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# GLOBALIZATION AND THE INSTABILITY OF GLOBAL FINANCIAL MARKETS

**Pantelis Sklias***
*Associate Professor, Dept. of Political Science & International Relations, University of Peloponnese, Corinth, Greece*

**George Maris**
*Researcher, Dept. of Political Science & International Relations, University of Peloponnese, Corinth, Greece,* (*E-mail: gmaris@uop.gr*)

**ABSTRACT**

The financial and economic crisis that began in 2007 is a clear example of how is globalisation connected to the instability of global financial markets. Our target is not to analyze the immediate and direct contributing factors for the current financial instability. This paper focus on the issue of how globalisation is related to the instability of global financial markets by noting that the instability of global financial markets can be influenced not only from the vulnerabilities of global financial and banking system but also from the impact of globalisation on state power and uneven development and distribution of the wealth. These factors have contributed to the creation of a highly fragile financial system which is vulnerable to prospect crises anytime.

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## 1. INTRODUCTION

Globalisation is one of the most ambiguous notions in social sciences. Even now, the debates and clashes between skeptics, globalists, and transformationalists remain remarkable. On the one hand, globalisation is just a myth and on the other globalisation is not. Despite the disagreement between the theorists for the existence of globalization, the notion has acquired a universal acceptance. It could be said that globalisation affects anything from the stability or instability of global financial markets to the protestors in Seattle and Genoa.

The global economic system can be seen among others as a 'casino capitalism' as 'market fundamentalism' and as a 'flat world'. Under these conditions, an entire argumentation has been developed the last years under the headings of the so-called

*Corresponding author: *E-mail: psklias@hotmail.com*

'Washington Consensus'. It could be argued that today the problem is that markets and especially financial markets have been deregulated so much (Krugman, 2008). Moreover, it could be said that globalisation is responsible for the current vulnerabilities on the financial and banking system and the uneven development and distribution of the wealth. In other words, the financial and economic crisis that began in 2007 is a clear example of how is globalisation connected to the instability of global financial markets.

However, our target is not to analyze like Orlowski (2008) the immediate and direct contributing factors for the current financial instability. Instead, this paper will begin by introducing the notion of globalisation and it will analyze some important theoretical matters like the idea globalisation as an ideological construction. It will then go on to the analysis of how globalisation is related to the instability of global financial markets. According to this organization, the chapter three will analyze how is globalisation connected to the instability of financial markets in four different cases (a) the case of the nation state (b) the case of the financial system, (c) the case of the banking system and (d) the case of income inequality and distribution of the wealth. Finally, the last chapter will provide some concluding remarks on how is globalisation related with the instability of global financial markets.

As a result, this paper will focus on the issue of how globalisation is related to the instability of global financial markets by noting that the instability of global financial markets can be influenced not only from the vulnerabilities of global financial and banking system but also from the impact of globalisation on state power and uneven development and distribution of the wealth. The aforementioned factors have contributed to the creation of a highly fragile financial system which is directly or indirectly vulnerable to prospect crises anytime.

## 2. THEORETICAL FRAMEWORK

### 2.1. Definitions and Explanation

Even though globalisation's origins can be traced back to the works of Saint-Simon and Karl Marx, the concept was mainly first used during 1960s and 1970s (Held and McGrew, 2005). In particular, after the collapse of communism in 1989 and the information revolution many could argue that because of globalisation the ideas of geography and time became vague (O' Brien, 1992). However, this is only one aspect of the complex and in many ways controversial globalisation debate. In fact, there are three main considerations namely the skeptics, the globalists and the transformationalist. According to Held and McGrew (2005, p. 3) the main divergence between all those considerations is 'the differential emphasis which it is given to the material, spatio-temporal and cognitive aspects of globalisation'. As a consequence, an agreement for what defines globalisation is very complex and difficult task.

