International Economics and the Question of Power: A Manifold but Obscured Relationship

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During the Peloponnesian War the powerful Athenians came to the small island of Melos offering its inhabitants the choice of either paying tribute or facing conquest. The Melians answered that Athens might be able to conquer the island by force, but in this case would act completely unjust. The Athenians replied bluntly that justice and the rule of law are for equal partners, but that the stronger will always act by the rule of force. At the end of this "Melian debate" (as termed by the Greek historian Thucydides), Melos rejected to surrender, at the same time warning the Athenians that the balance of power might someday shift against them. Athens nevertheless waged war, and, as a result, killed all Melian men and sold all women and children into slavery (Chalk and Jonassohn 1990, 65-73).

What does this story have to do with economics? Nothing, the ordinary mainstream economist would most probably state. But that is simply not true, because the story leads us to an existential question, which has been more or less neglected and even obscured by the economic mainstream and is thus in desperate need of debate: the question of power.[1] Of course, there are several approaches in economics aware of some kind of power: the monopoly and oligopoly theory, the theory of asymmetric information, some branches of institutional and political economy, development economics, and many more. Forms of power are particularly addressed with regards to bargaining power, purchasing power, market power, or—rather technically—explanatory power, or predictive power.[2] But to quote the most

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[1] *Power* is understood here as a very basic asymmetry following Max Weber's well known idea of power as an "opportunity existing within a social relationship which permits one to carry out one's own will even against resistance and regardless of the basis upon which this opportunity rests" (Weber 1962, 117). Thus, power is understood as dominance, as a potential, and in a descriptive way. Particularly important in social relations is the power of definition (which one may also call structural power or discursive power).

2 A check in the most pertinent publication database *Econlit* leads to the following statistics: between 2000 and 2007, the term power was used in the titles, abstracts, or keywords of 8,401 journal articles, which is only approximately 4% of all, a share also holding for the—with respect to *SSCI* (Social Science Citation Index) impact factors—top-15-journals. Further, 875 of these 8,401 articles particularly refer to *market power*, 597

popular online encyclopedia, *wikipedia*: “There is no agreed-upon definition of power in economics” (Wikipedia).[3] Hence, the question of power is either neutralized or at least considered as a distortion correctable by the “invisible hand” of the market—a very powerful institution indeed—, and is therefore not addressed prominently in economics. To provide some anecdotal evidence: among about 400 articles published in 2007 in the ten top-journals of the discipline, there were only two which had the term power in their title (Weisbach 2007; Tokatli 2007), two articles were explicitly discussing market power (Kovrijnykh and Szentes 2007; Hortacsu and Syversen 2007), one was addressing bargaining power (Hughes et al. 2007), but only Bortolotti and Perotti (2007) discussed political power at all.

This almost complete ignorance—at least in mainstream economics—was mourned already by Kurt Rothschild (1971) in his readable collection of articles about power and economics, which were published between 1943 and 1968. It is especially true for the disciplinary debate about international trade and, to a lesser extent, globalization. The basics in these fields (in models as well as in thought) are almost completely ignorant of other forces than those of the market, although the processes of international exchange in general and trade in particular are very much a question of the interrelation of political, institutional, economic, cultural, and even military forces. This was true centuries ago and still is. But at the foundations of these fields there are “even weights” assigned to the “partners” in international economics and in trade, and these foundations are not only in theory very influential, they are often also the starting point of policy papers and thus indirectly powerful as well. If the basis of analysis is biased with respect to the question of power, then the result will be biased as well. Officially, this is done for reasons of limiting complexity, but it also reflects the non-neutrality of power in economics, which is a very serious distortion from empirical reality. Thus, the following questions are to be discussed in this chapter: in which way is the question of power considered by the economic mainstream? What important features of power are therefore neglected? And where are potential sources of a holistic approach to be found to overcome these shortcomings?

History tells lessons indeed: a decade after the “Melian debate,” Athens had lost power, was terribly defeated by mightier enemies and never again regained former importance.

to *purchasing power*, 408 to *bargaining power*, and 453 to *explanatory power*, but only 57 to *empowerment*, 94 to *economic power*, 180 to *political power*, and 24 to *military power*.

