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LIMITED COOPERATION IN MONEY AND TRADE: AND INTERNATIONAL POLITICAL ECONOMY

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International political economy is an emerging discipline. Major contributions have been produced in the United States and partly in Europe while the approach is almost completely ignored in Italy.

Conceptual background

Over the past fifteen years the international economic system has changed its hegemonic structure into an interdependent oligopoly i.e. a system which is characterized by a small number of leading countries (for representative references see Balogh 1974, Cohen 1977, Hirsch and Doyle 1977, Kindleberger 1978, Kehoane and Nye 1977, Kehoane 1984). The hegemonic (Bretton Woods) structure allowed for the supply of a particular public good, an international system. In the oligopolistic system, on the contrary, the supply of such a public good falls short of demand. This is due to the fact that in such a system each leading country is able to constrain the others' decision while not being able to impose its own solution to arising conflicts.

The fact that over the last four years the US have acquired renewed strength in the international system, both politically and economically, does not imply that we are facing a new hegemonic system. Rather, this may be interpreted as the fact that the US have resolved in their favour oligopolistic conflicts with other countries.

The present role of the US does not in itself provide a new hegemonic system (a public good) as no new rules of the game have so far been agreed upon for the international system as a whole. In particular, no new international payments system may be said to exist today.

Conflicts arise both between single countries and between groups of countries, and they usually concern a double level (Hamada 1977, 1979): a) the definition of new rules of the game when these are lacking and b) the policy play once rules are established (or, in some cases, even when rules are not established at all). These two conflicting levels interact with each other.

Distinguished scholars and experts have lately advocated the need to return to international cooperation in order to cope with still widespread instability (see e.g. Meade 1984). Cooperation has been called for in all fields of international economic relations, monetary and fiscal policy as well as trade policy. The argument for cooperation is well known: a cooperative solution is always "first best" with respect to a non cooperative one if we assume - realistically - that the system may not be represented as a general competitive equilibrium. The problem then arises of why such a solution is not implemented

4452

or just sought for by national governments. The economists' answer is quite often discouraging. It is a political and not an economic problem.

This rather widespread attitude presents shortcomings. In the first place, this attitude assumes a definition of cooperation which is somewhat extreme. Cooperation is a general agreement on all relevant issue areas which involves (at least) the leading countries. In this respect cooperation is seen as the opposite of conflict. This assumption may be challenged on different grounds (Kehoane 1984). Cooperation may, and in fact it does, arise both on limited selected issues and among few countries. Secondly, a cooperative structure may often include conflicting scenarios producing what has been called cooperation after hegemony (Kehoane 1984).

In addition (Hardin 1982), one should distinguish between "explicit contracting" and "contract by convention". Actors may cooperate either by explicit agreement or by coordination of actions following tacitly understood norms. In the first case higher precision is obtained with a higher bargainig cost, while in the second case lower precision avoids lengthy bargainig on rules.

This brings us to the second point. The underlying theoretical structure on which the economists' position rests is, in most cases, the free market general equilibrium framework. In this framework any deviation from free and perfectly competitive market relations is seen as a road which inevitably leads to conflict. This implies the assumption that all countries should be considered as "small open economies" which is clearly not realistic if one takes a systemic viewpoint (see Bryant 1980). Bryant has suggested that at least the most important industrial countries should be classified as "intermediate interdependence economies" which affect and are affected strongly by the international environment.

In the third place this attitude ignores the fact that progress has recently been achieved in an emerging field in international relations research: international political economy (for surveys see Frey and Schneider 1982, Frey 1983). One of the scopes of this new approach to international relations is to investigate the economic base of political processes and hence to try to respond on economic, as well as political grounds, to the problems posed by international cooperation. This approach draws on different branches of economic as well as political theory: group theory, public choice, the theory of international monetary relations, game theory, rent-seeking theory, economic nationalism theory and others. Although international political economy may not yet be called an established branch of social sciences the growing number of significant contributions which have appeared in the last few years indicates that progress in this direction is encouraging

The application of this approach to the problem of international cooperation should allow to achieve a double objective. The first one is to link economic and political factors in the explanation of national government behaviour; the second is to link into a single "model" the operation of market forces in the international arena with that of national economic policies. To put it differently, this approach should provide a general framework of analysis in which national states and private agents interact together in the international system.

