

International crises like those connected with the Chinese decline have been a recurrent feature of the global economic system, ranging from the 1982 Mexican debt crisis to the Asian financial crisis (1997–99). The booms and busts of international petroleum markets have been particularly volatile. As a key commodity necessary for economic growth in the industrial era, a major driver of economic success for the oil-exporting countries that depend on revenue for foreign exchange, and the financier of sovereign wealth funds, petroleum plays a key role. Yet in one year, 2008, oil prices ranged from a high of \$145 a barrel to a low of \$33 a barrel, disrupting markets and economies worldwide. Although Marx saw such crises and volatility as a fatal weakness of the capitalist system, economic liberalism predicts that the market will regain equilibrium. The booms and busts will self-correct; they will not bring down the global system.

Indeed, reforms were undertaken after many of the historic crises to ensure that the underlying conditions would not recur. For example, after the depression of the 1930s, the banking system was reformed. Financial standards in accounting, bank regulations, and ratings agencies were established to improve information and transparency. When states encountered economic difficulties, the Bretton Woods institutions were available for temporary fixes. And the volatility of petroleum markets was

ECONOMIC CHALLENGES IN THE TWENTY-FIRST CENTURY Crises of Economic Globalization

of China, Russia, and Brazil, 80 percent, 62 percent, and 38 percent, respectively, of the value of the stock market is held by state enterprises. As *The Economist* reports, "The invisible hand of the market is giving way to the visible, and often authoritarian, hand of state capitalism."²⁷ And that model has found resonance in Africa, where China's public and private investment has provided needed capital without the strings of conditionality. But, by 2015, China's economic slowdown, its rapidly increasing debt load from \$7 trillion in 2007 to \$28 trillion in 2014, its oversold real estate market, and its unregulated banking had led critics to question the sustainability of that model.

Both states and international organizations seem to be taking a more pragmatic approach to development; they are less constrained by the requirements of the economic liberal model and more accepting of economic nationalist approaches. But whatever economic development strategy they attempt, states are confronted by the persistent challenges of global crises and by the antiglobalization movement.

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The 2008–2009 Global Financial Crisis

Despite all the reforms undertaken during past economic crises, the Bretton Woods institutions did not include actual surveillance and temporary fixes for the richer countries or the economically strong United States. The 1980s and 1990s saw an explosion of unregulated, highly leveraged financial instruments, including oil futures and derivatives markets. U.S.-based financial institutions and governmental units at all levels were participating in those markets. Excess credit against insufficient equity prevailed across the housing market, the financial sector, and consumer-credit markets. That spending spree was accompanied by the importation of cheap goods from China, causing an unsustainable trade imbalance with China and the oil-exporting countries. By 2007, it was clear that the U.S. economy itself was exhibiting fundamental structural weaknesses, although few policy makers were ready to take action. First to feel the impact was the subprime mortgage market. Because financial companies and international banks were carrying unsustainable debt with no assets to back up the loans, defaults increased. Credit became more difficult to acquire. Private investment to build factories and produce goods dried up.

What began as a financial crisis centered in the United States rapidly became a global economic crisis. The U.S.-based financial instruments that had spawned the excess lending had been sold abroad to investors ranging from local communities in Norway to banks in Europe and East Asia and investors in Japan and China. What safer place to invest, they thought, than the United States? That proved not to be the case. Financial institutions were unable to meet their obligations. Credit became almost impossible to obtain in the United States and Europe. Businesses cut expenditures and workforces. Consumer demand plummeted. States such as China, South Korea, and Japan, dependent on exports to the United States and Europe, saw their markets shrink and export earnings fall. Oil prices dropped by 69 percent between July and December 2008, severely affecting such oil-exporting countries as Russia, Angola, and Venezuela. In emerging markets dependent on private foreign investment (especially Eastern Europe and states of the former Soviet Union), investment plummeted; in 2008, it was less than half that of a year earlier. In late 2008, Iceland became the first state victim when its banking system collapsed. In the Baltic states, Ukraine, and Eastern Europe, economies virtually collapsed. International trade declined. The crisis rippled outward to developing countries that faced the prospect of sharply

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As growth within the states in the EU began to slow or reverse because of the global economic crisis, a crisis closer to home was magnified. In the early years of the new millennium, easy credit had ushered in a decade of risky borrowing from international banks and profligate spending by some EU countries. In Greece, high public-sector wages and long-term pension obligations fueled public-sector borrowing. In Ireland and Spain, private-sector borrowing accelerated, like it did in the U.S. housing bubble. Then, when the global economic crisis hit, households faced underwater mortgages, foreclosures, and even bankruptcy. Many individuals whose net worth had dramatically declined now faced unemployment and declining wages, only deepening the debt trap.