3 The rather small section also contains a conclusion economists should memorize: “In general, those with more power also have more freedom than others and may be able to exploit others in society and/or cause some sort of market failure” (Wikipedia).

Power Economics?

Institutional, bargaining and market power

Since economists hardly ever regard books as important sources of knowledge, the essence of the discipline has to be derived from journal articles.[4] However, even if books are taken into account it turns out that the most promising contributions to the debate come from neighbors (historians, geographers, sociologists, political scientists, and others), but not from family members (Legro 2007; MacIntyre 2003; Peet 2007; Seabrooke 2006). Perloff et al. (2007) can be seen as one of the rare recent examples of systematic (and rather technical) discussions of market power in the form of a book. This particularly holds for the prestigious field of international economics (prestigious at least compared to development economics), in which—Mancur Olson (1982) and Douglass North (1991 and 2005) put aside—mainly non-economists publish books addressing issues of power (cf. Ferguson 2001; Herbst 2000; Kennedy 1987; Lane 1979; MacNeill 1982; Mann 1986 and 1993). But even in journal literature power is not well reflected, and besides some contributions on the "power of the pill" (Bailey 2006; Goldin and Katz 2002), or "power couples"[5] (Costa and Kahn 2000; Compton and Pollak 2004), and papers combining these ideas to discuss power relationships within families (Chiapori and Oreffice 2008; Pollak 2005), the contributions are mainly about power and institutions, bargaining power, and market power.

The analysis of (political and economic) institutions, especially in the tradition of North and Olson, has recently been carried further by Daron Acemoglu and his colleagues (Acemoglu and Robinson 2006 and 2008; Acemoglu et al. 2005; Acemoglu 2005). In the latest of these papers, Acemoglu and Robinson carefully differentiate between political and economic institutions and between de facto and de iure power. While they concluded in their theoretical treatment of 2006 that "this model is useful in thinking about how the frequent changes in the identity of those who hold political power can go hand in hand with the continuation of disastrous policies" (Acemoglu and Robinson 2006, 329), in 2008 they demonstrated a possible channel by which persistence of bad governance is enforced: when economic institutions favor an elite, the political system may become a "captured democracy" which is actually unable to change policy, because elites remain stable by continuously investing in de facto political power. In a more historical setting, Acemoglu et al. (2005) have also demonstrated that after 1500 specifically those European societies developed, which where able to constrain the power of the monarchy, particularly—closely in line with North—by means of protecting private property rights. In related papers (Aghion et al. 2004; Maskin and Tirole 2004), the question of political checks and balances—"endogenous institutions" in

4 If you are a keynote speaker of an important conference, however, you will most probably refer to a lot of books, some of them being classics. But the way of becoming a keynote speaker is itself paved with an awful lot of journal contributions. This may be one reason, why contemporary intellectual history of economics is dominated by shifts in theoretical fashions (instead of paradigms) and, besides that, by infinitesimal progress.

5 In these papers, "power couples" are couples in which both partners are holding a college degree.

economic terms—is discussed further, while Jones and Olken (2005) analyze the role of leaders, especially their powerfulness, for economic growth.[6] Finally, Kauppi and Widgren (2004) took a look on how relative voting power influences EU council decisions about budget allocation, as compared to actual needs.

Analyses of bargaining power often focus on companies—as for example Ryan and Wiggins (2004), who show that the relationship between the management of a company and its board as well as the independence of the board-members is very important for the kind of compensation and its consequences (equity-based, and thus in line with the share-holders' interests, or in cash, and therefore independent of the companies' success). Bebchuk et al. (2002) and Bebchuk and Fried (2004) even come to stronger results: they show how managerial power can be exploited for extracting rents from a company and demonstrate that executives have power to influence their own pay and, even more, that their desire to camouflage rent extraction (recent examples from the banking sector could be named at length) might lead to inefficient pay arrangements. Equally, in labor relations power is usually also regarded as a distortion, particularly the power of trade unions (Besley and Burgess 2004; Botero et al. 2004). Finally, in another context Chiappori and Oreffice (2008) have recently shown in which ways innovations in birth control technologies (like the pill) increase the bargaining power of women within households and hence their wealth.