In general, the dispute about globalization can be separated in three main stages and in the current last stage even the anti-globalist thesis acknowledges that globalisation is unavoidable (Talani, 2009). Moreover, two main definitions namely the quantitative and the qualitative definition for the term globalisation can be identified. According to the quantitative definition globalisation is 'the intensification of economic, political, social, and cultural relations across boarders' (Talani 2009, p. 29). However, as Talani (2009) argues by this explanation many questions remain unresolved. On the other hand globalisation is a process or a syndrome by which 'a number of qualitative transformations, which in turn characterize the current phase of capitalist development' can be identified (Talani 2009, p. 30).

The aforementioned qualitative definition of globalisation comprises many elements of the current unstable global political and economic system. As Talani (2009, p. 30) observes these are 'the technological transformation; financial transformation; geographical reallocation of production; the process of commodification; the polarisation of wealth; the subordination of politics to economics and the related decline of the nation state; and the emergence of a new global division of labour'. As a result, it can be said that by analysing many of the elements of the qualitative definition of globalisation, a better exegesis of how globalisation is related to the instability of global financial markets can be provided.

### 2.2. Globalisation as an Ideological Construction

Even though the skeptics believe that globalisation is just a myth (Hirst and Thompson, 1999) this essay will not provide any evaluation of whether or not globalisation is a fact. However, a more critical view that confronts globalisation as an ideological construction, as convenient excuse for the justification and legitimization of the so called Washington Consensus needs a closer attention (Held and McGrew, 2005). According to this perspective 'Neoliberalism gave capitalists and states managers alike the ideological cohesion and self confidence to force back organized labour; it legitimized the deregulation and global integration of financial markets' (Callinicos 2009, p. 207). Moreover, Watson (2005) argues that globalisation not only offers the justification and legitimization for self-interest behavior and actions but also it offers an exegesis and explanation to confront their actions as moral. As a result, it can be said that the last century the United States has used the globalisation as an excuse for their imperialistic plans and the consolidation of global neoliberal markets (Callinicos, 1994; Hirst, 1997).

Nevertheless, this is not to say that globalisation does not exist or globalisation is just a myth. Rather, globalisation is an arena for political, economic and geopolitical movements, an image for a unique and unified global market, an inevitable reality. In this respect, Susan Strange (1996) believes that the United States was encompassed in the global neoliberal market forces when they tried to liberalize not only the American economy but also the European, Latin-American, Asian, and African economies. According to her the global markets are impersonal, immaterial, and do not have a rational behavior (Strange, 1996). As a result, it can be argued that it is crucial first to analyze how state's behavior influences the instability of global financial markets in the globalisation era.

## 3. GLOBALISATION AND THE INSTABILITY OF GLOBAL FINANCIAL MARKETS

### 3.1. The Case of the Nation State

Although, Callinicos (2009, p. 190) refers that the 'non-territorial imperialism of the open door suited US interest better' one can be said that the shift of power from the states to markets was the most important change in the global political economy the last century (Strange, 1996). As Keohane (1995, p. 157) states 'Globalisation seems irreversible with all its implications for the permeability of borders and the transformation of sovereignty among the economically advanced democracies'. Furthermore, it can be said that economic globalisation transforms the state's role and power crucially (Ohmae, 1995). Thus, the states seems unable to protect manage and regulate not only their national economies but also the global economic activity. Consequently, 'the sovereignty and regulatory power of the state have been weakened by transnationalism and that politics have been subordinated to economic forces' (Talani 2009, p. 25). Indeed, it seems that globalisation entails the decline of the legitimization of the nation states to act as political authorities (Habermas, 2004; Sassen, 1996). In this context, it can be argued that the absence of state's authority was the one of the main reasons for the global financial and economic crisis that begun in 2007. The aforementioned result is a clear example of how is globalisation related to the instability of global financial markets. Obviously, the states, which are constrained by the global financial forces, pursue even more neoliberal plans, and at the same time assign parts of their authority and sovereignty to the markets. Hence, the states are trapped in a vicious cycle under which anytime they liberalize the markets at the same time they lose their ability to stabilize their economy.

