Frieden, “Invested Interests: the Politics of National Economic Policies in a World of Global Finance”

Whereas Rogowski uses S-S to analyze the political ramifications of trade integration, Frieden modifies it to analyze the patterns of coalition formation in light of financial integration. Rather than focusing on factors (read classes), Frieden emphasizes that the crucial cleavages in a world of global finance are between sectors (i.e. members of different industries). The crucial variable in Frieden’s model is the degree of asset specificity in a given sector. In his model, there are two actors: liquid asset holders (e.g. those in the financial services industry) and fixed asset holders (i.e. owners of and workers in industries which require high levels of location specific capital such as utilities, etc.). These two actors can be found in either capital poor or capital rich countries. Following the logic of S-S, as financial integration in capital poor countries increases, returns to liquid asset holders diminish while those accruing to specific factors increase. An increase in integration in capital rich countries has the opposite effect. To direct his argument towards the ramifications of specific government policy choices, Frieden uses the Mundell-Fleming conditions to show that in a world where capital is mobile, governments can retain monetary autonomy only by manipulating the exchange rate. Governments therefore choose the following: 1) the level of the exchange rate (high or low); 2) a fixed or floating exchange rate regime. Obviously, exchange rate level is a continuum and there are intermediate exchange rate regimes like floating pegs or fluctuation within bands but, for the sake of parsimony, exchange rate choice in the paper is limited to these categories. Different policy choices can be expected to produce different distributional outcomes and hence different political coalitions. A fixed exchange rate, which produces currency stability, will be favored by international traders and investors as well as producers of export oriented tradable goods. A floating exchange rate will be favored by producers of non-tradable goods and services as well as producers of import competing goods for the domestic market. Because a low exchange rate makes domestic goods cheap relative to their foreign counterparts, such a policy will be favored by import-competers and producers of exportable goods. A high exchange rate, on the other hand, will be favored by producers of non-tradables as well as international traders and investors.