Market power analyses mainly emerge from the theory of industrial organization. Barry Nalebuff (2004), for example, clearly shows in theory how a monopolist can gain extensively by deterring the market entry of competitors through bundling and thus by executing market power. In an empirical study, Fee and Thomas (2003) are able to connect mergers with buying power gains, i.e. rents from "monopsonistic collusion" (referring to the setting of excessive prices by a single buyer or a syndicate acting unitarily) or improved purchasing efficiency. Furthermore, Ellis and Halvorsen (2002) show that the typical assumption that market power leads to price mark-ups for those "in power," is true at least for the international nickel industry, where arguments were made that it is not.

Imperfect competition, exchange rate systems, and asymmetric information

While the books mentioned above continue a long tradition (dating back at least to Karl Marx and Adam Smith) and discuss power in an elaborated interdisciplinary historical context in different epochs and regions, other more mainstream contributions in international economics—set aside those about "purchasing power parity"—mainly focus on imperfect competition, exchange rate systems, and asymmetric information (cf. DeGrauwe 2003; Eichengreen 1996; Helpman and Krugman 1985; Krugman and Obstfeld 2000; Markusen et al. 1995).

[6] This is investigated by the "external shock" (i.e. something imposed on the economy) that these leaders die in office.

Recent Nobel Laureate Paul Krugman was the most important figure for the integration of imperfect competition into trade theory (Krugman 1980; Helpman and Krugman 1985). His contribution was mainly to explain intra-industry trade and to better understand dumping, and it has been very influential in international economics ever since. But it also allows looking at the importance of the market power of certain world market actors for trade. If there is an actor in international trade, competing at a foreign market with domestic firms while enjoying monopoly (or oligopoly) conditions at home, this actor is able to sell at lower prices abroad (financed with home-market-rents) and to win the market. However, most models following Krugman's concept do not refer to power—Martin and Rey (2004), who at least integrate monopoly power into their analysis of asset trade, Amiti and Pissarides (2005), who point to "monopsony power" (and its erosion) in agglomerations, and Konings and Vandenbussche (2005), who challenge the orthodoxy of the original argument, only count as exceptions.

A crucial issue in monetary economics is the discussion of exchange rate systems. One basic distinction in the field is that between symmetric and asymmetric systems (cf. DeGrauwe 2003, chapter 6). While the former are considered as an even playground of equal partners, the latter are seen in the classical pattern of a leader and some followers. But, if the system is asymmetric, the leader enjoys much more freedom in shaping his economic environment and is able to carry out a monetary policy oriented towards domestic goals while enjoying the benefits of fixed exchange rates and capital mobility at the same time. History tells that systems tend to become asymmetric over time—like Bretton Woods as well as the European Monetary System (EMS) (Eichengreen 1996, chapters 4 and 5).[7] But this case for asymmetry also holds in general. When looking at the theory of asymmetric information, used widely also in international economics, one can easily see that there is a useful information surplus emerging from that. In the end, the difference between a domestic market and the foreign market (or world market) is basically about information costs. The ordinary analysis, nevertheless, is a little different: Spiegel (2005), for example, shows that a situation, in which the borrower from an International Financial Institution (IFI) is in possession of superior information, will lead to adverse selection, i.e. the least, not the most credible borrowers are provided funds.

On the contrary, spheres in which power most often does not appear at all are almost all spheres which are not directly connected to political forces (at least by the economists), like standard trade models, monetary theory, and even the issue of free trade. An interesting paper by Redding and Venables (2002) for example investigates the relationship between international inequality and geographical factors. They come to the conclusion that "the

7 "Bretton Woods" is referring to the global system of fixed exchange rates, agreed on in Bretton Woods, New Hampshire, in 1944, which included the whole Western hemisphere and collapsed in the 1970s—the US-Dollar played a leading role herein. The EMS replaced Bretton Woods as a system of fixed exchange rates between all big players in Western Europe, existing from 1979 until 1998 (actually it collapsed already in 1993), in which the *Deutschmark* clearly dominated. On the other hand, the European Monetary Union (EMU) as a strictly symmetric system with a single monetary authority and a common currency may challenge this rule, but its ten-year-history is too short to judge so far.

geography of access to markets and sources of supply can explain much of the cross-country variation in per capita income. After controlling for a variety of other determinants of per capita income, we continue to find highly statistically significant and quantitatively important effects of economic geography" (Redding and Venables 2002, 54). However, their analysis remains idiosyncratic. Although it makes sense for a country to control the aforementioned "access to markets and sources of supply" and to exclude others from these gains (i.e. to execute power), and although there are commensurable benefits in terms of per capita income by doing so, the shaping of power relations are not further analyzed.

