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The political economy of cooperation and macroeconomic relations in the industrialized world

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From hegemony to oligopoly

International financial relations have undergone profound changes over the past decade. The widespread instability which affects them represents a deep behavioural modification with respect to what has been called the "long decade" of the Bretton Woods system (Keohane 1982). The fact that instability has reigned for so many years suggests that it has deep roots which still have to be eradicated. These roots are to be found in the very forces which led to the collapse of the Bretton Woods system. In other words, to look for the reasons of the still ongoing instability requires a short investigation of the causes of that collapse.

The end of the Bretton Woods system has produced a number of "reaction mechanisms" on the part of both private and institutional operators, both national and international. They represent the reactions to the breakdown of a generally accepted set of rules which constituted the framework of the system itself. However, although over the past decade the role of the single agents, be they individual market agents or nation states, has been greatly emphasized, a "sistemic" approach has to be adopted in the analysis of international relations since it is the interaction of the behaviour of the single agents which is crucial to the understanding of international financial instability. This is particularly true, paradoxically, since nationalistic attitudes have mounted thus leading to a much higher degree of conflict.

Economic theory still has to provide a satisfactory analytical framework for the overall comprehension of international financial and monetary phenomena. We do, however, dispose of a large number of contributions pertaining to different aspects of the matter which allow us to make some headway in that direction. We are now in a position to try to make some progress in the construction of a new approach to international economic and financial problems following an international political economy approach.

A major point deals with the very structure of the international monetary and financial system. This structure has shifted from an hegemonic to an oligopolistic framework (3). The former structure, i.e. the Bretton Woods system, was based on one hegemonic country which was able and willing to

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monitor the behaviour of the whole system. The remaining countries accepted the hegemon's choices since this brought benefits to them.

The second type of structure, which has been developing over the past decade, includes a (small) number of nation states which are able to influence the behaviour of the international system. As in industrial oligopoly, however, no single agent is able to impose on the other its solution to conflicts which eventually arise but it is only able to prevent others from doing so. It follows that such a system will operate succesfully, i.e. without conflicts, only if "rules of the game" are agreed upon among the oligopolists. To put it differently, an international oligopoly will be a stable system only if a cooperative solution is reached among the oligopolists.

The past decade has witnessed the emergence of a number of nation states, in addition to the US, which are able (but not necessarily willing) to influence the behaviour of the international system, thanks to their economic and political weight (4). Not all countries have of course reached such a position and this means that, in the present system, interstate relations present both oligopolistic and domination (5) features. This means that present international relations are also characterized by an articulated hierarchical structure.

A second element, closely linked to the first one, is the increase in interdependence (6). Interdependence has been a topic deeply investigated by international political economy students; what interests us is the role of monetary and financial policies in a highly interdependent system. This is a crucial aspect for our purposes if we consider that an international monetary system actually exists only as long as "rules of the game" on the appropriate policy behaviour are in operation and are generally accepted by its members.

A recent assessmant of international monetary interdependence (Bryant 1980) classifies countries according to their size in an interdependent system. In the Bretton Woods years countries could be roughly divided into two groups. There were the "large closed economies" which were able to influence the international system without in turn being influenced by it; this group included only the US. The remaining economies were all classifiable as "small open economies" which, symmetrically, were influenced by theoperation of the system with no power to influence it. A well known implication of such an approach is the "small country assumption in monetary models of the open economy which asserts that international prices and inflation rates are given for the single country and hence that, in equilibrium, each country must be in line with those magnitudes.

Over the past decade, however, a new group has emerged, which has been labeled the "intermediate interdependence" group. As the expression suggests, countries belonging to this group are both influenced by the international system and have enough power to influence the system itself, at least partially.

