Introduction

International political economy (IPE) is about the interplay of economics and politics in world affairs. The core question of IPE is: what drives and explains events in the world economy? For some people, this comes down to a battle of 'states versus markets'. However, this is misleading. The 'markets' of the world economy are not like local street bazaars in which all items can be openly and competitively traded and exchanged. Equally, politicians cannot rule the global economy. World markets and countries, local firms, and multinational corporations that trade and invest within them are all shaped by layers of **rules**, **norms**, laws, organizations, and even habits. Political scientists like to call all these features of the system **institutions**. International political economy tries to explain what creates and perpetuates institutions and what impact institutions have on the world economy.

In 2008 a global economic crisis began when a major US financial firm failed (see Case Study). The crash of Lehman Brothers exposed the degree to which some banks had excessively leveraged themselves, spiralling into a dizzyingly profitable but—as it turned out—catastrophically risky way. All too few institutions prevented them. As a result, prominent economists declared that the world was facing a 'Great Depression' of a kind not seen since the 1930s. Governments in the USA and the UK were forced to bail out banks, and to pump money into the wider economy to prevent jobs, sales, and markets from drying up. Other countries were also affected. In Europe, those whose financial systems were connected to the USA and the UK, such as Ukraine, Hungary, Iceland, and Latvia, were soon seeking emergency assistance from the IMF (International Monetary Fund). Elsewhere in the world a wider 'development emergency' soon emerged as the collapse in demand for commodities, goods, and services in the world's largest richest economies affected all those countries that supplied them. The global dimensions of the problem were recognized by leaders who created a new forum—the **G20**—comprising the leaders of the world's largest economies so as to coordinate responses to the crisis.

The economic shocks of 2008 brought into sharp focus perennial themes of international political economy. The relationship between states and markets was highlighted by the fact that some (but not all) states failed to restrain their financial markets. They let their banks make massive profits at the expense of societies (and other countries), which ended up paying the costs when the banks failed. Globalization and who benefits most from it was revisited in the wake of the crisis, particularly by countries that benefited little from financial liberalization but were harshly affected by the crisis. The primacy of the US economic model came under renewed scrutiny as emerging economies trumpeted the success of their more state-centric policies in weathering the crisis. Relations between the so-called **'North'** (industrialized countries) and **'South'** (developing countries) were transformed as emerging economies carved out a new position for themselves in international institutions, including in the new G20, while other developing countries remained marginalized. Perhaps surprisingly, the international economic institutions used to manage the crisis were those created in the aftermath of the Second World War, in spite of widespread agreement that they needed updating.

The post-war world economy

The institutions and framework of the world economy have their roots in the planning for a new economic order that took place during the last phase of the Second World War. In 1944, policy-makers gathered at **Bretton Woods** in the USA to consider how to resolve two very serious problems. First, they needed to ensure that the **Great Depression** of the 1930s would not happen again. In other words, they had to find ways to ensure a stable global monetary system and an open world trading system (see Box 15.1). Second, they needed to rebuild the war-torn economies of Europe.

At Bretton Woods three institutions were planned in order to promote a **new world economic order** (see Boxes 15.2 and 15.4). The **International Monetary Fund** was created to ensure a stable exchange rate regime and the provision of emergency assistance to countries facing a temporary crisis in their balance of payments regime. The **International Bank for Reconstruction and**

Development (IBRD, later called the **World Bank**) was created to facilitate private investment and reconstruction in Europe. The Bank was also charged with assisting **development** in other countries, a mandate that later became the main reason for its existence. Finally, the **General Agreement on Tariffs and Trade** (GATT) was signed in 1947 and became a forum for negotiations on trade **liberalization**.

The 1944 plans for the world economy, however, were soon postponed when in 1945 the USA made its first priority the **containment** of the Soviet Union. Fearing the rise of communism in war-ravaged Europe, the USA took a far more direct role than planned in reconstructing Europe and managing the world economy. In 1947 the USA announced the **Marshall Plan**, which directed massive financial aid to Europe and permitted the USA to set conditions on it. The planned gold standard was replaced by the **dollar standard** which the USA managed directly, backing the dollar with gold. Unsurprisingly, by the time the IMF, the World Bank, and the GATT began to function in the 1950s, they were distinctly **Western bloc organizations** that depended heavily on the USA.