Power negligence

Hence, some pieces of power are picked up by economists, but most are left on the sidewalk. The standard theory of international trade, for example, works well if (and only if) we assume perfect price equalization on world markets, if we assume no specific spill-over-effects according to certain goods, and if we assume full liberalization of markets. Behind all that is the very basic assumption of theories in international economics that nobody will agree to exchange without benefits ("mutually beneficial voluntary exchange"). In practice, this does include situations in which the benefit is derived from avoiding more serious losses. Generally, it is easy (although not costless) for more powerful actors in international relations to act predatorily (at least up to the point when trade distortions offset benefits). Further, if any of these basic assumptions is violated, due to imbalances in power or other reasons, conclusions will certainly change. If, for example, the equalization of prices at the world market does not work properly (because a powerful actor factually dictates prices), two effects will immediately take place: firstly, the distribution of gains will be uneven (in favor of the dictator), and secondly, the volume of trade will be suboptimal (too low). Both effects are very serious distortions of equilibrium solutions.

If the goods traded are not technically neutral (which is usually the case), there is another source to derive profits from power. In practice, there is a major difference between specializing, for example, in the production of computers or drugs (a direction in which comparative advantage and market forces may drive certain countries). Basically, it is the difference between positive and negative externalities of production, and of long-run versus short-run benefits from trade. Thus, it is not irrelevant what kind of production is established in a country to serve the world market, an insight a lot of scholars (particularly mercantilists and protectionists) already had, but one that was—while officially still in place—theoretically obscured or suppressed, especially by the ideologists of free trade.

Furthermore, all trade negotiations are essentially about selective liberalization—and hence also about selective protection. At the very end, every country wants to optimize gains and thus prefers to open (close) markets, in which it is (not) competitive. This is almost unavoidable because trade never starts *tabula rasa*. On the contrary, interest groups will always push national governments in the direction of selective opening. Thus, trade in general is always too low (Anderson 2000) and the more powerful actor will destine more accurately to open and close markets in his favor. Falkinger and Grossmann argue "that an unequal distribution of political power, biased to landed elites and owners of natural resources, in combination with openness to trade is a major obstacle to development of natural resource- or land-abundant economies" (Falkinger and Grossmann 2005, 231). This can be generalized:

> When they were trying to catch up with the frontier economies, the NDCs [now-developed countries] used interventionist industrial, trade and technology policies in order to promote their infant industries … In relative terms …, many of them actually protected their industries a lot more heavily than the currently developing countries. If this is the case, the currently recommended package of 'good policies' … seems at odds with historical experience, and the NDCs seem to be indeed 'kicking away the ladder' that they used in order to climb up to where they are (Chang 2003, 28).

World trade is path-dependently shaped mainly by mighty powers, always having primarily established nationally exclusive trading networks. Free trade is on the agenda if—and only if—there is a global leading super-power, which is also a leading, super-competitive economy. This is an important reason for the historically unique rise of free trade in the second half of the nineteenth century under British rule, which was duplicated after World War II under US rule. Generally, only loosely interconnected national, protected and mostly even monopolized networks of trade dominated throughout history, be it the Venetian, the Portuguese, the Dutch, or any other (cf. Exenberger 2005).

