

Chapter 2

International Economic Institutions Since World War II

■ Outline

Introduction: International Institutions and Issues since World War II

International Institutions

A Taxonomy of International Economic Institutions

The IMF, the World Bank, and the WTO

The IMF and World Bank

The GATT, the Uruguay Round, and the WTO

Case Study: The GATT Rounds

Regional Trade Agreements

Five Types of Regional Trade Agreements

Case Study: Prominent Regional Agreements

Regional Trade Agreements and the WTO

For and Against RTAs

The Role of International Economic Institutions

The Definition of Public Goods

Maintaining Order and Reducing Uncertainty

Case Study: Bretton Woods

Criticism of International Institutions

Sovereignty and Transparency

Ideology

Implementation and Adjustment Costs

Case Study: China's Alternative to the IMF and World Bank: The AIIB

■ Learning Objectives

After studying this chapter, students will be able to:

- 2.1** Classify with examples the main types of international economic organizations.
- 2.2** Identify economic circumstances in which the IMF, the World Bank, and the WTO are active.
- 2.3** Compare the different levels of integration found in regional trade agreements with examples.
- 2.4** Analyze the roles of international economic organizations.
- 2.5** Debate the pros and cons of international economic organizations.

■ What Students Should Know after Reading Chapter 2

Chapter 2 introduces the major international governmental organizations of the global economy. This background material is designed to remove some of the mystery about the IMF, World Bank, WTO, and GATT early in the course. Chapter 2 also addresses both the need for these organizations and the criticisms against them. Institutions are supposed to reduce uncertainty and increase stability. Drawing on material from the new institutionalists, such as Doug North, the chapter introduces international institutions as organizations that set the rules that govern behavior and potentially constrain or limit a nation's actions.

Chapter 2 makes the case for international institutions and addresses some of the criticism they have received. It defines international public goods and addresses the free-rider problem. It gives some examples of international economic crises that may have been related to market failures. The main benefits of institutional relationships are the maintenance of order and the reduction of uncertainty. The latter part of the chapter address some of the criticism these organizations receive, including issues related to sovereignty and transparency, ideology, and implementation and adjustment costs.

Another chapter goal is for students to understand the various types of regional trade agreements and the level of policy integration associated with each type of agreement. In the recent past, bilateral and regional trade agreements have expanded more rapidly than multilateral negotiations. Chapter 2 provides a taxonomy of these agreements and includes accompanying arguments for and against as drawn from the economics literature.

■ Supplemental Lecture Possibilities

- 1. The Global Players: Given some of the sub-themes of this chapter, it usually takes a day to lecture on what I call the global players: national governments, international multilateral and regional organizations, multinational or transnational corporations, and nongovernmental organizations. Understanding issues related to global economic development, the politics of trade policies and agreements, the responsibilities and criticisms of international economic institutions, and other current developments requires a clear sense of who the players are and what they bring to the table. I define each of these players and address their strengths and weaknesses. I focus on economic development, national sovereignty, and how trade-related laws are negotiated and changed.

For development, I focus on the increasing role of direct foreign investment, which covers multinational corporations and national governments. Criticisms of world trade often come from civil society/NGOs, who often have a special role to play in the least-developed countries.

2. In presenting the major international organizations that deal with the global economy, it is useful to do a historical overview. What happened in terms of trade, foreign investment, and exchange rates from World War I through the Bretton Woods conference that made the United States and the United Kingdom think the IMF, World Bank, and something resembling GATT were necessary institutions? By covering prior crises, we can explain the framework in which the Bretton Woods institutions were created and how they operate. The prior lecture on the global players helps students understand why it was easy to create institutions that were banks and more difficult to create an institution that would affect trade laws.
3. Prior to starting Chapter 3, some instructors prefer to go directly from Chapter 2 to a case study on a specific regional trade agreement. Chapter 14 on the European Union is one such case study. One purpose moving to a specific case study is to familiarize students with the various levels of economic integration as well as the concepts of “widening” versus “deepening.” Students tend to be able to handle Chapter 14 without first having a more theoretical base, and it builds some interest in later topics such as foreign exchange. It also gives them a real-world foundation for understanding trade theory.

■ Assignment Ideas

Most important international organizations have Web sites where they provide a large variety of information as well as detailed descriptions about themselves. Students could be assigned to choose an organization, go to its Web site, and use the information there to write a short paper (two to three pages) detailing both the organization's purpose and structure and the institutional environment it creates. In addition, they should be asked to think about which countries have the greatest control over their organization's policies.

The table below contains the URLs for a number of important international organizations. These organizations are particularly relevant throughout the book. Addresses for a large number of additional sites can be found on the United Nations Web server: <http://www.unsystem.org>.