If one assumes a political economy approach, on the contrary, organized relations (in trade, finance, etc.) should be considered the norm rather than the exception and do not necessarily lead to disorder. Economic approaches need to be integrated into a politico-economic framework; i.e. political as well as economic motivations must be included in the evaluation of policy options. This is self evident if we consider sovereign states as the main actors involved in the search for new forms of cooperation. If a purely economic approach is followed (e.g. Sachs Oudiz 1984) the implementation of cooperative macroeconomic policies may produce a limited increase in welfare.

The above mentioned points lead us to a final question. The reciprocal interaction between nation states and international regimes in the determination of a cooperative framework. Two contrasting assumptions are usually made. On one extreme, outcomes in international relations are considered as dependent only on the actions of single nation states seeking to maximize their interest and power. On the other extreme international regimes are supposed to act as exhaustive constraints on national policies and hence they are the only relevant elements in the determination of behaviour and outcomes. These two conflicting views form the traditional institutionalist vs. realist approach debate. As has been recently discussed (Kehoane 1984), both approaches may be integrated in a comprehensive view of international relations. The analysis of oligopolistic interdependence (and of other structures as well) suggests that international regimes and national policies interact and mutually constrain each other.

Case studies in international monetary policy.

Political economy analyses have recently been extended to monetary policy of major industrial countries (see e.g. Frey Schneider 1981, Beck 1982, Duesenberry 1983, Wolley 1983). These studies analyze the politico-economic interaction between the central bank and the governement in political business cycle management. This literature, while providing new insights into the behaviour of monetary authorities, presents two major flaws as far as our topic is concerned.

In the first place, central banks are viewed as responsible for monetary policy in a traditional and somewhat limited sense (i.e. control of the money supply and/or the interest rate) targeted on macroeconomic variables. In a financially sophisticated economy, however, monetary authorities also wish to keep under control the degree of financial fragility (which increases during expansions: see Minsky 1982) and this may be achieved both over the cycle and through structural intervention (regulation).

Several political economy implications follow. The most evident is that monetary authorities have to take into account political interaction with the banking and business communities as well as with the government.

The second shortcoming stems from the fact that these analyses largely ignore international aspects of monetary policy (for an exception see Willet and Mullen 1982). Monetary policy in an open economy involves traditional balance of payments and/or exchange rate management but also includes the control of the degree of fragility of the national financial system operating in international markets.

The second element is obviously relevant for US monetary policy and for those countries whose national financial systems have developed an international dimension.

Central banks of leading countries interact both with the international banking community and among themselves and thus pursue forms of limited cooperation.

This represents a good example of what Hardin (1982) calls "contract by convention". In fact an implict agreement is more probable when actors involved (central banks in our case) share a common and limited ground of action. When national governments are instead involved this kind of cooperation is usually more difficult as national governments are tempted to establish linkages among issues, thus making an agreement more costly.

Analysis of strategic interdependence among central banks pioneered by Niehans (1968) and Hamada(1976) has recently been the object of new investigations (Bryant 1980, Canzoneri 1982, Marston 1982, etc). In some cases these contributions follow a public choice approach and adopt game theory techniques, but do not consider politico-economic aspects. This latter aspect is particularly relevant since, as we mentioned above, when general rules of the game do not exist in oligopolistic interdependence the conflict is played on two levels: a) when new rules have to be decided; and b) when the game has to be played (Hamada 1977, 1979).

Whenever the level a) is activated the standard reaction function approach to policy analysis is no longer sufficient and it has to be integrated by a full politico-economic analysis. Limited cooperation may well emerge at this level but very little is known about the mechanisms which produce it.

After the collapse of the Bretton Woods System many cases of limited cooperation have materialized. We intend to focus on two case studies. The first relates to international banking regulations and international lender of last resort intervention. The second deals with the introduction of two composite currencies in the system: the SDR and the ECU.

This section suggests future research lines. A first part should investigate the political economy of international monetary policy of selected countries: the US, West Germany, and Italy. They represent respectively the largest economy in the world, one of the leaders of international oligopoly, and a representative middle-size country which maintains strong links with the other two.

Such a research should not produce representative "reaction functions" but should concentrate on the policy mechanisms followed by monetary authorities as far as external targets (in the sense described above) are concerned.

Cooperative or non-cooperative attitudes of monetary authorities are the result of different pressures coming from the central government as well as from national banking and business communities given institutional differences (different degrees of independence of monetary authorities). Hence the "propensity to cooperate" will vary also with changes in policies pursued by central governments. Changes in administration, in the period under consideration, have in fact led to significant changes in economic and monetary policies. In addition, the banking community has varied the demand for regulation and intervention according to the degree of international financial instability which is also a function of the degree of international financial cooperation.