In addition, it can be argued that states affect the instability of global financial markets because they are unable to cooperate in the globalisation era. As Wade (2009) says the weak and eroding interstate cooperation in both finance and trade was one of the main destabilizing factors for the global financial crisis that began in 2007. According to him there is a mismatch between regulatory capacities and the global scope of markets in trade and finance and as a result the persistent global imbalances deficits are direct drivers of financial instability which lead to financial crises. As it is believed the global financial crises confirm the great importance of collaboration between states and the greater difficulty of achieving it (Pauly, 2007). Clearly as Soros (1997) wrote 'Too much competition and too little cooperation can cause intolerable inequities and instability'. Besides, one can says that globalisation's syndrome affect states which remain and stand unable to evaluate and in many times to act against a potential financial crisis in the global financial markets. This feature can be observed not only in the financial crisis in Mexico, Argentina, Japan and Asia but also in the financial crisis that begun in 2007. In contrast, to remarkable scholars who had stated that the global economy will not anymore suffer from depressions, the last two decades severe crises started worldwide (Lucas, 2003). Furthermore, it could be said that even though realists believe that the 'stabilization and regulation of financial markets depends on major states willingness to cooperate in order to impose common rules on the system' (Talani 2009, p. 34), it seems that this is not completely true. Rather, as Hay (2007, p. 259) states 'globalisation poses a series of problems for the nation state which it has never had the capacity to deal with'. As a result, the aforementioned interpretations clearly shows how is globalisation related to the lack of political capacity, to the subordination of politics to economics, to the related decline of the nation state and consequently to the instability of global financial markets.

**3.2. The Case of the Financial System**

As Wade (2009) states 'features of post 1970s world financial regime generate chronic financial instability'. Despite this, how is globalisation related to the post 1970s world financial regime? As stated above, the qualitative definition of globalisation is mainly connected to the post 1970s technological and financial transformation. By this way the global markets has been transformed into a unique arena where the financial instability is transmitted everywhere. Moreover, many could argue that the post 1970's world financial architecture, the neoliberal project or the so called Washington Consensus is responsible for the post 1970's global financial instability. The Washington Consensus adopts the idea that the economic growth is better achievable with lower inflation rates, healthier balances, market deregulations, limited government, privatization, programmes of structural adjustments and free trade. However, Strange (1994, p. 92) states that 'the market system may be more efficient and flexible and better adapted to change and innovation; but it is also apt to be more unstable. It suffers bankruptcies and bank failures. It experiences financial crises both national and international'. Under these conditions De Grauwe (2010, p. 5) believes that 'bubbles and crashes are endemic features of financial markets […] financial markets are incapable of regulating themselves'. As a result, in order to analyze how globalisation is related to the instability of global financial markets one should analyze the features of the neoliberal financial regime and the policies that have been developed the last 40 years that have created not only an unstable financial system but also an unregulated banking system.

One very important feature of the contemporary financial globalisation is the highly interconnected vulnerable financial system. According to Held, McGrew, Goldblatt and Perraton (2008, p. 235) the contemporary financial market is 'a highly institutionalized infrastructure such that twenty-four-hour real-time cross-border financial trading constitutes an evolving global financial market which generates significant systemic risks'. In this case, the volatility and systemic risks in global financial markets can easily be transferred from one market to another. The contagion effect was obvious during not only during the financial crisis that begun in 2007 but also in Mexico 1995-95, and Asian 1997-98. As a result, it could be argued that the features that differentiate the global financial era from the previous one like the extensity, intensity, complexity and speed of financial transactions are related with the instability of global financial markets.