US support for the Bretton Woods system began to change when weaknesses emerged in the US economy. After 1965 the USA widened its costly military involvement in Vietnam, and also started to spend more money on public education and urban redevelopment programmes at home (President Johnson's 'Great Society' programmes), and all this without raising taxes. The damage was dramatic. As prices rose within the US economy, the **competitiveness** of US goods and services in the world economy dropped. Likewise, confidence in the US dollar plummeted. Firms and countries turned away from the dollar and the US capacity to back its currency with gold was brought into question. Meanwhile, other countries in the world economy were enhancing their position. European allies were benefiting from the growing and deepening economic **integration** in Europe. By the late 1960s, the development of the European Economic Community (EEC) provided a springboard for European policy-makers to diverge from US positions, such as over **NATO**, military exercises, and support for the gold standard. In Asia, the phenomenal success of **export-led growth** in Japan and in newly industrializing countries such as South Korea and Taiwan created a new challenge to US trade competitiveness, and a new agenda for trade negotiations.

Box 15.1 Planning the post-war economy and avoiding another Great Depression

The Great Depression had been greatly exacerbated, if not caused, by 'beggar-thy-neighbour' economic policies. In the late 1920s and 1930s, governments all over the world tried to protect themselves from economic crisis by putting up trade barriers and devaluing their currencies. Each country believed that by doing this they would somehow manage to keep their economy afloat while all around them neighbouring economies sank. The Great Depression demonstrated that this did not work. At the end of the Second World War, the challenge was to create a system which would prevent this, in particular by ensuring:

- a stable exchange rate system;
- a reserve asset or unit of account (such as the gold standard);
- control of international capital flows;
- the availability of short-term loans to countries facing a temporary balance of payments crisis;
- rules to keep economies open to trade.

Box 15.2 The Bretton Woods institutions: the IMF and the World Bank

Both the International Monetary Fund and the World Bank were established in 1946 after wartime negotiations held at Bretton Woods in the USA with headquarters (opposite one another) in Washington, DC. The **IMF** was created to promote international monetary cooperation and resolve the inter-war economic problems (see Box 15.1), although several of these functions ended when the Bretton Woods system broke down in 1971 (see Box 15.3). The IMF now has a membership of 185 countries, each of whom contributes a quota of resources to the organization (proportionate to the size of their economy), which also determines their percentage of voting rights and the amount of resources to which they can have automatic access. Since the 1980s, the IMF has become an institution offering financial and technical assistance to developing and transitional economies. The terms on which countries receive assistance include the government having to commit to undertake specific 'conditions' or policy reforms, called **conditionality** (see www.imf.org).

What we now call the **World Bank** started out as the International Bank for Reconstruction and Development (IBRD), an agency to foster reconstruction in war-torn Europe as well as development in the rest of the world. It has since become the world's largest source of development assistance, providing nearly $16 billion in loans annually to eligible member countries, through the IBRD, the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Guarantee Agency (MIGA). As with the IMF, the World Bank requires members to whom it lends to undertake specific reforms within their economy. Most recently, this has included requiring borrowing governments to demonstrate their commitment to reducing poverty within their countries. With the exception of IDA (which is funded by donations), the World Bank's resources come from its issue of bonds in the capital markets. These bonds are backed up by guarantees provided by the governments who belong to the institution (see www.worldbank.org).

Box 15.3 The 'Bretton Woods system' and its breakdown

What was the 'Bretton Woods system'?

At the Bretton Woods Conference in 1944 it was agreed that all countries' currencies would be fixed at a certain value. They became fixed to the dollar, and the US government promised to convert all dollars to gold at $35 per ounce. In other words, exchange rates were anchored to a dollar-gold standard. In the Bretton Woods system, any country wanting to change the value of its currency had to apply to the IMF for permission. The result was very stable and unchanging exchange rates.

What was the 'breakdown' of the system?

In August 1971 the US government announced that it was suspending the convertibility of the dollar to gold at $35 per ounce. This removed gold from the dollar-gold standard and paved the way for major currencies to 'float' instead of staying at fixed values. The USA also announced in August 1971 that it was adding a 10 per cent surcharge on import duties (to improve trade balance by curtailing imports that were flooding into the USA, and to try to stem the outflow of dollars to the rest of the world), hence also turning back the Bretton Woods ideal of maintaining open trade in times of economic difficulty.