Increasing interdependence, the emergence of intermediate interdependence countries and the growth of oligopoly are closely linked phenomena. Oligopolistic countries present a typical intermediate interdependence structure. Hence one of the most relevant features of the oligopolistic system of the 70's is the growing interdependence of national economic and financial policies. It is easy to understand that it is much harder to define "reles of the game" for such a system than for an hegemonic one. Or, to put it differently, international cooperation is much harder to achieve, and, therefore, international stability is a much costlier (public) good in an oligopolistic system (7).

The shift from an hegemonic to an oligopolistic structure has produced a large number of transformations in the behavioural mechanisms of the system itself. These transformations, in turn, reflect the fact that the international economic system has undergone a profound crisis over this period.

New hegemony or struggle for power?

The favourable performance of the United States economy in the first part of the decade, and the dramatic rise in the value of the dollar could be considered as a sign that the international system is entering a new era of American hegemony. Such an impression might be further enhanced by the state of widespread frustation which has characterized all attempts by the other industrialized countries to resist the rise of the American currency in the international markets and to minimize the damage that this is producing on their economies.

The failure to reach agreements on the control on international monetary relations was a constant feature of the first half of the present decade and confirmed once again just how very difficult it is to implement cooperative policies in an oligopolistic environment (1). it is our opinion that the present state of international relations is still far away from a situation of new hegemony. We also think that the condition for a return to a new hegemonic structure of international relations in the near future are lacking.

A fruitful discussion of our statements may be carried out with the help of the theory of hegemonic stability taking into account the modifications recently suggested by Keohane (1984).

Hegemonic stability theory, in its traditional form, asserts that hegemonic system will collapse as a consequence of a shift in the distribution of power against the hegemon. This will decrease the ability and willingness of the hegemon to supply the public goods required of the establishment and maintenance of an international regime.

Keohane's (1984) criticism of this version of the theory is based on two major points. In the first place, this theory accounts for only some of the major regime changes which have come about in the post-Bretton Woods period. While the collapse of the energy regime seems to be well explained by the theory, it is more difficult to say the same for changes in money and trade regimes. In the second place, the theory in its most widely accepted version is far too mechanistic in the sense that it neglects the role of policy choices in the production and management of international regimes. A corollary of this critique is that it is incorrect to view non-hegemonic regimes as associated with widespread conflicts and that it is necessary to recognize the fundamental role of institutions in providing information and hence increasing the propensity to cooperate among actors (Runge 1984).

We agree with Keohane's point and may assume a modified version of the theory in order to carry on our discussion. The modified version should retain the fundamental links between the behaviour of economic variables, the shift in the distribution of power and the supply of public goods. These links have to be integrated in a more policy oriented framework. Policy choices may heavily alter the causal relations implied in the original version of the theory by enhancing or weakening the original effect. In addition we should recall that a major feedback exists between changes in the institutional environment (supply of public goods) and the behaviour of the economic variables. A diagrammatic representation of the theory is included in fig. 11.1.

In order to assume that the structure of oligopolistic interdependence is turning into a new hegemonic structure the causal relationship implied in the theory of hegemonic stability should work backwards. This should hold both for the "necessary" condition, the shift in the distribution of power, and the "sufficient" conditions, the willingness and ability of the leading country to use that power to supply the public goods. Let us start with the first point.

The first problem to be discussed is the definition of power. Several suggestions have recently been advanced to deal with this problem.

FIGURA 11.1

Keohane (1984) defines the four conditions which, in his view, the hegemonic economy must meet in order to fulfill its role in the international economy. The hegemon must exert control over: 1) raw materials, 2) capital, 3) markets, and 4) must hold a competitive advantage in the production of highly valued goods. Strange (1982) suggested a definition of financial power directly associated with the role of the currency as an international vehicle of exchange as well as with the capacity of a country to act as a financial centre of the international system. According to this approach the power of a country derives from the necessity that others have to obtain credit from it. Lake (1984) provides an interpretation of the transformation of the international system based on long run productivity changes. His definition emphasizes real aspects of economic power while Strange's approach centres on financial aspects. Keohane's approcah is more comprehensive but it does not provide a full definition of the links between the elements of what could be called a "power vector".