Bringing power back in

Of course there is some hope. Not only has the bulk of globalization literature, but also development economics and international political economy provided fruitful points of departure to bring power back in the analysis of international economics. Aisbett (2005), for example, has undertaken an ambitious study about the important question, if globalization supports poverty and why its critics are so convinced that it does. The whole study is very much concerned about the question of power, particularly the increasing upward concentration of economic and political power of transnational corporations. In another paper, even more fundamentally questioning the usual reading of globalization as a process eroding the power of nation-states, Gritsch (2005) strongly emphasizes the increasing autonomy (i.e. power) of certain, namely advanced capitalist states. In her view, "globalization … is significant as a soft geo-politics, or states' zero-sum pursuit of geo-political power on non-militaristic terrain" (Gritsch 2005, 9). Its major source is an increased cohesiveness of the interests of national political elites and global economic elites and the diminishing of intranational sources of power. The consequence is a separation of political and economic legitimacy (changing its character and addressee), and a limitation of participation.

On the remaining pages I will focus on papers from *World Development* and the *Review of International Political Economy*, two of the leading critical journals in the fields of development economics and political economy. In general, many of these alternative approaches, a lot of them case-study-oriented, are also about questions of market power and bargaining power—the latter, not by chance, much more with regards to labor relations (Caraway 2006; Paczynska 2007) and gender relationships (Kabeer 2001; Kusago and Barham 2001; Lim et al. 2007) than the mainstream. But they also go further analytically, when for example Silvey and Elmhirst (2003), in a social-capital-driven analysis about Indonesia, combine bargaining power within families and within labor relations to an analysis of gendered power relations, or when Ponte (2002) discusses the power shift in the world coffee market, which changed from being producer-driven to consumer-driven in around 1990. Furthermore, they much more often and much more explicitly emphasize in particular the influence of political power on the economy.

To name some examples, in a case study about Peru, Muñoz et al. (2007) argue that the persistence of inequality is closely related to poor institutions, because collective action is rather costly, particularly for poor people. On a more international level, Higgott and Weber (2005) discuss the evolution of a *lex mercatoria*, which has materialized in the rules of the World Trade Organization (WTO) and particularly the General Agreement on Trade in Services (GATS), while Woods and Lombardi (2006) discuss the question of power differences of certain countries in decision-making within the International Monetary Fund (IMF). Bertram (2004), in an empirical paper about the growth performance of countries, comes to the interesting conclusion that keeping the political linkages to a former colonial power (i.e. to sustain an asymmetric power relationship) is beneficial at least for small island states. Hardie (2006) even discusses a question which is completely absent in mainstream economics, i.e. the power *of* markets. He investigates, with rather mixed conclusions, if international investors had significant influence on the 2002 presidential elections in Brazil. Finally, in another empirical study, Englebert (2000) explains the “AFRICA-dummy” in growth-equations (i.e. the “influence” of “being African” on a country’s growth). Power is at the centre of his analysis, when discussing the transplanted nature of the nation-state in Africa (see also Bayart 1993; Herbst 2000). As Englebert points out, power is an external, but even more an internal problem for African elites: “African independent elites soon discovered how truly little power they had inherited … The true challenge to their rule came from the competing institutional claims to sovereignty which their state harboured” (Englebert 2000, 1823). This lack of power of national elites, directly connected to state legitimacy, led to their concentration on power-consolidating “neo-patrimonial” policies—in contrast to developmental policies. By this relatively simple framework Englebert is able, as he claims already in the title of his paper, to “solve” the “mystery” of the AFRICA-dummy by revealing that being African is not a problem per se, but lacking state legitimacy is a problem, not only in Africa.

In a paper about foreign aid (referring to Marcel Mauss, Marshal Sahlins, and Pierre Bourdieu), Hattori (2001) prominently discusses the power relations embodied in the relationship between donor and recipient. These relations have an important influence, no matter in which way of resource allocation (economic exchange, redistribution, or gift) aid is understood. In his view, foreign aid means “symbolic domination or a practice of signaling and euphemizing a social hierarchy” (Hattori 2001, 635). What is particularly important is to distinguish debt from aid, neither in the way most economist do, nor in the way most aid workers do, but: “Whereas debt falls in the category of ‘economic exchange’, which presumes a social relation of equality, giving is distinguished by strategic ambiguity and the power to transform a relation of domination into one of generosity and gratitude” (Hattori 2001, 640). Further, in a—to some extent—historical paper, Konings (2008) discusses the United States and their “structural power” in international finance, which, in his view, is clearly not restricted to market power. He discloses the very nature of global financial relations as strongly resting on the internationalization of US financial relations and on the Americanization of international financial relations during the 1960s and 1970s. He fills the conceptual gap between (global) structural power and (national) state power “by emphasizing that the re-emergence of global finance has not so much involved a process of de-institutionalization but rather the construction of a new institutional regime from which one state in particular derives an extraordinary degree of power” (Konings 2008, 56). These conclusions challenge both ideological camps, not only those who refer to the present financial system as “casino capitalism,” but even more those who interpret it as an increasingly liberal and thus exclusively market driven venture.