Was this a sign of declining US hegemony?

Over a decade after the breakdown of the Bretton Woods system, leading academics debated whether the change reflected a loss in US power, or was indeed an exercise of its power. For some, the breakdown of the system was an exercise of US leadership: the US hegemon smashed the BW system in order to increase its own freedom of economic and political action (Gowa 1983). Others argued that the USA had lost its capacity to maintain the system, but explained that a regime could nevertheless survive without the hegemon (Keohane 1984). At the heart of the debate was a disagreement about whether cooperation in the international political economy depends upon one state being both capable and willing to set and enforce the rules of the game, with powers to abrogate and adjust those same rules. This debate about the nature of cooperation continues today in competing explanations of international institutions (see last section of this chapter).

Facing these pressures, the USA changed the rules of the international monetary system in 1971. The government announced that it would no longer convert dollars to gold at $35 per ounce, and that it was imposing a 10 per cent surcharge on import duties (to improve its trade balance by curtailing imports which were flooding into the USA, and to try to stem the outflow of dollars to the rest of the world). These actions broke the Bretton Woods system. This was not the only change in the world economy during this period.

In the 1970s, the period of high growth enjoyed after the Second World War came to an abrupt end, leaving very high inflation. Further compounding the problem, the first oil crisis in 1973 plunged the world economy into **stagflation** (a combination of economic stagnation or low growth and high inflation). In the monetary system, the role of the IMF collapsed when the Bretton Woods system broke down in 1971 and the major industrialized countries failed to find a way to coordinate their exchange rate policies within the IMF framework. Instead, the major currencies floated and industrialized countries began to discuss monetary issues among themselves in groups such as the Group of Seven (or **G7**, comprising the USA, Japan, Germany, the UK, France, Italy, and Canada), which first met in 1975.

In the trading system, **cooperation** had steadily grown in negotiations under the auspices of the GATT (see Box 15.4). However, in the 1970s, the gains that had been made in reducing tariff barriers, especially among industrialized countries, were reversed by policies of **new protectionism.** As each country grappled with stagflation, many introduced new forms of barriers (or 'non-tariff barriers'), in particular to keep out the new competitive imports from successful developing countries. An egregious example of the new protectionism was the Multifiber Arrangement of 1973, which placed restrictions on all textile and apparel imports from developing countries, blatantly violating the GATT principle of **non-discrimination.**

The new protectionism in industrialized countries further fuelled the anger of developing countries, which in the 1970s launched a concerted campaign in the United Nations General Assembly for a **New International Economic Order** (NIEO). The determination of developing countries to alter the rules of the game was further bolstered by the success of OPEC oil-producing developing countries in raising oil prices in 1973. The agenda of the NIEO covered trade, aid, investment, the international monetary and financial system, and institutional reform. Developing countries sought better representation in international economic institutions, a fairer trading system, more aid, the regulation of foreign investment, the protection of economic **sovereignty**, and reforms to ensure a more stable and equitable financial and **monetary system.**

A kind of **summit diplomacy**, which also took place in the 1970s, was that between North (the industrialized countries) and South (developing countries). These negotiations were underpinned by a different kind of thinking and scholarship about IPE. The developing countries' push for reform of the international economic system reflected **dependency theory** and structuralist theories of international economic relations that highlighted negative aspects of **interdependence.** In particular, these theorists were concerned to identify aspects of the international economy and institutions that impeded the possibilities of development in the South. Their central concern was to answer why so many countries within the world economy remained underdeveloped, in spite of the promises of modernization and global growth. The most sympathetic official 'Northern' answer to these concerns was voiced in the **Brandt Report** in 1980, the findings of a group of high-level policy-makers who had been asked to examine how and why the international community should respond to the challenges of interdependence and development.