The 2009 Eurozone Crisis

reduced or negative growth and the erosion of gains from globalization-driven growth. The speed and depth of the collapse in global financial and international trade markets surprised even the experts; the self-correcting mechanisms were not working as economic liberals had theorized. Both the United States and various EU member governments took unprecedented steps, bailing out banks and insurance companies to get credit markets functioning again and stimulate investor confidence. These same states, along with Japan and China, each responded with substantial economic stimulus packages to encourage economic growth. Some coordinated actions were taken among central bankers. The U.S. Federal Reserve, the European Central Bank, and the Bank of England engaged in currency swaps. The IMF also responded to the crisis by making available almost \$250 billion for credit lines. Iceland became the first Western country to borrow from the IMF since 1976. Substantial loans were made to Ukraine, Hungary, and Pakistan. The IMF, with an infusion of \$750 billion, created the Short-Term Liquidity Facility for emerging-market countries suffering temporary liquidity problems. It reorganized the Exogenous Shocks Facility, designed to help low-income states by providing assistance more rapidly and streamlining conditions. Unfortunately, the IMF's capacity had already been weakened by those preferring market solutions over greater regulation and those wanting to abolish the Bretton Woods system itself. But the International Development Association was able to increase its resources during the crisis for loans to some of the poorest developing countries. Short-term responses were needed, as well as better long-term cross-border supervision of financial institutions, standards for accounting and banking regulations, and an early warning system for the world economy. But these were not yet in place for the subsequent Eurozone crisis.

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And governments dependent on borrowing in international markets were turned away, deepening their debt obligations.

But the crisis was not just a debt problem. It was also caused by an imbalance of trade. After the turn of the century, Germany's export trade grew, while that of the so-called PIGS (Portugal, Italy, Greece, and Spain) had worsening balance-of-payments positions. Wages rose faster than gains in productivity, making their exports uncompetitive, while Germany's wage restraint made German exports even more competitive. Today, Germany's trade surplus is the world's largest at \$200 billion; 40 percent of that surplus comes from trade within the Eurozone.

The arrangements within the European monetary union and within the Eurozone itself made addressing the twin problems of unsustainable debt and trade imbalances even more difficult. As the Eurozone's critics wondered, how could the euro work with no fiscal union and no treasury? Individual states did not have the ability to manage their monetary policy: they could not print more money, and they could not devalue their currency to make their exports more competitive. Labor mobility was constrained, and there were no agreed-upon procedures for transferring funds between states.²⁸ When the banks, including German ones, that had lent money liberally during the credit explosion became stressed, they demanded higher interest rates from the PIGS, making it more difficult for those governments to finance budget deficits and service the existing debt, a problem compounded by low growth rates.

There were more than 25 summits to address the Eurozone crisis. In response, the PIGS undertook numerous reforms to reduce government debt, slashing expenditures, increasing the retirement age, promising to improve the tax collection system, and using financial transfers to avert bankruptcy. Greece was the government in the most severe crisis. Not only did that country have a debt problem, but also in worsening balance-of-payments problems and its high wages and low productivity made its exports uncompetitive. Greece was forced to take bailouts from the IMF, the European Central Bank, and the EU, totaling \$380 billion by the middle of 2017. In return for the bailouts, the Greek government slashed public spending by cutting services, laying off workers, improving tax collection, renegotiating labor contracts, and ending subsidies. With that bailout, there has been increased pressure to ease the Greek debt burden for fear that the government will never be able to repay the loans. As in African developing countries, negotiations continue with the IMF for a debt-relief package.

Domestic constituencies suffered through the economic distress: Greeks stood in line at soup kitchens; Cypriot bank customers could not withdraw funds; Spanish youth faced an unemployment rate of 50 percent; Germans paid the bailout costs. These constituencies continue to pressure their democratically elected leaders for outcomes favorable to their own interests—in other words, there has been a

resurgence of economic nationalism that could undermine Eurozone stability.

As the European states cope with the crisis, the unexpected 2016 decision to leave, though it had never joined, has thrown the future of the EU. Just as economic constraints imposed on governments have been eased.²⁹ Discussions on widening the scope of deepening integration in part of the EU of Brexit are hammered out between Britain and EU member states. The project remains unknown.

Responses to Economic Crisis

Crisis does not affect all states equally. The crisis adversely affected the economies of the global financial crisis did not affect Africa. Prior to the crisis, rapid resurgence in terms of growth rates, unprecedented Chinese debt-relief initiatives.