It can also be argued that the aforementioned vulnerable financial system was the effect of the deregulatory neoliberal policies since the 1970s. As Helleiner (2007, p. 169) states 'the first step in a liberalizing direction took place when the British government encouraged the growth of the 'euro-market' in London'. Indeed, during the last forty years the deregulation of global financial markets, the removal of capital controls and the elimination of restrictions were responsible not only for the expansion of new financial products and instruments of international banking, international bonds, international equities, derivatives, and the new financial money markets but also for the highly vulnerable financial system (Held, McGrew, Goldblatt, and Perraton, 2008). At the same time that the global transactions were facilitated by significant technological changes, some scholars believed that the world was becoming flat (Friedman, 2005). However, at the same time many economies became more vulnerable because they borrowed huge amounts of money from abroad (Krugman, 2008). As Crouch (2008) said the encouragement of debt among people facilitated by the developments of financial products created an ever tougher and more unstable system. According to Roubini (2008, p. 45) 'in today's flat world, interdependence boosts growth across countries in good times but unfortunately, these trade and financial links also mean that an economic slowdown in one place can drag down everyone else'. Clearly, the liberalization and deregulation of the global financial markets, which was caused by financial globalisation, has diminished the state's authority and control on financial markets. Subsequently, it seems all these technological and market innovations like derivatives, options, and swaps are the endogenous deficiencies of the current global financial era that on the one hand increase economic growth but at the same time generate a more vulnerable system.

The deregulation of financial markets since 1970s gave also to the speculators the opportunity to intervene with capital flows in emerging countries (Grabel, 1995). In particular, as Woods (2005, p. 340) states 'the financial crisis in Asia highlighted the potential vulnerability of all countries to massive inflows and outflows of capital […] some states suffer the impact of globalization more than others'. As Strange (1997) argues the contemporary financial system looks like a casino where the players and speculators are able to use the stock exchange markets instead of roulette or poker. It could be argued that the globalisation of financial markets is accompanied with increasing role of speculators anywhere and anytime and at the same time the hedge funds was released without any control. However, as Krugman (2008) states in the long run the casino wins and the speculators loose and at the same time many speculative investments become boomerang. Moreover, their role is not only prominent but also devastating for entire countries. Furthermore, as Pauly (2007, p. 177) states 'the panic that moved rapidly in 1997 and 1998 from East Asia to Russia and Latin America and eventually to Wall street, vividly threatened the system itself'.

The speculators not only negatively affect the countries but also have a destabilizing effect for the whole of the neoliberal project.

Finally, it can be said that the most important feature of how globalisation is related to the instability of global financial markets is the vulnerability of the financial markets to the financial crises (Helleiner, 2007). As Soros (1997) put it the contemporary financial markets are inherently unstable and are liable to break down. In this context, without any doubt manias, panics and crashes are inherent elements of any contemporary financial market (Kindleberger, 1978). Subsequently, the financial bubbles are look like an irrational ponzi game (Shiller, 2000). As Krugman (2008) put it an eruptive vicious cycle of financial crises can be identified between the loss of trust, the economic problems in general and devaluation, increased interests rates and depression. Thus, the excessive optimism of economic actors is changed instantly to excessive pessimism. In particular, from July 2007 to July 2008 the stock prices dropped by 30%, destroying $3.5 trillion of value (De Grauwe, 2010). Besides, the direct global financial links between economic actors spill over not only the financial crises but also their devastating costs anywhere instantly. According to Pauly (2007, p. 186) these are 'unemployment, increasing taxes, personal despair and hopelessness, family breakdown, and rising crime rates'. As a result, it could be said that because of the globalisation not only financial crises and the global financial instability have become an inherent cyclic element of the financial markets but also the aforementioned costs are spilling over directly everywhere in the world.

### 3.3. The Case of the Banking System

During 1980s considerable reforms were noticed in the banking system worldwide. Moreover, De Grauwe (2010) argues that the efficient market paradigm was not only extremely influential but it provided to the bankers the excuse for more deregulations. Consequently, the new neoliberal remedies imposed further deregulations and consequently an independent and more vulnerable banking system was created. In this respect, the Glass-Steagall Act was cancelled in 1999. Hence, the financial risks increased considerably, the moral hazard diffused globally, and the new ambiguous and lazy financial and banking regime was unable to provide stability (Krugman, 2008). Indeed, according to Roubini (2008, p. 45) today in the United States there is 'a shadow banking system, made up of non-bank financial institutions that borrow cash or liquid investments in the near term, but lend or invest in the long term in non liquid forms'. This unregulated shadow banking system without any doubt has emerged on the basis of excessive risk-taking and it is the one of the major causes for the global financial instability (Orlowski, 2008). Unfortunately, it can be said that 'the deregulation of the banking sector that started in the 1980s fully exposed the banks to the endemic occurrence of bubbles and crashes in asset markets' (De Grauwe 2010, p. 11). As a result, it could be argued that the current globalisation era is related with a more deregulated-unregulated banking system which is more vulnerable to crises.