Box 15.4 The post-war trading system, the GATT and the WTO

The General Agreement on Tariffs and Trade (GATT) was an interim agreement signed in 1947 in the expectation that it would be superseded by an international trade organization. A permanent trade organization was not created until 1994, and so for four decades the interim GATT continued to exist as an arrangement among 'contracting parties' backed up by a very small secretariat based in Geneva and a minuscule budget. In essence, the GATT was a forum for trade negotiations, with numerous rounds of talks culminating in the very successful Kennedy Round of 1962-7, where breakthroughs were made in the reduction of trade barriers among industrialized countries. However, when protectionism flourished in the 1970s, the GATT proved powerless to restrain powerful members such as the USA and European countries from restricting trade (e.g. the Multifiber Arrangement 1974 restricting textile imports) and abusing the many exceptions and safeguards written into the agreement. The GATT also functioned as a forum for dispute settlement (i.e. upholding trade rules). However, it was both slow and impotent in this regard, constrained by the need for consensus on any decision regarding disputes. The GATT was replaced by the World Trade Organization (WTO) as a result of agreements forged in the last round of GATT talks, the Uruguay Round (1986-94). Established on 1 January 1995, the WTO's functions include: administering WTO trade agreements; being a forum for trade negotiations; handling trade disputes; monitoring national trade policies; supplying technical assistance and training for developing countries; and cooperating with other international organizations. It is located in Geneva with a secretariat staff of 500 (see www.wto.org).

The NIEO campaign was unsuccessful for several reasons. The United Nations General Assembly (UNGA) was an obvious institution for developing countries to choose in making their case since, unlike the IMF or World Bank, it offers every country one vote. However, the UNGA had no power to implement the agenda of the developing countries. Furthermore, although many industrialized countries were sympathetic to the developing countries' case in the 1970s, these governments did not act on the agenda in the 1970s and by the 1980s a new set of governments with a distinctly less sympathetic ideology had come to power in the USA, the UK, and Western Germany.

The 1980s opened with a shift in US economic policy. In 1979 the US Federal Reserve dramatically raised interest rates. This action was taken to stem inflation by contracting economic activity in the USA. However, the reverberations in the rest of the world economy were immediate and extensive. During the 1960s and 1970s, US and European policies had facilitated the rapid growth of **global capital markets** and financial flows. In the 1970s these flows were further buoyed by the investments of oil producers who needed to find outlets for the vast profits made from the oil price rise of 1973. The money found its way to governments in developing countries, which were offered loans at knock-down prices. The rise in interest rates in 1979 was an abrupt wake-up call to both borrowers and creditors (many of whom were US-based banks), who suddenly realized that many of the loans could not be repaid. The IMF was immediately called in to prevent any developing country defaulting on these loans, since it was feared that such a default would causes a **global financial crisis.**

The **debt crisis** meant that the IMF's role in the world economy became largely that of ensuring that indebted countries undertook 'structural adjustment' in their economies. **Structural adjustment** meant immediate measures to reduce inflation, government expenditure, and the role of the government in the economy, including **trade liberalization, privatization,** and **deregulation.** These 'neo-liberal' policies were in marked contrast to the Keynesian analysis that had prevailed until the 1980s, during the decades of growth in the world economy. **Keynesians** (named after economist John Maynard Keynes) believe that governments should play an active and interventionist role in the economy in order to ensure both growth and equity. By contrast, the new 'neo-liberalism' sought to roll back the state and the role of government, leaving decisions about allocation, production, and distribution in the economy to the market. By the late 1980s the term **Washington consensus** was being used, sometimes pejoratively, to imply that these policies were mainly a reflection of US interests.

The 1990s brought the end of the cold war, and the challenge of how to integrate Central and Eastern European countries and the former Soviet Union into

the global economy. The IMF and World Bank became deeply involved but the Washington Consensus was not broad enough for the purpose. Both institutions began to embrace a broader and deeper view of conditionality aimed at promoting 'good governance' in member countries. But many thought conditionality had gone too far when, in the wake of the **East Asian financial crisis** in 1997, the IMF imposed far-reaching and overly draconian conditions on countries such as Korea. The impact would be felt in subsequent years as the IMF's lending role waned in most emerging market economies. Over this time, the World Bank sought to broaden its appeal through enhanced relations with governments as well as with **non-governmental organizations** (NGOs). Its legitimacy seemed less tarnished. At the same time, the newly established **World Trade Organization** (WTO) began operations in 1995, opening up a new forum within which a broad range of international issues would be negotiated, including not just traditional trade issues but such things as **intellectual property rights**, trade-related investment measures, and food safety standards.

