African Economic Outlook, as the global economy remained weaker and some African countries saw severe domestic problems of various natures. But the world economy is improving and if the AEO 2015 predictions are right, Africa will soon be closing in on the impressive growth levels seen before the 2008/09 global economic crisis

4.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Examine the African economic structure
- Understand the issues underlining Africa's economic progress
- Identify the problem of African economic progress

4.3 MAIN CONTENT

4.3.1 Africa's rising economic profile

Domestic demand has continued to boost growth in many countries while external demand has remained mostly subdued because of flagging export markets, notably in advanced countries and to a lesser extent in emerging economies. Export values of goods were also depressed by lower export prices. African exports are expected to strengthen in 2015 and 2016 as the world economy improves. In 2014, domestic demand was in most countries boosted by private consumption and public infrastructure investment with the latter also increasingly financed by issuing international sovereign bonds. On the supply side, many African countries have improved their investment climate and conditions for doing business, which enhance long-term growth prospects. Benin, Côte d'Ivoire, the Democratic Republic of the Congo (DRC), Senegal and Togo are even in the top ten countries worldwide with the most reforms making it easier to do business. Africa's supply side growth in 2014 was mainly driven by agriculture, extractive industries, construction and services, and to a lesser extent by manufacturing. But sectoral growth should not be seen in isolation, as there are important spill-overs between sectors. Furthermore, modernisation and structural transformation, the process by which new, more productive activities arise and resources move from traditional activities to these newer ones, is also happening within some sectors.

So far African economies have been relatively resilient to the sharp fall of international commodity prices. Production of commodities has often increased despite the lower prices, and overall growth has also been boosted by other sectors. But if commodity prices remain low or decline further, growth in resource-rich countries might slow down as governments need to cut spending. Governments will be keeping a close watch on conditions in key markets, especially China and Europe. There are some positive effects, however, as lower oil prices ease inflation, increase real incomes and strengthen export markets. In countries where inflationary pressures have eased – such as Botswana, the members of the Central African Economic and Monetary Community (CEMAC), Mozambique and Rwanda – policy interest rates have been reduced to stimulate growth. By contrast, in countries where exchange rates came under pressure, such as Nigeria, central banks responded by tightening policies to stabilise exchange rates and contain inflation. Most African countries continued their prudent fiscal policies to keep budget deficits at sustainable levels. But in several countries, including oil exporters, fiscal positions weakened despite efforts to limit spending and to improve tax revenue.

Political and economic governance in Africa

There were some positive governance developments in 2014. In Tunisia, a constitution endorsed in January 2014 enshrined religious freedom and guaranteed gender equality. This was followed by largely undisputed parliamentary and presidential elections, held in October and December 2014 respectively. South Africa held its fifth round of peaceful elections 20 years after its historic 1995 elections marked the end of the apartheid era. Over 179 million people went to the polls and voted in largely peaceful and credible elections (IFES, 2015; International IDEA, 2015). In Burkina Faso, mass protests led to the ouster of President Compaore in a short, successful transition. Several countries nevertheless continued to experience instability, acts of terrorism or conflicts. In 2015, a record 266 million people could be called to the polls (IFES, 2015). Elections are planned, or have been held, in countries that are among both the continent's largest economies and most populated, including Egypt, Ethiopia, Nigeria, Sudan and Tanzania. In Nigeria, the April 2015 elections were hailed as the first handover between civilians of different political parties since independence. Overall, public sector management has not improved much for the continent, but there has been some progress in specific areas, especially equity in the use of public resources, statistical capacities and public administration. The outbreak of the Ebola virus in Guinea, Liberia and Sierra Leonehighlighted the fragility of health systems, although it also demonstrated the importance of a committed leadership at the community level. The business environment has improved markedly in countries that needed it the most. Sub-Saharan Africa remains the region with the most difficult business environment, but it is also the region making the most progress, accounting for one in every three regulatory reforms worldwide. The ten countries that most improved their business environment from June 2013 to June 2014 include five African countries that were in the bottom quintile globally for ease of doing business: Benin, Côte d'Ivoire, DRC, Senegal and Togo. The fact that these countries remain in the bottom quintile, however, indicates that further efforts are needed.