Neither Ghana nor Kenya were affected at the time. Ghana, a long-time ally, had been increasing cooperation in international trade, a 32-year-old leader, it benefited from high oil prices. It benefited from declining oil prices, and the petroleum field off its coast, and 7.7 percent annual growth rate. Kenya, too, did not experience the crisis. Other east African states, because of Chinese investment in railroads and port exports among these states, education, building more schools, more than in other countries. Kenya are bringing new companies to the service and banking sectors.

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more authority to an IMF-like institution—namely, the European Central Bank. Mechanism—to handle bailouts and work with the European Central Bank. Economic liberals believe that these rather incremental reforms can preserve the system, giving more transparency to market transactions. They point to the promising economic recovery after 2010 as evidence that equilibrium can reemerge.

Reformers both outside and within the international financial institutions question fundamental premises, governance, and specific policies.³³ Some reformers are skeptical that the **moral hazard** problem can be overcome. States that are rescued from the consequences of their reckless behavior have little incentive to change that behavior. So reforms designed to rescue states from their own bad decisions may not necessarily lead to better decisions in the future. In terms of governance, reformers propose altering the weighted voting system the IMF and the World Bank now use in favor of greater representation for the emerging economies. In the current system, the major donors are guaranteed voting power commensurate with their contributions. The largest shareholders in each institution—the United States, the European Union states, Japan, and Canada—hold about 60 percent of the total votes. Reformists believe a more representative voting structure might lead to a fairer system and one that promotes different policies. While incremental changes have been proposed, including giving more weight to China by increasing its weight-voting share from 3.66 percent to 6.06 percent, fundamental voting power has not shifted. Further, hiring a more diverse group of bureaucrats, instead of relying on the current group, which is dominated by economists trained in developed Western countries, might bring new, innovative solutions to development dilemmas.

Other reformers are critical of specific policies; here, the critics differ. On the one hand, some argue that both the IMF and the World Bank have strayed too far from their liberal economic foundations, taking on too many different tasks (e.g., trying to promote an environmental agenda or gender equality) and deviating from actions promoting market liberalization. In fact, some maintain that aid and loans themselves should be allocated by competition, creating a liberal market for aid funds. On the other hand, radical political economists claim the institutions promote the interests of private international capital, pointing to the economic returns for firms that provide services for dams and power plants. Other bank policies that have been rigidly developed without considering local conditions and local knowledge end up disproportionately affecting the disadvantaged sectors of the population: the unskilled, women, and the weak.

The World Trade Organization has also become a lightning rod for criticism from many countries. They feel that the WTO, a symbol of economic globalization, is usurping local decisions and degrading the welfare of individuals. NGOs are

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Farmers in Manila protest the WTO's regulation of agricultural trade in advance of a speech by WTO director-general Roberto Azevêdo. The liberalization of agricultural markets has been a major point of contention between developed and emerging economies in recent rounds of trade negotiation.

some of the major critics of WTO activities. Some of them oppose the idea that the WTO has the power to make regulations and settle disputes in high-handed ways that intrude on or jeopardize national sovereignty. Still others fear that promotion of unregulated free trade undermines the application of labor and environmental standards; they believe that the WTO sets economic liberalization above other social values. In actuality, the WTO is relatively weak; its resources are stretched thin, constrained by its limit of 640 employees, and it has a slow dispute-settlement mechanism. In an age of protracted supply chains across countries and continents, the trade rules written for another era are no longer as useful or relevant.

Alternative Institutions: The Debate over Globalization Continues

Failing fundamental changes in the organizations discussed above, there is a movement to create alternative institutions that reflect changing power relations, with China playing a key role. Among these alternatives are two multilateral development banks, the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB). The AIIB became operational in 2015. When first proposed in 2006, China's foreign-exchange reserves were reaching \$4 trillion and the bank was a way to invest those funds through a new institution

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Another alternative ma initiative "One Belt, One Migration in Asia and beyon nations of the Silk Road E these together as the "One infrastructure projects des and to extend all the way to Chinese imports and expor growth at home, this plan p any production, promising connecting them to China.

and in emerging-country markets. With a capitalization of \$100 billion, the bank is designed to rapidly respond to loan requests that promote long-term growth, mainly through massive investment in infrastructure. The target is to lend \$1.2 billion annually. As of early 2018, 56 members have joined the AIIB, with 24 others pending. But the United States and Japan are not among the members. The United States has argued that the AIIB will not follow governance procedures and will not adhere to environmental standards. Furthermore, the United States sees the bank as a project to promote China's economic and geopolitical role in Asia. Despite pressure from the United States, American allies like Australia, South Korea, and the United Kingdom have joined the AIIB.

The NDB was founded by the BRICS states of Brazil, Russia, India, China, and South Africa and became effective in 2015. With an initial authorized capital of \$100 billion, one-half of which were shares equally distributed among the founding members, the NDB grants equal voting power to each member. Its purpose is to support public and private projects through loans, guarantees, and equity participation. Projects are to focus on infrastructure and renewable energy. Loans are focused on BRICS member states themselves.