In the first decade of the twenty-first century, a shift in global economic power was emerging. In September 2003, during global trade negotiations in Mexico, a group of 20 countries including Brazil, South Africa, India, and China, resisted the powerful USA and European Union and refused to engage unless some of their terms were heeded. In the IMF and World Bank in 2006 a shift in voting power was conceded in favour of China, Mexico, Turkey, and Korea. Yet few believed this would be enough fully to engage these countries in the institutions. Several emerging countries—with China in the lead—became donors in their own right. As world energy consumption grew, so too did the power of countries supplying energy resources. In Venezuela, this led to a rhetoric of renewed Third Worldism not seen since the 1970s. Meanwhile, across most industrialized countries, calls for greater efforts to reduce climate-changing emissions became ever stronger. For scholars of international relations, the twenty-first century brought serious questions about how international institutions might assist not only in managing new challenges in the global economy, but equally in managing a shift in power among the states that make up—and make work—the existing institutions. This questioning was greatly accelerated by the financial crisis that began in 2008.

Key Points

- Immediately after the Second World War international institutions were created to facilitate cooperation in the world economy.
- The onset of the **cold war** postponed the operation of these institutions, as the USA stepped in directly to manage the reconstruction of Europe and the international monetary system based on the dollar.
- The Bretton Woods system of managed exchange rates and capital flows operated until its breakdown in 1971, when the USA announced it would no longer convert the dollar to gold.
- The 1970s were marked by a lack of international economic cooperation among the industrialized countries, which floated their exchange rates and indulged in new forms of trade protectionism.
- Developing countries' dissatisfaction with the international system came to a head in the 1970s when they pushed unsuccessfully for a new international economic order.
- Trade negotiations were broadened to include many new areas, but this led to later resistance from emerging economies.
- In 2007 a power shift became more obvious in the global economy, with emerging economies such as China and India playing a more prominent role in negotiations in trade, finance, and development assistance, and in the G20 formed after the 2008 financial crisis.

Traditional and new approaches to IPE

Traditional approaches to IPE: liberal, mercantilist, and Marxian

There are several competing explanations for the nature of the institutions and system described above. A slightly old-fashioned way to describe the competing approaches to IPE is to divide the subject into liberal, mercantilist, and Marxist traditions. These labels still usefully describe different economic traditions, each of which has a particular moral and analytical slant on global economic relations.

The liberal tradition

The liberal tradition is the **free market** one in which the role of voluntary exchange and markets is emphasized both as efficient and as morally desirable. The

assumption is that free trade and the free movement of capital will ensure that investment flows to where it is most profitable to invest (hence, for example, flowing into underdeveloped areas where maximal gains might be made). Free trade is crucial, for it permits countries to benefit from their comparative advantages. In other words, each country can exploit its own natural advantages, resources, and endowments, and gain from specialization. The economy is oiled by freely exchangeable currencies and open markets that create a global system of prices, which, like an **invisible hand**, ensures an efficient and equitable distribution of goods and services across the world economy. Order in the global economy is a fairly minimal one. The optimal role of governments and institutions is to ensure the smooth and relatively unfettered operation of markets. It is assumed that governments face a wide range of choices in the world system and likewise vis-à-vis their own societies and populations. This means that governments that fail to pursue 'good' economic policies do so because decision-makers are either too corrupt or too ignorant of the correct economic choices they might make.

The mercantilist tradition

The mercantilist tradition stands in stark contrast to the liberal one. Mercantilists share the presumptions of **realists** in international relations. They do not focus on individual policy-makers and their policy choices, but rather assume that the world economy is an arena of **competition among states** seeking to maximize relative strength and power. Simply put, the **international system** is like a jungle in which each state has to do what it can to survive. For this reason, the aim of every state must be to maximize its wealth and independence. States will seek to do this by ensuring their self-sufficiency in key strategic industries and commodities, and by using trade protectionism (tariffs and other limits on exports and imports), subsidies, and selective investments in the domestic economy. Obviously, within this system some states have more power and capability than others. The most powerful states define the rules and limits of the system: through **hegemony**, alliances, and **balances of power**. Indeed, stability and order will be achieved only where one state can play the role of hegemon, or in other words, is willing and able to create, maintain, and enforce basic rules. Amid this, the economic policies of any one government will always be subservient to its quest to secure the external and internal sovereignty of the state.