3.3.2. Key facts and figures by sub-regions

Central Africa

Central Africa's growth accelerated in 2014 to 5.6% from 4.1% in 2013. Economic conditions are, however, quite different between countries. The Central African Republic is affected by a political and security crisis. Despite some moderate growth, gross domestic product (GDP) will remain much lower than before the conflict broke out at the end of 2012. In Equatorial Guinea, GDP continues to fall due to lower oil production. All other countries in the region should remain on a relatively high growth path. Despite some damage from lower commodity prices, the mining sector and related investment remain the main engines of growth in the region. But in some of the countries such as in Cameroon, the Democratic Republic of the Congo, Gabon, and Sao Tome and Principe, growth is broader based.

East Africa

East Africa's growth accelerated in 2014 to more than 7%, from below 5% in 2013. It is projected to decelerate to 5.6% in 2015 and accelerate again to 6.7% in 2016. East Africa will then again become the continent's fastest growing region. East Africa recorded the highest increase in foreign direct investment in 2014. Fluctuations in East African average growth are due to volatile development in South Sudan, where armed conflict cut oil production and GDP in 2013. It recovered in 2014 but is projected to decline again in 2015, although forecasts for this country are highly uncertain and depend on the evolution of the peace process. Ethiopia, Kenya, Rwanda, the United Republic of Tanzania and Uganda kept up their relatively high growth. As these countries have small mining sectors and their manufacturing is also not very large, or has declined as a percentage of GDP, their growth is more driven by services and construction. But countries are achieving growth with different degrees of sectoral transformation. In Ethiopia structural changes are most pronounced with the share of agriculture in GDP shrinking (although remaining higher than in the other countries) and services expanding more than in the other countries. In Sudan, growth remains weaker as the economy is still coping with the shock of South Sudan's secession in 2011 and the loss of oil revenues.

North Africa

North Africa's growth remains uneven as fallout from the uprisings of 2011 is still affecting countries. Libya is highly unstable with power struggles between different groups and a collapse of political and economic governance. Its oil production declined again in the first half of 2014. Despite some recovery in the second half, growth was again negative in 2014 and prospects are highly uncertain. By contrast, in Egypt and Tunisia greater political and economic stability is helping to improve business confidence. The gradual recovery of export markets and improved security should support growth, including in tourism, although in Tunisia terrorist attacks in March have created new concerns. Algeria's oil production increased for the first time in eight years and is boosting growth together with the non-oil sector. In Morocco, agricultural production declined in 2014 from its exceptionally high level in 2013 and reduced GDP growth. But assuming normal harvests and better export markets, growth is expected to accelerate. Mauritania continues to achieve the highest and steadiest growth in the region, supported by favourable macroeconomic and structural policies. This was mainly boosted in 2014 by parts of the mining sector (iron ore) and construction and on the demand side by private consumption and private investment. The exceptionally high total investment of around 45% bodes well for future growth.

Southern Africa

Southern Africa's growth slowed to below 3% in 2014, and only a moderate recovery is projected for 2015 and 2016. The subdued performance is due to the relatively poor growth in South Africa. The key economy's growth fell to 1.5% in 2014 from 2.2% the previous year. It suffered from weakened demand in trading partners and lower prices for its raw materials, while labour unrest and electricity shortages disrupted economic activity. South Africa's growth is projected to recover gradually on the back of more buoyant export markets and improved competitiveness due to the large depreciation of the rand. In Angola, growth also decelerated due to the oil price fall, a temporary reduction in oil production as well as a drought, which reduced agricultural production. Angola's growth is projected to remain lower than for most of the past decade as government expenditures are depressed due to lower oil revenues. Mozambique and Zambia are achieving the highest growth in the region. Mozambique is mainly driven by so-called mega projects and large infrastructure investment, financed by foreign direct investment and the government. In Zambia, good harvests boosted 2014 growth and mitigated the effect of lower growth in mining, manufacturing and services. Growth is expected to remain strong in both countries, but more efforts are needed to broaden the economy and make growth more inclusive.