Despite this, one can argue that under these conditions in the era of globalisation the commercial and investment banks were allowed to act uncontrollably (De Grauwe, 2010). According to this 'double movement' commercial and investment banks 'built up a lethal combination of credit and liquidity risks' (De Grauwe 2010, p. 26). For instance, in 1984 Lehman Brothers invented the auction-rate security which where readjusted with an auction and its system collapsed in the beginning of 2008. In fact, there are many banking transactions that cannot be protected by the whether or not shadow banking system (Krugman, 2008). According to Geithner (2008) president of the Federal Bank of New York 'The scale of long-term risky and relatively illiquid assets financed by very short-term liabilities made many of the vehicles and institutions in this parallel financial system vulnerable to a classic type of run, but without the protections such as deposit insurance that the banking system has in place to reduce such risks'. As a result, it can be argued that globalisation's pressures created chaotic and dynamic banking system whose products and links are able to diffuse the instability even with or without regulations. Under these conditions the lack of a global central bank to control and regulate the financial operations is obvious (Strange, 1996).

### 3.4. The Case of Income Inequality and Distribution of the Wealth

In fact globalisation 'is associated with growing and uneven worldwide economic integration' (McGrew 2007, p. 221). In this context, globalisation is a phenomenon that has not been everywhere and by everybody to the same extent (Scholte, 2005). As Callinicos (2009, p. 205) believes the economic exclusion is not a situation that has erased during the last forty years and 'because uneven development is pervasive in contemporary capitalism, massive global economic poverty and inequality will persist'. Even though globalisation a positive impact on poverty and inequality, it seems that the neoliberal argument may be wrong (Wade, 2007). In this case, the growth of the US economy has released almost thirty million people under the minimum levels of hunger and poverty (Krugman, 2008). Accordingly, it can also be said that the financial crisis that begun in 2007 had also a direct considerable impact on the labour and employment rates worldwide (ILO, 2009). In this respect, it can be observed a decreasing support of globalisation not only in developing but also in developed countries. According to Wade (2009) this can be observed also in the United States because the share of the top 1% of United State's income increased from 7% in 1960's to nearly 20% the last decades. As Robert Wade (2009) believes the high and rising income inequality in the west but especially in the US is the second more important de-cause, a cause that exist outside the financial system, for the current global financial instability. Under these conditions he said, the relative economic weakening and the United States political polarization create a state that is unable to take the leadership in global economic governance. As a result, it can be argued that globalisation created the conditions under which none hegemonic power can provide stability not only to the global financial markets but also in global political arena.

## 4. CONCLUSION

In conclusion, from the aforementioned analysis it is clear that there are four different areas in which globalisation can influence the instability of global financial markets. Namely, these factors are the nation state, the financial and banking system and the income inequality and distribution of the wealth. In this context as Strange (1994, p. 92) has already stated by 'liberalizing the system of credit creation brought with it risks of greater financial and thus economic stability'. In this sense it can be said that the 'Unregulated financial markets carried the seeds of their own destruction' (De Grauwe 2010, p. 14). Even though globalisation has been confronted as an ideological construction, it could be said that its impact on the contemporary instability of financial markets is nonnegotiable. However, neither the refusal of globalisation as a phenomenon of the contemporary world helps to the understanding of the current episodes in the field of global political economy. This is not to say that the skeptical approaches are wrong. On the contrary, there are many theoretical explanations that offer us valuable alternative views. Under the aforementioned conditions, it is clear that the analysis and evaluation of how is globalisation related to the instability of financial markets is not as simple as it looks. There is a need to deepen our understanding for the above phenomenon that direct or indirect affect our way of living so easily.

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