The Marxian tradition

The Marxian tradition also sees the world economy as an arena of competition, but not among states. **Capitalism** is the driving force in the world economy. Using Marx's language, this means that world-economic relations are best conceived as a **class struggle** between the 'oppressor and the oppressed'. The oppressors or capitalists are those who own the **means of production** (trade and industry). The oppressed are the working class. The struggle between the two arises because capitalists seek to increase their profits and this requires them to exploit the working class ever more harshly. In international relations this description of 'class relations' within a capitalist system has been applied to describe relations between the **core** (industrialized countries) and **periphery** (developing countries), and the unequal exchange that occurs between the two. **Dependency theorists** (who have focused mainly on Latin America) describe the ways classes and groups in the 'core' link to the 'periphery'. Underdevelopment and poverty in so many countries is explained as the result of economic, social, and political structures within countries that have been deeply influenced by their international economic relations. The global capitalist order within which these societies have emerged is, after all, a global capitalist order that reflects the interests of those who own the means of production.

Box 15.5 Traditional perspectives on IPE

Liberal	Mercantilist	Marxist
The world economy has the potential to be a seamless global marketplace in which free trade and the free movement of capital shape the policies of governments and economic actors. Order would be achieved by the 'invisible hand' of competition in the global market place.	As an arena of inter-state competition, the world economy is one in which states seek to maximize their wealth and independence vis-à-vis other states. Order is achieved only where there is a balance of power or hegemony.	The world economy is best described as an arena of capitalist competition in which classes (capitalists and workers) and social groups are in constant conflict. Capitalists (and the states they are based in) are driven by the search for profits, and order is achieved only where they succeed in exacting the submission of all others.

It becomes clear in contrasting these traditions of thinking about international economic relations that each focuses on different actors and driving forces in the world economy, and that each has a different conception of what 'order' means and what is necessary to achieve it.

Comparing the different traditions also highlights three different levels of analysis: the structure of the international system (be that international capitalism or the configuration of power among states in the system); the nature of a particular government or competition within its institutions; and the role of interest groups and societal forces within a country. At each of these levels of analysis we need to ask: what drives the actors concerned and therefore how might we explain their preferences, actions, and the outcomes that result? In answering this question we enter into more methodological preoccupations that today divide the study of IPE.

New approaches to IPE

International political economy is divided by the different normative concerns and analytical questions highlighted by the traditions outlined above. Equally, the discipline is now subject to a lively **methodological debate** about how scholars might best explain policies and outcomes in IPE. In essence, this debate is about whether you can assume what states' (and other actors') preferences and interests are. If you can, then rational choice (or 'neo-utilitarian') approaches to IPE make sense. However, if you open up the question as to why and how states and other actors come to have particular preferences, then you are pushed towards approaches now often labelled '**social constructivism**' (see Ch. 9).

Political economy: the application of rational choice to groups within the state

In the USA, the study of IPE has become dominated by a 'rational choice' or neo-utilitarian approach. This borrows economic concepts to explain politics. Instead of exploring the ideas, personalities, ideologies, or historical traditions that lie behind policies and institutions, rational choice focuses on the **incentive structure** faced by those making decisions. It is assumed that actors' interests and preferences are known or fixed, and that actors can make strategic choices as to how best to promote their interests. The term 'rational choice' is a useful one to describe this approach since it proposes that even though a particular policy may seem stupid or wrong, it may well once have been rational. 'Rational' in this sense means that for the actor or group concerned, this was the optimal choice given the specific incentives and institutional constraints and opportunities that existed at the time.

Rational choice has been applied to interest groups and their influence on IPE in what has been called a **political economy approach**. This approach has its roots in explanations of trade policy which focus on interest groups. More recent applications have attempted to explain why countries adapt in particular ways to changes in the world economy. The analysis proceeds on the assumption that governments and their policies are important but that the policies and preferences of governments reflect the actions of specific interest groups within the economy. These groups may emerge along class or sectoral lines. Indeed, the assumptions of rational choice are applied to explain how particular groups within the economy emerge and what their goals and policy preferences are. Furthermore, rational choice provides a framework for understanding the coalitions into which these groups enter and their interactions with other institutions. For example in explaining why banks were able to expose the public to such risks through their excessively leveraged activities, some scholars focus on the ways the financial sector 'captured' the regulatory system. The private financial sector had greater information, far more resources and lobbying power than other stakeholders, and regulators had little incentive, institutional or personal, robustly to apply regulation (Mattli and Woods 2009).