West Africa

West Africa achieved relatively high GDP growth of 6% in 2014 despite the outbreak of Ebola in the region. The virus significantly reduced growth in the most affected countries: Guinea, Liberia and Sierra Leone. In Nigeria, Africa's largest country, growth accelerated to 6.3%, from 5.4% in 2013. It was again driven by the non-oil sector, notably services, manufacturing and agriculture, which shows that Nigeria's economy is diversifying. Its oil and gas sector has declined to around 11% of GDP and is now a similar size to manufacturing at around 10% of the total. Benin, Côte d'Ivoire, Niger and Togo also remained on a relatively high growth path. But growth slowed in Ghana, and Gambia's economy shrank slightly. West Africa's growth is projected to become more moderate in 2015 and to strengthen again in 2016, driven mainly by Nigeria.

4.4 SELF-ASSESSMENT EXERCISES (SAEs) 4

1. Critically assess the African economic profile from 2014-2016?

4.5 SUMMARY

This unit reviewed the improving scene of the African economic space. Thus, it was noted that this improved economic outlook has spurned the rapid growth of an African middle class which had been nearly wiped out by the oppressive economic situation of the last three decades. Coupled to the improving economic space in Africa is the issue of heightened political awareness in the continent. This state of political consciousness has enabled to people of Africa to question and in several instances depose despotic rulers.

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4.7 POSSIBLE ANSWERS TO SAEs 4

Domestic demand has continued to boost growth in many countries while external demand has remained mostly subdued because of flagging export markets, notably in advanced countries and to a lesser extent in emerging economies. Export values of goods were also depressed by lower export prices. African exports are expected to strengthen in 2015 and 2016 as the world economy improves. In 2014, domestic demand was in most countries boosted by private consumption and public infrastructure investment with the latter also increasingly financed by issuing international sovereign bonds. On the supply side, many African countries have improved their investment climate and conditions for doing business, which enhance long-term growth prospects. Benin, Côte d'Ivoire, the Democratic Republic of the Congo (DRC), Senegal and Togo are even in the top ten countries worldwide with the most reforms making it easier to do business. Africa's supply side growth in 2014 was mainly driven by agriculture, extractive industries, construction and services, and to a lesser extent by manufacturing. But sectoral growth should not be seen in isolation, as there are important spill-overs between sectors. Furthermore, modernisation and structural transformation, the process by which new, more productive activities arise and resources move from traditional activities to these newer ones, is also happening within some sectors.

UNIT 5: GLOBAL ECONOMIC AND FINANCIAL CRISIS

CONTENTS

5.1 INTRODUCTION

At the end of April 2009, the International Monetary Fund (IMF) released the latest edition of its flagship publication, the World Economic Outlook (WEO). This report marks the most extensive effort to measure the health of the global economy since the outbreak of the global financial crisis. The WEO's centrepiece is its GDP growth projections, given for 182 countries over the next five years. This indicator alone provides a wealth of information, allowing an examination of not only how countries will fare this year, but whether expectations of the crisis' impact have stabilized, where and when the recovery might come and how much poorer the crisis will eventually leave the global economy.