A related point has recently been raised by Padoa-Schioppa and Papadia (1984). They discuss a classification of national currencies which are ranked according to their relative quality. The quality of a currency, in turn, is directly related to its purchasing power stability (i.e. inversely correlated to the rate of inflation). The determination of the relative quality of a currency is discussed in an oligopolistic setting in which central banks are considered as the oligopolistic firms which produce the quality and quantity of the currency. Each central bank is faced with a trade-off between short term and long term strategies. Quality is acheved only if a long term strategy is pursued.

The approach followed by Padoa-Schioppa and Papadia rests on Hayek's (1976) ideas on currency competition. In an international setting deterioration of a currency (inflation) leads to devaluation. Inflation, in turn, depends only on monetary policy. Free market forces will punish central banks who choose short term strategies which let inflation depreciate their currencies. Low quality currencies will be substituted with high quality ones.

The Padoa-Schioppa and Papadia argument contains useful suggestions for the understanding of international monetary conflicts. What is to be rejected, however, is the Hayek approach they follow. As we have discussed elsewhere ( ), the international position of a currency (and hence of the issuing country) ultmately depends on the country's creditworthiness. The quality of a currency

is not dependent only on its capacity to minimize transaction costs as Hayek holds but, more importantly, credit. Credit is a two dimensional good ( ) but the quality of credit must be distinguish from the quality of money. The approach followed by Minski (Minski 1979) maintains that the quality of a currency as a credit denominator depends on the ability of the issuing country to make profits, i.e. to run a current account surplus.

This "creditworthiness" approach to international currencies presents one major advantage with respect to the Hayek approach. It allows us to consider simultaneously real and financial elements as determinants of the quality of a currency. In this respect this approach could reconcile Lake's (1984) suggestion to base the international position of a country on its productivity performance with financial elements suggested by Minski's approach.

We may now sum up our brief discussion of financial power.

The financial power of a country is an increasing function of three variables: 1) the extension of the use of the national currency in the international system (quantity); 2) the quality of the currency; 3) the flexibility of the country to adjust to changes in the external environment.

The meaning and role of quantity is straightforward. It is useful to note that the extension of the use of a currency in the international system is directly associated with the international extension of its banking industry. In this respect state power is directly associated with the power of its private financial system.

As far as quality is concerned let us recall that quality, in turn, is a multi-dimensional variable if we follow the creditworthiness approach. Insofar as this is dependent on the ability of an economy to make profits in the international system, financial power also depends on real (productivity) elements.

The ability of a country to make adjustments determines the time dimension of power. The higher the adjustment flexibility the less the country's power is dependent on short term or contingent elements. This may also be stated differently. The power of a country will be directly correlated, in the long run, to its ability to give up short term goals for long term ones.

The ability and willingness of a country to make adjustment, in turn, depends on its ability to impose on other countries the costs of such an adjustment if this is needed.

One important clarification is necessary here. The use of this ability involves a consumption of power (Keohane 1978, 1982). Consequently one should not confuse the margins for adjustment that a country has (which increase its power) with the use of such margins. To be powerful means that one can dispose of one's power, i.e. one can consume some of it.

The structure of the balance of payments of a country provides a useful synthetic description of a country's financial power as it provides an immediate description of a country's relative profitability (trade balance) in relation to its financial payments commitments (capital movements) vis-à-vis the rest of the world. In this respect, the discussion of the conditions for the stability of the hegemonic system carried out by Minski (1979) may easily be reformulated in terms of power analysis (and we might therefore talk of seigniorage power). Analogously Minsky's approach to international financial relations may provide a useful base for the discussion of internatinal financial power.

US financial power and the dollar

We may now address the problem raised at the beginning of the paper, that is, whether the United States has increased its international power to the point where it is in a position to reassume a hegemonic role if it wishes to do so. We recall that our discussion is limited to the analysis of financial power. In this respect the problem is not whether a full Bretton Woods-type system can be reestablished but, more modestly, whether a US-centred financial hegemony can be reestablished.