Institutionalism: the application of rational choice to states

A different application of rational choice lies in the **institutionalist approach** to IPE (about which more is said in the last section). This approach applies the assumptions of rational choice to states in their interaction with other states. Drawing on theories of **delegation and agency**, it offers an explanation as to why institutions exist and for what purposes. The core assumption is that states create international institutions and delegate power to them in order to maximize utility within the constraints of world markets and world politics. Frequently, this comes down to the need to resolve collective-action problems. For example, states realize that they cannot achieve their goals in areas such as trade or environment unless all other states also embark upon a particular course of action. Hence institutions are created to ensure that there is no defection or free-riding, and the collective goal is achieved.

Box 15.6 Examples of new approaches to IPE

Institutionalist	Political economy	Constructivist
Institutionalists regard the world economy as an arena of inter-state cooperation. They see the core actors as governments and the institutions to whom they delegate power, and the key driving forces as rational choice at the level of the state, motivated by the potential gains from cooperation. For institutionalists, the key condition for order is the existence of international institutions, which permit cooperation to continue.	For political economists, the world economy is characterized by competition among vested interests within different kinds of states, and the core actors are interest groups formed within the domestic economies of the states. The key driving force is rational choice at the level of groups within the domestic economy responding to changes in the international economy. Political economists are not concerned with theorizing about the conditions necessary for international order.	Constructivists focus on the ideas, knowledge, and historical circumstances that shape identity and preferences in the global economy and the boundaries within which international economic relations take place. The concept of **hegemony** is used by those who probe the interests and ideas embodied in the rules and norms of the system. Neo-Gramscians highlight that the dominant power within the system will achieve goals not just through coercion but equally by ensuring the consent of other actors within the system. This means that dominant powers will promulgate institutions, ideologies, and ideas, all of which help to persuade other actors that their best interests converge with those of the dominant power.

Social constructivism

In contrast to rational choice analysis, other approaches to international political economy assume that policies within the world economy are affected by **historical** and **sociological factors**. Much more attention is paid to the ways in which actors formulate preferences, as well as to the processes by which decisions are made and implemented. In other words, rather than assuming that a state or decision-maker's preferences reflect rational choices within given constraints and opportunities, analysts in a broader tradition of IPE examine the beliefs, roles, traditions, ideologies, and patterns of **influence** that shape preferences, behaviour, and outcomes.

Interests, actions, and behaviour in the world economy are conceived as taking place within a structure of ideas, culture, and knowledge. We cannot simply assume that the preferences of actors within the system reflect objectively definable competing 'interests'. Rather, the way actors understand their own preferences will depend heavily upon prevailing beliefs and patterns of thinking in the world economy, many of which are embodied in institutions. The question this poses is: whose interests and ideas are embodied in the rules and norms of the system?

For some, the answer to the question 'in whose interest?' lies in hegemony. The dominant power within the system will achieve goals not just through coercion but equally by ensuring the consent of other actors within the system. This means that dominant powers will promulgate institutions, ideologies, and ideas, all of which help to persuade other actors that their best interests converge with those of the dominant power. For example, **neo-Gramscians** interpret the dominance of market liberalism from the 1980s at least through until 2008 as a reflection of US interests in the global economy, successfully projected through structures of knowledge (it became the dominant paradigm in top research universities), through institutions (such as the IMF, which became forceful proponents of neo-liberal policy prescriptions), and through broader cultural beliefs and understandings (the very language of 'free' market contrasting with restricted or repressive regimes).

New approaches to IPE highlight a powerful debate within the subject about whether we should treat states' interests and preferences as given or fixed. We return to this question in the final section of this chapter. There we shall examine why states form institutions and what role such institutions might play in managing **globalization**. First, though, we need to establish what is globalization in the world economy and what are its implications.

Key Points

- Rational choice explains outcomes in IPE as the result of actors' choices, which are assumed always to be rationally power or utility maximizing within given particular incentives and institutional constraints.
- Institutionalists apply rational choice to states in their interactions with other states in order to explain international cooperation in economic affairs.
- Constructivist approaches pay more attention to how governments, states, and other actors construct their preferences, highlighting the role of identities, beliefs, traditions, and values in this process.
- Neo-Gramscians highlight that actors define and pursue their interests within a structure of ideas, culture, and knowledge, which itself is shaped by hegemonic powers.