4.2 INTENDED LEARNING OUTCOMES

By the end of this unit, you will be able to:

- Understand the issues behind the periodic global financial crisis
- Examine the nature of global economic structure
- Identify ways of addressing the global economic problems

5.3 MAIN CONTENT

5.3.1 What's the latest outlook for the global economy?

Over the past decades, the world economy has been going through, more or less continuously, a series of strains and stresses in the current wave of globalization. Until recently, however, most of the downside risks of globalization have been borne largely by the developing world. In the 1980s, middle- and low- income developing countries went through a severe debt crisis. The majority of low-income countries had to wait for the resolution of their protracted debt crisis until the heavily indebted poor countries (HIPC) debt relief had culminated in a major reduction of their debt stock under the Multilateral Debt Relief Initiative (MDRI) in 2005. In the early 1990s, most middle-income countries, together with the newly formed transitional economies, were reintegrated into the international capital markets as emerging market economies, through the market-based debt restructuring process under the Brady Plan.

However, emerging market economies have been exposed repeatedly to financial crisis at the mercy of investors' instant decision to withdraw and follow the herd. In particular, they have suffered bitter experiences with currency attacks and collapses, adversely affecting the balance sheets of their financial institutions, corporations and households due to a high degree of liability dollarization, thus, deepening and prolonging the crisis further. Extremely disruptive to economic growth and development, these experiences have made policy makers in emerging market economies aware of the enormous costs that they have to bear from the periphery by participating in the financial globalization process. Consequently, many of them have opted to hold large amounts of international reserves for self-insurance purposes, far in excess of any shortfalls foreseen as a result of current account transactions (Kaltenbrunner and Nissanke, 2009; Jeanne, 2007; Miller and Zhang, 2007). Coupled with the special status accorded to the United States dollar in the international monetary and payment system in the post-Bretton Woods era, the global savings glut (Bernanke, 2005) has led to emergence of global macro imbalances. From the early 2000s the United States economy had become the largest debtor in the world by building up massive deficits in both fiscal and current account balances, which led to the global financial crisis in 2007-2008.

The flow of large amounts of savings into the United States economy under the easy monetary condition led to the housing and credit boom, which eventually ended in the sub-prime mortgage debacle. Unsurprisingly, in the context of contemporary financial globalization with fully integrated money and capital markets worldwide, this seemingly localized phenomenon could not be contained within the United States financial system. The first global financial crisis of the twenty-first century was in the making for some time, with its epicentre firmly located in the United States economy - at the heart of the global capitalist system.

By mid-2007, over-dependence on market forces and mechanisms without proper and workable regulatory mechanisms and systems in place to govern the globalization process, led to the appearance of large cracks threatening the stability of the world economy on the two fronts: the sharp hike of primary commodity prices and the global financial crisis. Many primary commodities have registered a steep rise in prices since 2002, reaching an all-time high in 20072008, with extreme volatility. The soaring key commodity prices hit the world economy at a time when most Western economies were struggling to escape a sharp economic downturn and recession amidst the credit crunch that had gripped the financial institutions and markets in the United States and Western Europe.

The fear of inflationary pressure, particularly jeopardizing macroeconomic stability in Western economies, creates a major dilemma for the central banks and monetary authorities of these economies. The belief that any inflationary expectation could be dispelled timely and successfully by adopting an institutional framework of inflation targeting faced a severe test. Inflation targeting with fine-tuning of a single policy instrument of interest rates was ill-equipped to deal with cost-push inflation associated with a sudden increase in imported commodity prices involving structural shifts in relative prices. In particular, rapidly increasing prices of basic consumer goods such as fuel and food, the prices of which are exogenously determined in world commodity markets, had sparked off social-and political unrest across the globe. Since mid-2007, policy makers in developing countries, particularly those with a high degree of dependence on imported oil and foods, became acutely concerned with the detrimental effects of the rising fuel cost and food shortages on the livelihood of the urban and the rural poor as well as internal and external macroeconomic balances.