Name	URL
Asia-Pacific Economic Cooperation (APEC)	www.apecsec.org
European Union (EU)	europa.eu
International Labor Office (ILO)	www.ilo.org
International Monetary Fund (IMF)	www.imf.org
Organization for Economic Cooperation and Development (OECD)	www.oecd.org
Organization of American States (OAS)	www.oas.org
United Nations Conference on Trade and Development (UNCTAD)	www.unctad.org
World Bank Group	
World Bank and links to its subgroups	www.worldbank.org
International Finance Corporation (IFC)	www.ifc.org
Multilateral Investment Guarantee Agency (MIGA)	www.miga.org
World Trade Organization (WTO)	www.wto.org

Note that the World Bank is divided into five subgroups, two of which have their own Web sites. These five subgroups are: the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), the International Bank for Reconstruction and Development (IBRD), and the International Center for Settlement of Investment Disputes (ICSID).

The following questions can be worked into the assignment:

- What is the role of the organization you chose to write about?
- What kind of public good does it try to provide?
- Describe the main elements of the institutional environment it supports.
- What is its structure? Do some countries have a greater voice in setting policies?

■ Answers to End-of-Chapter Questions

1. What is a formal and an informal institution? Give examples of formal and informal international economic institutions.

Answer: A formal institution is a written set of rules embodied in a club, association, or a legal system. There are pre-determined objectives, policies, rules and regulations, coordinated and controlled activities, and other formalized structures in highly institutional contexts. An informal institution is a custom or tradition that dictates standards of behavior but without legal enforcement. It forms a dynamic set of personal relationships, social networks, communities of common interests or motivations. Examples of formal institutions include NAFTA, GATT, and UNFCCC; a gentleman wearing a tuxedo and a bowtie to a formal dinner or opening doors for the elderly are examples of informal institutions.

2. What are the arguments in favor of international organizations? What are the arguments against them? Which do you think are stronger?

Answer: Arguments in favor: International organizations are essential for the containment of national or regional crises and the avoidance of their propagation internationally. By providing a set of rules (institutions) which are certain and known (transparent), they reduce uncertainty and increase stability. In many instances, they overcome problems of free riding in the international economy in order to insure the provision of (international) public goods such as lender of last resort financing for resolving a liquidity crisis, or open markets in a recession.

Arguments against: The text describes the problems with institutions in terms of issues of sovereignty (may force adoption of domestic policies against nation's will or interests), transparency (decision making at institutions may be dominated by others pursuing their own interests), ideology (advice may be bad or biased), and implementation and adjustment costs (asymmetries in negotiation power and in ability to absorb costs imposed). Overall, critics question whether institutions generate economic inequality and compound risks to vulnerable groups.

The issue of which arguments are stronger is ambiguous. Either can be viewed as more cogent. The key is that students understand both arguments and that they develop a set of reasons to support their views.

3. Almost all members of the WTO are signatories to at least one Regional Trade Agreement (RTA). Nearly all the WTO members belong to at least one RTA. Define an RTA. How does an RTA create or destroy trade between countries? Explain with examples of RTAs.

Answer: An RTA refers to a trade agreement between two or more countries at a regional level. An RTA creates trade by reducing or eliminating trade barriers between the member countries, thus increasing the volume of trade between them. An RTA is detrimental to trade as it favors the interests of its members over the interests of non-members, thus discriminating between RTA members that are WTO members and other WTO members that do not belong to the RTA. In this case, trade is destroyed between the RTA members and non-members. Examples of RTAs include the NAFTA, Mercosur, EU, AFTA, ECOWAS, etc. If these RTAs have helped in the creation of trade between its signatories, they have also negatively impacted the trade relations between the signatories and those outside of the agreement.

4. What are public goods and how do they differ from private ones? Give examples of each.

Answer: Public goods are nondiminishable and nonexcludable. Private goods generally share neither of these characteristics. Private goods include most things that are bought and sold in private markets (restaurant meals, clothing, houses, cars, etc.) while public goods are often provided collectively. Public goods include national defense, public airways, civil and commercial codes, and so forth.

5. Describe the main functions of each of the following:

- The IMF
- The World Bank
- The GATT
- The WTO

Answers: (1) The IMF's role is to act as a lender of last resort in the case of a debt crisis or foreign exchange crisis. It provides technical expertise and advice and assists national governments with necessary but difficult reorganizations of their national economies.

(2) The World Bank's mission, in general terms, is to assist the economic development of nations through the provision of loans, technical expertise, and advice.

(3) GATT is a series of multilateral trade negotiations and resulting treaties which binds the tariffs and trade policies of nations and limits their ability to arbitrarily change them. Its mission is to keep markets for goods open and to ensure that nations follow a set of rules governing fair trade.