The international debt crisis has increased the role and scope of regulation of the international banking system and the need of international lender of last resort (LLR) facilities. The debate on the regulation of Euromarkets, which developed in the previous decade (see e.g. Hawley, 1984) has again brought to attention the issue of the conflicting relations between the banking community and the monetary authorities. These relations may be summarized in the efficiency/stability trade-off (Revell 1981). The former calls for far more freedom in financial innovations and hence more profits, the latter calls for more regulation and hence slower expansion as innovations often produce greater instability. Both elements are needed for the appropriate functioning of a financial system, but their relative weights vary with economic and financial fluctuations. The banking community will demand more or less regulation (i.e. it will accept more or less regulation) over the different phases of the cycle.

In an international enviromment the supply of regulation by monetary authorities will vary also as a function of the degree of cooperation with other central banks. Regulation is a public good, hence a classical public choice problem is involved.

International lender of last resort intervention is a related topic (see Guttentag and Herring 1983). In the absence of a world monetary authority, LLR facilities may be provided by joint central bank intervention with different intensity and characteristics in different occasions and enviroments.

The two above examples involve the two levels of conflict/cooperation mentioned above. Regulation implies the definition of rules (level a)) while LLR intervention is the performance of a policy game (level b)).

A second line of research should investigate how, in the period under consideration, cooperation has been achieved by the monetary authorities of the three countries in the fields we have discussed.

The final part of this section is dedicated to the issue of the introduction of two composite currencies in the international system: the SDR and the ECU. These two case studies provide (partially) opposing examples of how limited cooperation may emerge or collapse when institutions and market forces interact.

The Substitution Account episode shows how leading economies failed to reach an agreement on the distribution of the costs of supply of international stability (see e.g. Gowa 1984). This resulted in a definitive failure of the Substitution Account option when market forces showed a new interest in the dollar after the turn in US monetary policy.

The market success of the ECU is marked by the fact that the European currency unit had reached the third position as a denominator of financial activities at the end of 1983, inspite of institutional constraints such as the lack of a full-fledged clearing system (and a central authority acting as a LLR) and the opposition of German authorities to its official use (see e.g. Triffin 1983). These constraints are an obstacle to a substantial shift in the amount of monetary cooperation among European countries.

Both of the above mentioned cases show that the success of cooperation crucially depends on the interaction between institutional decisions and market forces.

Section II - Case studies in international trade and trade policy.

International trade relations have undergone deep changes over the last decade. The trade regime which characterized the two decades after World War II was based on mutual interests of member countries as well as of the hegemon (United States) (Krasner 1981). This regime was highly institutionalized and was based on explicit rules deriving from a number of basic principles: non discrimination (most favoured nation clause), liberalization of trade (gradual reduction of trade barriers), multilateralism (settlements of trade disputes through multilateral consultations, (Finlayson and Zacher 1983).

The remarkable growth of trade flows in the postwar period took place along with the application of these basic principles although some exceptions were present.

Over this period international cooperation in trade flourished at a remarkable pace.

During the 1970's the decline of US hegemonic power on one hand (Krasner 1979) and rapid structural transformations in international production and trade in an oligopolistic interdependent world on the other (Lipson 1982, Kehoane 1984), produced deep changes in the international trade regime.
In all major industrialized countries the accomodation to international market conditions came into conflict with internal economic and political equilibrium. As a consequence, government intervention in trade relations increased considerably in the attempt to minimize the negative impact on internal goals of international conditions. Trade barriers and non tariff protection measures were adopted in order to protect national markets from foreign competition either on a temporary or on a permanent basis (Franko 1980). Industrial policies aimed at the transformation of production were implemented, as well as regional and social policies aimed at regulating regional and national labour markets (Strange and Tooze 1981, Pinder 1982).

Adoption of old and new forms of protectionism have increased government intervention in trade relations. Bilateral negotiations have in many cases supplemented multilateral arrangements as governments have been directly engaged in trade negotiations (Cohen and Zysman 1983).

In addition to governments, other agents have changed their attitude in trade relations. Large state controlled corporations and private multinational firms have been directly engaged in trade following a different pattern from that predicted by orthodox theory (Vernon 1982).

Countertrade in various forms (barter, counterpurchase, buyback) has been growing rapidly over the last decade, as well as multinational enterprise trade and state purchasing.