For a year or so from mid-summer 2007, the financial turmoil, with its severe liquidity and credit crunch seemed to be confined, more or less, to financial markets and institutions in the United States and Western Europe. On the whole, the world economy managed to maintain its momentum on the back of the buoyant economic growth posted by emerging market economies as well as resource-rich developing economies that enjoyed a commodity boom of a longer duration than any in recent times. However, the series of events that hit major financial institutions on Wall Street in mid-September 2008 shocked the world and altered radically the fate and course of our globalized economies altogether. The fear of accelerating inflation and fuel and food shortages worldwide was completely overtaken by a greater fear of possible worldwide recession and depression engulfing all economies in the developing world, including emerging market economies in Eastern Europe, Latin America and Asia, as well as low-income developing countries in Africa, Asia and countries of the Economic Commission for Latin America and the Caribbean (ECLAC) region with limited financial market linkages. No country has been in a position to remain a mere bystander in the fast evolving financial crisis any longer.

By the end of 2008, the world economy had rapidly entered a phase of globally synchronized slowdown and, in the first quarter of 2009, headed towards a global recession. As time passed, there was a growing fear that the on-going financial crisis might well turn into a global depression of the twenty-first century. The speed at which the world economy has fallen victim to the recessionary wave of the financial turmoil in the United States and Europe caught everyone by surprise. In the second quarter of 2009, some signs were emerging indicating that the worst might be over following the large-scale counter-cyclical policy packages put in place by a number of larger developed and emerging market economies together with their massive liquidity injections into banking systems to mitigate the scale and depth of the recession. Yet, enormous damage has already been inflicted on real sector activities resulting, in particular, in a worldwide contraction of industrial production due to the severe global credit crunch and fall in world trade unprecedented in the post-war era.

3.3.2. How much worse off is the world today because of the crisis?

Events leading to the great financial crisis of the twenty-first century
Awash with plentiful liquidity flowing into the United States economy from the rest of the world against the background of the global macroeconomic imbalances discussed above, the United States consumers and households were at the ultimate receiving end of a large proportion of the global savings glut, under the easy monetary regime pursued by the Chairman of the Federal Reserve Board, Alan Greenspan, in response to the dot-com bubble of 2000-2001 and the 9/11 event of 2001. As often happens, this led to rapid expansion of consumer credit and uncontrolled acceleration of asset inflation in the United States. In particular, after the dot-com bubble, the asset inflation had taken the form of a housing boom in the United States. Although the boom was also prevalent in other European countries, such as, Ireland, Spain and the United Kingdom since the early 2000s, the United States housing boom had a special toxic element for future troubles in the form of sub-prime mortgages, which were sold aggressively, in particular since 2002-3, to low-income people with no down payments. They were often packaged at floating

or adjustable flexible rates, with a one- or two-year resets clause. The share of the sub-prime loans in the United States mortgage markets was estimated to have reached some 23 per cent in 2006. As expected, once the interest rates were adjusted upwards or the reset clause kicked in, many subprime mortgages became delinquent or were defaulted on outright leading to rising foreclosures.

Unfortunately, the sub-prime debacle was not contained within the United States housing market, since sub-prime housing loans were repackaged as structured credit products, such as collaterized debt obligations (CDOs) or special purpose vehicles (SPVs) or other innovative financial instruments, through multi-layered securitizations of underlying assets. These were traded globally through closely interlinked and poorly regulated financial markets and over-the-counter transactions. Led by executives, which were driven by distorted incentives for extortionate salary compensation with stock options at the core, financial institutions opted en masse for excessive risk-taking. They adopted a dynamic originate-to-sell trading model of securitization in place of a traditional buy-and-hold model. Leverage ratios of some of financial institutions increased as much as 30, well above the ceiling of ten generally imposed on deposit banks (UN, 2009).

In the process, potential default risks of original sub-prime mortgage products were overlooked, as they were reshuffled many times over and hidden from their balance sheets. The failure to demand transparency in their off-balance sheet activities on the part of regulatory and supervisory oversight agencies as well as the collusive practices and incompetence of the credit rating agencies to factor in market-wide systemic risks aggravated the situation. Credit risks were massively under-priced by all parties, given easy money and overly liquid markets as well as the availability of default risk insurance offered to debt holders by insurance companies though credit default swap (CDS) facilities. Although financial markets became irrational with systemic risks building up (Kindleberger 2000), individual market participants, driven by instant pay-offs and profit taking, believed that their decisions were based on rationality backed up by sophisticated financial modelling.