Finally, a working paper by Anderson and Young (2000) should be mentioned, in which they analyze the influence of the legal framework on trade. They argue not only that the rule of law supports “weak” partners in trading relationships, who otherwise could be overpowered (even deterred from trading at all), but also that it carries benefits for all actors in trade. Although this is definitively a strong and important result that is challenging some of the basics of international economics, this working paper was never published as a journal article. One reason may be that many economists are truly aware of the strength of power relations in international trade, which will not allow a legal framework, comprehensive as it may be, to effectively protect the weak.

Symmetric relationships are not common in real-world international economics. On a global scale there are no equal partners at all, but a very distinct pattern consisting of a relatively small centre and a rather large periphery (with large in-between-differences). There are some Athenians and many more Melians. Thus, international economics is in desperate need of a theoretical foundation aware of issues of power, which forms the basis of economics and, consequently, strongly influences analyses, conclusions, and policy advices derived from scholarly research. A more appropriate, holistic approach must depart from historically contextualized political economy. Power cannot remain restricted to market or bargaining power, but a broader, much more political understanding of it is needed. This, of course, means to question the foundations of the discipline and the basic assumptions of standard models, which may lead to a transformation of the theory of international economics into a more general theory of international relations, in which today’s “pure theory” would be a special but not the dominating logic.

Conclusions

The task waiting ahead is not easy. After all, economics is—like most arts and sciences—a discipline elaborated mainly by people from not-peripheral parts of the world and employed by the powerful. The extent of this bias can be demonstrated by statistics about Nobel Prize Winners in Economics: as of 2008, 68 percent were US citizens and 76 percent worked in the United States, when awarded the Prize. Even more, in the last ten years 18 out of 19 laureates worked in the United States.[8] That all 62 laureates are men will not surprise those familiar with power structures in general and in economics in particular.

However, as already said, history tells lessons. Hence, economic history provides interesting tools for the analysis of the special relationship between economics and power. History tells about both, about the importance of market forces to shape the political environment (particularly in the long run), but also about the importance of power, notably non-economic power, to shape the economic environment (particularly in the short run). International economics definitively is one of the sub-disciplines of economics having a much stronger impact on the lives of billions of people than others, because the issues dealt with are often vital issues such as being able to earn one's living (through production for trade or through migration) or not, at least at the macro level. Thus, it is a discipline very much in need of arriving in the twenty-first century by addressing the question of power prominently and, hence, to close the increasing gap between practical applications and recent public debates. However, international economics may be specifically vulnerable to the pitfalls of power negligence and the obscured influence of power, but it is by no way unique in that respect:

> Most economists have been satisfied, in Schumpeter's tradition, to stop their enquiry once they found a 'causal relation between two phenomena' where 'the one which plays the causal role is non-economic' … Yet, policies may be exogenous to economic models, but they are endogenous to social, political and historical factors (Englebert 2000, 1832).

The same is generally true for the question of power. Many economists stop their efforts after having identified power as an "exogenous" variable, which it impossibly can be in international economics. Despite that, most researchers in the field of economics simply ignore issues of power. As a consequence, especially the analysis of international economics has become too narrow-minded and blind for a lot of interactions. The essence of the theory has to be enriched to become, again, a theory of international relations, which can only be understood properly as "political economy" in the very sense of the phrase. To neglect this hand-in-glove-relationship leads into a one-way-street of a sparsely disguised exploitation of the weak and the poor by the powerful, but it will not lead to any desirable solution for the global problems ahead.

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[8] The only exception is Robert J. Aumann, who is working in Israel, but is twin citizen of Israel and the United States.

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