It is tempting to consider the dramatic rise in the value of the dollar since the beginning of the present decade as a sign that American financial power is again tremendously large. We suggest that such a temptation should be resisted.

it is a widely held view that the value of the dollar is far out of "equilibrium". This however requires a definition of an equilibrium exchange rate and hence and exchange rate theory.
Paradoxically the dollar may be considered at the same time over and undervalued. From a trade point of view the dollar may be considered "overvalued" (Williamson 1983) insofar as it depresses the competitiveness of US industry. However the dollar may be "in equilibrium" (or even "undervalued") if we accept the view that its dramatic rise reflects the excess demand for dollar denominated assets in the international system.

A simpler approach suggests that the dollar is the residual variable on which the behaviour of the US economy vis-à-vis other countries is discharged. In other words the movement of the dollar reflects the fact that the United States does not face an external constraint to the pursuit of its policies. This, however, is only a short term answer which does not allow an assessment of the problem of the United State's power position.

The dollar's strength must be assessed from a long run and systemic point of view, i.e. assessing whether the strength of the dollar reflects an increase in American financial power. Of the three components of financial power discussed above the most crucial appear to be the last two: the creditworthiness of the United States and its ability to make substantial (long term) adjustments. These two elements must be considered together. If one looks at the issue of creditworthiness one should conclude that the demand for dollar assets reflects the fact that international investors consider the United States as the most creditworthy economy in the world. This however could be only a short run phenomenon and in this respect it may reflect the fact that the United States in consuming its power rather than accumulating it. The inflow of capital to the United States could be considered an indication of long run creditworthiness and thus a clear indication of power accumulation if this may be considered as an irreversible phenomenon in the short and medium run. Unfortunately it is not possible to assess with certainty this crucial point, which would require a full investigation of the evolution and the modification of the real and financial accumulation process in the United States in the last few years.

A few insights may be obtained, however, by the consideration of the changes in the international investment position of the United States. At the end of 1984 the net international investment position of the United States had turned negative. This is the result of the following elements which have been operating over the last few years. The first is the slowdown in the accumulation of the private US assets abroad, which has only slightly increased since 1982, producing a substantial decrease in its rate of expansion. The most important slowdown is the one relative to the expansion of US claims reported

by US banks which reflects the outbreak of the debt crisis while since 1980 the rate of expansion of US direct investments abroad has practically stagnated.

Two elements deserve consideration on the liability side. The first is the substantial increase in US liabilities reported by US banks which accounts for about half of the increase in foreign assets in the United States and of more than half of the increase in foreign assets in the US. The second is that the increase in foreign direct investment in the United States has not shown substantial deviations from the trend of the previous years.

These facts suggest that the dramatic increase in demand for dollar denominated assets is largely a phenomenon related to the shifts in the flows intermediated by the US banking system which is the joint consequence of the international debt crisis and of the shift in US policies after 1979. In a word, this shift may be considered as the international financial system's reaction to the consequences of the "upper turning point" of the international financial cycle.

An examination of the United States stock position suggests that it has considerably strengthened its position as world banker. However, in order to assess the banker's creditworthiness, this analysis must be completed with an examination of flow behaviour. ( )

The current account of the United states has followed an increasingly negative trend in the past few years.

The evolution of the balance of payments of the United States suggests that, in the medium run, the profitability of the American economy is progressively declining. In this respect the role of the United States as a world banker cannot be considered as a clear sign of increased financial power as the extrapolation of the flow trends suggests that the profitability and hence the creditworthiness of the US economy (as reflected in the current account's behaviour) is rapidly declining.

Let us now discuss the third element which determines the amount of financial power: the ability to adjust. As we have said, this in turn is a function of the ability to discharge abroad internal disequilibrium. In this respect the behaviour of the dollar seems to suggest that the other countries, and the other oligopolists in particular have de facto accepted (if not gladly) that the American economy would shift the burden of adjustment to the rest of the world. Consequently one would be tempted to conclude that US power in the international oligopoly has increased. In this case too, however, one should distinguish between short and long term elements.