As a consequence, a large part of international trade is now based on a radically different basis with respect to a trading world designed according to Gatt principles. These have been progressively weakened by informal amendment, exceptions and - more often - through open violations (Vernon 1983).

The tendencies we have just recalled have strengthened in the first part of the present decade. This confirms the fact that the international trade regime has transformed itself from a system based on automatic mechanisms operating within a defined set of rules (Bretton Woods) to a system of (almost) permanent negotiations in which rules of the game themselves, as well as the policy choices of single countries, have become the object of negotiations (Krasner 1983, Pelkmans 1983).

It would be a mistake, however to infer from such evidence that the liberal trade regime is disappearing and giving way to widespread protectionism and to a repetition of the trade wars that were so frequent in the 1930's. Several arguments may be advanced in support of this view. In the first place the proliferation of 'managed trade' has been accompanied by a continuous growth in world trade. Imports and exports of manufactured goods have been rising relatively to world manufacture production (Michaley 1983). The degree of trade openness of major industrialized countries has increased as well as trade interdependence. As a consequence increasing trade flows and increasing trade restraints presently coexist (Lipson 1983).

Secondly, in spite of increased commercial disputes, the Tokyo Round agreements have been signed. In addition, trade liberaliaztion has increased in several sectors (Finlayson and Zacher 1983). Thus "the pattern of trade was a mixed one of incremental protectionism combined with the maintenance of basic liberalism, a mixture of discord and cooperation" (Kehoane 1984).

The present organization of world trade offers a very complex picture which is very difficult to explain and to interpret. Under this respect orthodox economic theory is far from helpful. Orthodox theory usually provides arguments in favour of free trade and in favour of global harmony in the international markets and among countries which are based on the purely competitive model of comparative advantage. Orthodox theory however is not useful if we try to understand conflicts in trade relations since these are considerd as undesirable deviations from the free trade equilibrium solution.

The political economy approach to trade relations seems much more fruitful and insightful if we wish to investigate both changes in the international trade system (Ruggie 1983, Kehoane 1984) and the complex pattern of national trade policies (Caves 1976, World Bank 1981, Frey 1984).

One main feature in the evolution of the trade regime in the last decade has been its sectoral differentiation. Trade restrictions vary markedly across industrial sectors in relation to specific characteristics of industrial production and, more generally, to relative ability of producers to adapt to international competition.

This deeply influences the nature of trade tensions among countries, giving rise to a variety of mutual adjustment policies which lead, in many cases, to new forms of international cooperation in trade based on differentiated rules and behavioural patterns.

In order to analyze the development of these cooperative agreements, one could follow a sectoral analysis which focuses on three case studies relating to three types of 'representative sectors': a mature industry confronted with surplus capacity (textiles); a high technology industry confronting rapidly evolving markets (semiconductors); a relatively new industry deeply involved in international politico-economic relations (process plant contracting).

In particular it would be interesting to compare how the US and the European economies (EEC) have designed and implemented strategies to deal with structural shifts in international trade in these sectors in order to assess the source, the nature and the purpose of trade cooperation arising from these different strategies.

The sectoral approach permits an operational specification of the relevant market structures, behavioural patterns of firms, decision making structure and institutional as well as specific interest groups behaviour bearing most directly on trade policies from a political economy point of view.

Such an examination would provide a description and an analysis of alternative approaches (American and European) to conflict management in different market intervention situations (both international and domestic) as well as in different international trade contexts.

Closely related to these problems is the issue of the appropriateness of GATT in reconciling trade conflicts which arise from the interaction of structural adjustment and international competition.

A multilateral agency such as GATT does not seem to be sufficiently well equipped from an institutional point of view to deal with problems arising from the evolving trade system. GATT is increasingly bypassed by direct action of national goverments pursuing bilateral trade agreements which imply the application of selective discrimination.

Under this respect, according to several investigations trade policy pursued by the European Community, both in the past and at present, has been creating serious problems to the system based on GATT rules. The most relevant trade policies of EC countries have always followed a preferential approach. In addition to the creation of a custom union the Community has developed a network of selective arrangements with non member countries both in Europe and outside.

Such preferential schemes, based on discriminatory measures, have in some cases produced a more open trade system but also more protected markets in other cases. A final point of research should deal with EC preferential schemes as a case study of a relevant example of the links beteween cooperation and liberalization in trade policies as well as of the different outcomes which can be produced by cooperation depending on the goal which is pursued.

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