With sub-prime mortgage defaults accelerating since 2006, the inevitable crash of housing price bubbles in the United States led to an initial freezing of credit and money markets in the United States and Europe in July-August 2007. Despite immediate interventions through a series of large-scale liquidity injections by the Federal Reserve and the main central banks in Europe, inter-bank money markets have been largely frozen since then, leading to liquidity crunch in inter-bank money markets and credit crunch in many financial institutions. With problems Senbet (2008) reports that average real CEO pay for S&P companies grew to $15 million in 2007, 400 times average employee compensation, up 40 times from 1980. Stemming from asymmetric information and adverse selection looming, banks and financial institutions have ceased to trust and lend one another. Several over-leveraged banks and financial institutions in the United States and Europe were the first to go bankrupt, and some of them were nationalized after the governments were forced to become a major equity holder.

Despite the anxieties and tensions reflecting huge uncertainty and a crisis of confidence that gripped global financial markets and sectors during the intervening period, between the summers of 2007 and 2008, the continuing buoyant economic growth of several emerging market economies, such as Brazil, Russia, India and China (BRICs), sustained an optimistic growth prospect for the world economy for some time. Many oil-exporting and commodity-dependent economies in the Gulf States, Latin America and Africa recorded an economic growth rate that was historically high, largely due to the commodity boom induced by the rising demand for natural resources, particularly from the emerging Asian economies. A number of Asian economies escaped the impact of the initial wave of the present financial turmoil, since they have managed to reconstruct their banking and financial systems after the Asian Crisis of 1997-8, with generally robust balance sheets of financial institutions and non-financial corporations.

However, unprecedented events of an unimaginable scale in the Wall Street in mid-September 2008, abruptly and completely changed the course of economic policy debate as well as immediate prospects for the world economy. The early bankruptcy of Bears Steams and its takeover by JP Morgan-Chase in March 2008 and the collapse of other banks and financial institutions in the United States and Europe indicated the depth of the crisis and credit freeze impeding the normal operation of financial markets in these economies. These proved to be precursors to what would follow. In early September, the government of the United States sponsored mortgage buyout of Freddie Mac and Fannie Mae, which together accounted for some half of United States mortgage loans, amounting to $5 trillion. The two were practically nationalized after the early rescue package failed to shore them up. Then came the news of the bankruptcy of Lehman Brothers - one of the four big Wall Street investment banks - immediately followed by the take-over of Merrill Lynch by Bank of America and a $85 billion rescue package hastily arranged for American Insurance Group (AIG) which made everyone wake up to the scale of the problems on the Wall Street.

Due to instant flight-to-quality by investors worldwide, which switched from equity markets to purchases of safe investment, stock markets began to tumble globally. Financial papers such as money market funds and commercial papers, which are usually regarded as liquid and low-risk, were no longer seen as safe assets. Carry trade related flows, predicated on betting on exchange rate movements and interest rate differentials between major currencies and emerging market currencies were fast unwinding. With these swift portfolio adjustments, a large reversal of relative positions between the three major currencies- United States dollar, euro and yen - took place in a matter of days and weeks.

The global financial crisis has rapidly become a reality, with the real-economy side-effects being felt imminently worldwide. No country has been immune to the cascading effects of the crisis. For the first six months after September 2008, the possibility of the repeat of the Great Depression was feared, becoming no longer just an academic question. The hazardous combination of the negative wealth effects stemming from the price collapse of financial and real estate assets, deteriorating balance sheets of banking and other financial institutions and borrowing-constrained household and corporate sectors amidst severe credit crunches, has been depressing further both consumption and investment demand. This is a classical recipe for triggering a deflationary tendency, according to the debt deflation theory advanced by Irving Fischer, to explain the Great Depression in the 1930s (Fisher, 1933). By the end of 2008, it had become clear that the crisis could quickly result in a deeper, globally synchronized slowdown, leading to a possible prolonged recession in the world economy, unless effective and concerted policy measures were deployed in a timely, coordinated manner globally to prevent such a powerful tidal wave. Although the imminent danger of depression has been somewhat receding since the G20 summit in London in April 2009, the global economy still faced a high degree of uncertainty that it may endure prolonged recession.