In the short run the expansionary effects of US fiscal policy have supplied a public good to the rest of the world. Other countries have reaped neomercantilistic benefits from the growth of American demand for their exports, boosted also by the revaluation of the dollar. The countries which have most benefited are Japan and Germany, i.e. the most important non-US oligopoly leaders of the international system. In this respect American policy has succeeded in overcoming the resistance of other oligopolists by exchanging more short run power against neomercantilistic benefits.

This short term outcome of oligopolistic conflicts cannot be considered as a return to hegemony as it lacks the long run power accumulation needed for the restoration of a such a structure. In fact, the short run behaviour of US policy has to some extent increased the long run power costs for the US itself. This stems from the two facts that the United States has become the world's largest debtor and that expected trade flows point to a decrease in long run creditworthiness.

The ability of the United States to adjust in the long run rest on its ability to absorb the "twin deficits" (Volcker 1984) of the budget deficit and the trade deficit. The isue of the budget defecit has complex systemic implications which cannot be discussed here. We may simply note that the evolution of the federal deficit reflects long run strategic choices in domestic (welfare) and foreign (defense) policy. More importantly the absorption of the federal deficit involves oligopolistic relations only marginally. The situation is quite different for the trade deficit.

The absorption of the trade deficit depends essentially on the evolution of two variables: the exchange rate of the dollar and the rate of expansion of the American economy with respect to the other industrialized countries (2). However, a fall in the dollar's value which restores US competitiveness might turn out to be worse than the disease insofar as it leads to higher monetary instability and hence to a deterioration of the United States's creditworthiness.

The dollar's trend might be reversed in - at least - two ways: with an abrupt fall (the financial collapse hypothesis) or through a "soft landing".

The first hypothesis seems, however, scarcely realistic. A full-fledged financial crisis requires that "technical insolvency" be followed by "effective insolvency", i.e. that the borrower and the lender "agree" to produce a disruption of the financial relation in the sense that they refuse to find a cooperative solution (3) to the crisis, letting market forces go through the debt deflation process which would follow. If this is the case, then the resulting instability in international relations would further decrease the supply of public goods in the system. This solution would confirm that both the United States and the remaining countries are only in a position to deter the definition of a general agreement but do not have the power to unilaterally provide a public good (financial stability).

The second hypothesis, which is obviously the more preferable, requires however that a degree of coordination also be reached on the macroeconomic policies of the oligopolistic countries, i.e. that the adjustment of the American trade deficit be pursued both through a depreciation of the dollar and through greater expansion of the economies of the other oligopolists which would lead to higher US exports.

All this means that the present state of relations among the oligopolists is caught in a dilemma.

Industrialized countries other that the United States have an increasing interest in maintaining the stability of the dollar, i.e. American creditworthiness, for the mere fact that, by so doing, they defend their interests as creditors towards the big borrower. Insofar as American creditworthiness depends on a lower US trade deficit and hence higher US exports, they have an interest in expanding their economies in order to increase imports from the American economy. By so doing they would also stabilize the international economy as a whole thus providing public goods. However, this would run against their neomercantilistic goals.

The very fact that such a dilemma presently exists implies that the main variable which determines American long run financial power, its creditworthiness, largely depends on the policy of other economies. This seems sufficient to reject the hypothesis that the distribution of (financial) power is such that the United States is in a position to unilaterally supply a public good, i.e. in a position to act as an hegemon.

One might be led to believe that this situation presents only short term difficulties on the basis of the following argument. The growing indebtedness

of the American economy is the outcome of a major investment effort that the US economy is undertaking. Once the transformations in the American productive system have been completed the productivity of the American economy will have increased to such a degree that the internal dynamics of the American economy will have increased to such a degree that the internal dynamics of the American economic system will be in a position to produce the resources needed to repay the mounting debt. By that time the American economy will have fully reacquired the economic strength and power to act as a hegemon in the international system.