(4) The WTO is an umbrella organization created by the Uruguay round of GATT. Its role is similar to GATT's, but it has expanded its function to include agreements on services, agriculture, and textiles and apparel, all of which were omitted from the previous rounds of GATT. In addition, it provides rules for the resolution of trade disputes between nations and acts as a forum for the discussion and implementation of further reductions in trade barriers.

6. The Doha Round of trade negotiations aimed to make the multilateral trading system work for the benefit of all member nations of the WTO. Why has the Doha Round collapsed and why might there be an urgent need to revive trade talks?

Answer: In 2001, the Doha Round of trade negotiations were set in motion and included the trade issues of developing countries such as farm subsidies, agricultural protection, and trade in services. Even though important measures on trade and food security and special safeguards to protect developing countries were adopted, the Doha Round of negotiations has failed to show any sign of success.

The rise of the emerging economies of China, India, and Brazil and the self-interested approach of the U.S. and the EU continue to undermine the multilateral trading system. The main reason for the collapse of the Doha Round has been the increased protectionism seen in both the U.S. and the EU. These countries have undergone major changes since the launch of the Doha Round. For example, the share of developing countries in the world trade has increased tremendously. The changing trends and new interests of the WTO members call for a new approach, principally by abandoning the understanding that required a whole list of issues to be negotiated and concluded at the same time. Moreover, countries must commit to work together to prevent the re-emergence of protectionism and strengthen the rules of the trading system such that they operate in a fair, development-oriented and inclusive manner.

7. Kindleberger's study of the Great Depression of the 1930s led him to believe that market economies are sometimes unstable and that nations can get locked into prolonged downturns. Other economists are not convinced. Suppose that you disagree with Kindleberger and that you believe that market based economies are inherently stable. How would you view the need for international institutions to address the provision of each of the public goods in Table 2.5?

Answer: If the international economy is inherently stable, then the need for international institutions decreases. Most of the cases where there is a failure to provide the public goods in Table 2.3 are a consequence of the failure governments to implement sound economic policies.

Governments may try to close markets during a recession but enlightened governments recognize this as self-defeating since other nations will retaliate. Government closure of markets is a governmental failure, not a market failure.

Private capital markets will channel funds to developing countries if these countries have the right policies. Again, the problem of capital shortages in developing countries may be as much a failure of the developing country's economic policies as it is a failure of markets.

Private markets will seek out payment methods that are acceptable to all the parties involved.

Financial crises caused by a shortage of liquidity are an indicator of deeper problems. At times, it is necessary to let bad firms fail. These types of crises will burn themselves out and leave little lasting impact on the international economy.

8. What are the five main types of regional trade agreements and what are their primary characteristics?

Answer: The five main types of regional trade agreements are: (1) a partial trade agreement; (2) a free trade area; (3) a customs union; (4) a common market; and (5) an economic union.

- (1) A partial trade agreement frees up trade between two or more countries in a few goods. An example is the U.S.-Canada Auto Pact which created free trade in cars and car parts in the 1960s. It later formed the basis for the U.S.-Canada free trade agreement.
- (2) A free trade area allows goods and services to cross international borders without paying a tariff and without limitations imposed by quotas. Many items, such as labor and environmental issues, are usually left out of the agreement. Example: NAFTA.
- (3) A customs union is a free trade area plus a common set of tariffs toward non-members. In this situation, members have free trade with each other and agree to levy the same tariff on imports from non-members. Examples: MERCOSUR, and from the mid-1970s to early 1990s, the European Union.
- (4) A common market is a customs union plus an agreement to allow the free mobility of inputs such as labor and capital. Example: the European Union in the 1990s.
- (5) An economic union is a common market with substantial coordination of macroeconomic policies, including a common currency, and harmonization of standards and regulations. Example: the 12 European Union members that participate in the euro.

Since most formal agreements combine incomplete elements, this classification is more clear-cut than the messier reality.

9. Critics of the global institutions have a variety of complaints about the WTO, the IMF, and the World Bank. Explain the main categories of complaints.

Answer: The text describes the problems with institutions in terms of issues of sovereignty (may force adoption of domestic policies against nation's will or interests), transparency (decision making at institutions may be dominated by others pursuing their own interests), ideology (advice may be bad or biased), and implementation and adjustment costs (asymmetries in negotiation power and in ability to absorb costs imposed). They especially question the dominance of the United States and industrialized nations in determining the policies institutions set for client countries, since those policies may be wrong or biased or impose particular harm to some groups in the client nations' populations. Overall, critics question whether institutions generate economic inequality and compound risks to vulnerable groups.