Beyond GDP: how will the crisis affect national income?

The contraction in global output forecast by the IMF undoubtedly has implications for living standards around the world. However, to obtain a better sense of how the crisis will affect income levels in different countries, we must also account for changes in the terms of trade: the relative price of exports and imports. When the prices of a country's exports rise relative to the prices of its imports - an improvement in the terms of trade - the country is able to afford an increased volume of goods and services irrespective of changes in the level of domestic production. When a country’s export prices fall relative to its import prices, the same production supports less consumption.

To estimate the income effect from changes in the terms of trade in the world’s major economies, we first estimate the value of net exports as a percentage of GDP for each economy, disaggregated into four commodity bundles: fuel, metals, food and agriculture. We then multiply these by the projected change in prices in 2009 for each of the four categories, for which forecasts are provided in the April WEO. Adding these together yields the income effect resulting from changes in the terms of trade. This effect can then be added to the forecast 2009 GDP growth to give an approximation of the overall change in national income.

The collapse in commodity prices over recent months has a significant bearing on national income in most of the world’s major economies. For net commodity importers, the terms of trade effect is positive, partially mitigating the effect of the crisis and providing much needed respite during a time of reduced global economic activity. Driving this effect is the reduction in fuel prices, acting as an automatic stabilizer in response to reduced global demand. China and India again come out best, rewarded for their rapacious demand of imported commodities. For net commodity exporters but particularly fuel exporters – Russia, Canada and Mexico - the opposite is true, with depressed prices compounding the collapse in demand for their exports. The net effect is particularly painful for Russia, whose national income is estimated to fall by 13.0 percent this year. A big question for many commodity-exporting developing countries is to what extent robust growth in China and India can buoy global commodity prices, despite continued weakness in the US and Europe.

While the national income story is a more complete account of the effect of the crisis on living standards, it remains incomplete without consideration of equality, unemployment and poverty. The human impact of the crisis is a compelling tale, but one which is more difficult to analyze with real time statistics.

5.4 SELF-ASSESSMENT EXERCISES (SAEs) 4

What are major forces for the emerging market economy?

5.5 SUMMARY

The unit reviewed the recent global financial crisis. The unit also that due to the fall in commodity prices living standards may be adversely affected worldwide.

5.6 REFERENCES/FURTHER READINGS

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5.7 POSSIBLE ANSWERS TO SAEs 5

However, emerging market economies have been exposed repeatedly to financial crisis at the mercy of investors' instant decision to withdraw and follow the herd. In particular, they have suffered bitter experiences with currency attacks and collapses, adversely affecting the balance sheets of their financial institutions, corporations and households due to a high degree of liability dollarization, thus, deepening and prolonging the crisis further. Extremely disruptive to economic growth and development, these experiences have made policy makers in emerging market economies aware of the enormous costs that they have to bear from the periphery by participating in the financial globalization process. Consequently, many of them have opted to hold large amounts of international reserves for self-insurance purposes, far in excess of any shortfalls foreseen as a result of current account transactions (Kaltenbrunner and Nissanke, 2009; Jeanne, 2007; Miller and Zhang, 2007). Coupled with the special status accorded to the United States dollar in the international monetary and payment system in the post-Bretton Woods era, the global savings glut (Bernanke, 2005) has led to emergence of global macro imbalances. From the early 2000s the United States economy had become the largest debtor in the world by building up massive deficits in both fiscal and current account balances, which led to the global financial crisis in 2007-2008.