We are not in a position to discuss this argument and we will just note that such a medium and long term perspective is producing short term costs to the international economy which way lead to a disruption of the system itself so acute as to prevent the full evolution of the American economy to the healthier stages of the balance of payment life cycle. Such a possibility requires, to be credible, that the other economies (mostly Europe and Japan) accept to bear the costs of such a transition by providing more expansion and giving up their neomercantilistic strategies. Consequently the dilemma discussed above emerges again.

After oligopoly?

One lesson which may be drawn from our discussion is that the interaction of national economic policies and private international financial markets has led to an increase in neomercantilism. Non-US industrial countries have been pursuing neomercantilistic goals to such a degree that they are unable to reach forms of limited cooperation in regional arrangements. The present state of European relations, and the failure of the European Monetary System to produce qualitative improvements is one of the most striking examples. Initiatives such as the implementation of the role of the ECU (Triffin 1983) as an alternative to the dollar have not been implemented fundamentally because of German resistance to the transfer of national monetary power to a supranational authority.

The maintenance of dollar creditworthiness requires that the United States reabsorb its soaring trade deficit so as to earn fund to service the mounting foreign debt.

Widespread neomercantilism may be compatible with a situation of stability only if a regime which provides an ex ante solution to the problem of the residual country exists if the potential for a hegemonic system exists this problem may be solved. If this is not the case, as in the present situation, neomercantilism inevitably leads to widespread conflicts.

The situation is made more untenable by the heritage of the financial instability mechanism which operated over the previous decade and which is wtill operating now. The main characteristic of the economic developments of the last fifteen years may be identified in the rapid and, in many respects, violent redistribution of financial wealth throughout the economic system. The increasing flexibility of private international financial markets has produced a cumulation of borrowing and lending positions that have to be financed. In order for these positions to be financed and eventually smoothed out, the international economic system has to restore an overall rate of growth which is far higher than the one now prevailing to to be expected in the near future in the absence of major changes in the operation of the world economy.

Higher growth is needed for both quantitative and qualitative reasons. Higher growth means higher exports and easier debt servicing. When growth is insufficient, debt relations cannot be maintained and financial distress spreads throughout the system. Higher growth, in addition, enhances the

propensity to cooperate of lenders and borrowers alike (Simonsen 1984) since it improves the expectations of both as to future debt servicing capacity. In this respect a high and stable rate of growth is a public good. (Kindleberger 1981, Wallace 1983).

The propensity to cooperate also increases with the amount of information that each actor has on the behaviour of the others. Information in turn increases with the amount of institutions and rules present in the system (Keohane 1984, Runge 1984). The restoration of stable growth and the strengthening of an international system interact with each other and both imply an increase in the production of public goods in the world political economy.

NOTES

1. The first one to discuss the oligopolistic structure of international monetary relations was Lord Balogh. A description of the hegemonic and oligopolistic (multipolar) systems is contained in Cohen 1977. See McMahon 1978.

2. The question here arises of the links between size and power. A wide literature exists on the topic. See Hart 1976.

3. A difference should be drawn between hegemony and dominance. As the matter is rather complex we may limit ourselves to note that only in the first case small size nations consent to the position of the leading power.

4. See Cohen 1977, Bryant 1980 and for a more formal approach Hamada 1976 and 1979 who, however, does not use the concept of oligopoly.

5. Examples are the several attempts to organize joint interventions in currency markets in 1983 and 1984 which failed mainly because of the lack of cooperation on the part of the United States authorities.

6. See Padoan 1986.

7. ibidem especially chapter 8.

8. For a given amount of protectionism in the world economy. For alternative scenarios relative to the international position of the US economy and of the dollar see World Financial Markets, March/April 1985.

9. In this respect the agreements recently reached in New York among the leading industrial countries on currency intervention may be considered as a sign that the "propensity to cooperate" has increased.

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