Are these two institutions rivals to the World Bank dominated by the United States, and the regional multilateral development banks like the Asian Development Bank dominated by Japan? Or are they partner institutions? In terms of resources available, they are not effective rivals. For example, the AIIB's capital is one-half of that of the World Bank and two-thirds of that of the Asian Development Bank. And experts in each of the banks point to their cooperation with other development institutions. Yet it is clear that these institutions are designed to stimulate cooperation among the BRICS and to serve China's economic and geopolitical objectives. Both are headquartered in China, and China is the major financial contributor, but it has no veto power.

Another alternative may be found in China's major economic and geopolitical initiative "One Belt, One Road." This initiative is designed to boost regional integration in Asia and beyond. In 2013, Chinese president Xi Jinping produced the notions of the Silk Road Economic Belt and the Maritime Silk Road. Combining these together as the "One Belt, One Road" Initiative, China is supporting massive infrastructure projects designed to connect China with Central and South Asia and to extend all the way to Istanbul, Moscow, and Venice, providing a conduit for Chinese imports and exports and serving later as production centers. With slowing growth at home, this plan provides an outlet for China's steel, cement, and machinery production, promising \$1 trillion in infrastructure touching 60 countries and connecting them to China.³⁴

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The View from Economic Theories

Most adherents of economic liberalism propose rather modest reforms to the system, as described above. Not surprisingly, economic radical theorists have a different take. They have always been critical of the liberal economic path, just as they were in the nineteenth century. Development has not occurred, they assert, and for dependency theorists in particular, MNCs and their facilitators are the culprit; they exploit the resources of the poor, and they perpetuate the dominance of the North and the dependency of the South. Radicals detest instruments of dependency, exploitation, and imperialism. They argue that decisions made in the economic and financial centers of the world—Tokyo, London, New York, Frankfurt, Seoul—create an inherently unequal and unfair international economic system. And it was those decisions and policies that were responsible for the global financial crisis. Radicals believe that political power must be altered, and international regulations aimed at redistributing wealth must be enacted. Thus, radicals recognize that delivering the hatchet to economic globalization would be necessary to achieve their goals of a more just and equitable international economic system.

Mercantilists and economic nationalists have their own take. Having acknowledged that the state has a national interest in determining economic policy and that it sees other states' growing economic prowess as a threat to its own, economic nationalists might applaud the return to state-level policies protecting a state's own citizens and the rise of state-controlled enterprises. After all, as they did in the seventeenth and eighteenth centuries, old-style mercantilists, with their interpretation of economic nationalism, argue that economic policy should be subservient to the state and its interests; for them, politics determines economics. This mercantilist thinking dominated explanations of the economic success of several East Asian states. Those governments harnessed the power of MNCs in the state's interest. Setting national economic and political objectives above international economic and political objectives, statisticians see MNCs as economic actors to be controlled. They suggest imposing national controls on MNCs, including denying market entry to some of them, using the power of taxation to control repatriation of profits, and imposing currency controls. Mercantilists, like economic nationalists, believe that the international system is dominated by competition among states for power; to economic nationalists, the global economy is a struggle over relative gains. States will take any action necessary to survive, protecting their self-interests. In the aftermath of crises and the consequences of economic globalization, economic nationalists support more policies favorable to individual states.

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IN SUM: FROM THE ECONOMY TO OTHER INSTITUTIONS OF COOPERATION

Globalization characterizes not only the international political economy but also, as we have hinted at here, intergovernmental organizations and nongovernmental organizations. We discuss those important institutions and groups in the next chapter.

Discussion Questions

1. You are an economist in the Mexican government. What policies can you suggest to influence economic policy?
2. Economic liberals, mercantilists/economic nationalists, and economic radicals see multinational corporations in different ways. What are those differences?
3. How are the international financial system and the international monetary system more complex than they were in the past?
4. Does economic regionalization lead to globalization? Why or why not? Provide evidence.
5. How has your belief in the economic liberal model been modified by the global economic crises?

Key Terms

balance of payments (p. 27)
Beijing Consensus (p. 302)
BRICS (p. 295)
capital accounts (p. 273)
comparative advantage (p. 273)
current accounts (p. 273)
derivatives (p. 281)
economic radicalism (p. 273)
exchange rates (p. 273)
fiscal policies (p. 272)
foreign direct investment (p. 279)
General Agreement on Trade and Tariffs (GATT) (p. 278)
Group of 7 (G7) (p. 278)
Heckscher-Ohlin theory (p. 278)
International Monetary Fund (IMF) (p. 278)
macroeconomic policies (p. 272)