Introduction to International Political Economy

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Fifth Edition

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PART IV Transnational Problems and Dilemmas

PREFACE

Even before we started working on this edition of the text, most of us felt as if a dark cloud had come over the world. Reading the international section of any major newspaper—a growing number of which have since gone bankrupt—it seemed as though the world was on the brink of a global catastrophe of one sort or another. What began as a combined banking and financial crisis in the United States in the fall of 2007 quickly spread into most industrialized and developing nations alike. As of December 2009, despite some claims that economic recovery was underway, the crisis continued to inflict severe social and even psychological damage on people the world over. Some experts and pundits expect yet another deep global recession—if not a second Great Depression. The November 2009 Copenhagen meeting on climate change produced another tepid agreement that signaled that generating economic growth, and with it carbon dioxide, was as yet a higher priority than addressing major environmental dilemmas, which some conclude may result in another global tragedy—one that may not be reversible.

Many people hoped that the election of Barack Obama as the first African-American president of the United States would bring about an improvement in economic conditions everywhere; thus far, little has seemed to change for the better. The IMF reports that many countries are suffering unemployment rates as high as they have ever been in the last forty years. Several G-8 and G-20 meetings to deal with the battered global economy have produced no consensus as to the nature of the problem or concrete strategies to deal with it. For many, global governance seems to have broken down at the same time that the dominant economic liberal ideology and policies associated with globalization have come under serious intellectual and political challenges. So far nothing has emerged to replace this popular ideology.

The war in Iraq continues, while the U.S.-led campaign against terrorism in Afghanistan has escalated and spread into Pakistan. Ethnic and religious conflicts persist in parts of the Middle East, South and Southeast Asia, and parts of Africa including Somalia, Sudan (especially Darfur), Congo, Kenya, and Ethiopia. Other growing sources of tension include control over weapons of mass destruction and strategic energy resources, poverty and the lack of economic development, growing numbers of political and economic refugees and immigrants, and increasing illicit economic activities.

In the summer of 2008, international oil price hikes contributed to a variety of major problems including yet another world food crisis that saw agricultural commodity and food prices skyrocket. While the U.S. real estate bubble was beginning to deflate, the number of seriously hungry and starving people in the world increased by at least 125 million, generating fears of another Malthusian nightmare of overpopulation, war, and global epidemics. For many, the Copenhagen talks in 2009 have generated hope for recovery of the earth's ecology and environment while generating new technologies and policies that support a "green" economic recovery.

How are we to understand this current historical juncture that appears to be on the verge of an abyss and that lacks a clear political, economic, and social order? Can states, international organizations, nongovernmental organizations, and global social movements effectively deal with the effects of hypermobile capital, balance the need to generate economic growth while not overtaxing the environment, and satisfy political and social demands peacefully? These are a few of the many questions we raise in this fifth edition of the text.

However, as has always been our major goal, we seek to provide both students and faculty with the tools necessary to delve deeper into many issues, develop their reflective thinking skills, and understand many of the theoretical and policy dynamics of the global political economy. Rather than profess one set of ideas or explanations, we offer a variety of different perspectives and views so that our readers will be able to form their own opinions about controversial issues. In this edition, however, each chapter concludes with a more critical edge to it than in past editions, which lays the foundation for students to assess and evaluate these issues for themselves.

NEW TO THIS EDITION

The fifth edition of the text is a major revision of more than 60 percent of the last edition. Most of the chapters contain extensive coverage of the connection of the global financial crisis to IPE theories, structures, and policy issues. Three completely new chapters have been written. Finally, Bradford Dillman is the new co-editor and co-author of the text. Professor Dillman specializes in illicit economies and the Middle East and North Africa (MENA), topics he wrote about in the last edition.

Here's what to look for by way of revision in the text:

- Chapter 1, "What is International Political Economy?" is a revised introductory chapter that shows students how IPE can help them understand the financial crisis. It updates and clarifies many of the concepts and ideas of IPE. Students are also introduced to the concept of globalization, which is now discussed throughout the book. The conclusion of the text in the fourth edition has been revised and appears in the conclusion of Chapter 1 in this edition. Instructors can assign it at any time during the term.
- Chapter 2 revises and extends coverage of economic liberalism to include how and why the current financial crisis has contributed to still more criticism of what has been the most popular IPE perspective since the early 1980s.
- Chapter 4, "Economic Determinism and Exploitation: The Structuralist Perspective," reframes and revises the presentation of Marxist and structuralist ideas and applies them to the global financial crisis.
- Chapter 5, "Alternative Perspectives on International Political Economy" significantly expands and updates the coverage of constructivist and feminist perspectives.
- Chapter 7, "The International Monetary and Finance Structure," includes a substantial revision and update of the changing economic structure, globalization, and the weakening U.S. dollar.
- Chapter 8, "International Debt and Financial Crises," includes detailed coverage of the Asian and current global financial crises.

- Chapter 10 offers significantly revised content and new perspectives on "The Knowledge and Technology Structure."
- Chapter 11, "The Development Conundrum: Choices Amidst Constraints" now includes an outline and discussion of development strategies that correspond to the three IPE perspectives.
- Chapter 13, "Moving into Position: The Rising Powers," is a new chapter on the rising powers of India, China, and the post-communist countries.
- Chapter 18, "Food and Hunger: Market Failure and Injustice," is also a completely revised chapter on food and hunger and the 2008 world food crisis.
- Chapter19, "Oil and Energy: Dependency and Resource Curses," has returned to the text based on reviewer request and focuses on oil in relation to resource scarcity and conflict.
- Chapter 20, "The Environment: Steering Away from Global Disaster," examines the controversy surrounding the issues of global warming and climate change, including the recent talks in Copenhagen.

FEATURES

While covering many of the "nuts and bolts" of IPE theories and issues, many of the chapters provide students with a historical context in which to understand the subject. More importantly, in contrast to other introductory texts, we challenge students to think critically when it comes to applying these theories to different issues and policy problems. Toward this goal, all chapters highlight more explicit connections between different IPE perspectives and policy issues.

As in previous editions, the book begins with five chapters designed to set out some basic tools for studying IPE. Chapter 1 introduces the fundamental elements of the subject and some recent developments in what has become a very popular field of study. We begin with relatively simple tools and concepts that deal with the nature of IPE—its subject boundaries, the three dominant IPE theories, four global structures, and the levels of analysis. In this edition, Chapter 1 includes a new section that discusses the major themes or "pillars" that connect the theories and subjects covered throughout the book. Thereafter, each chapter conclusion connects its material back to these central ideas. The conclusion of the text in the fourth edition has been revised and appears in the conclusion of Chapter 1 in this edition. Instructors can assign it at any time during the term.

Chapters 2, 3, and 4 explore the three dominant analytical approaches to studying IPE that reflect powerful forces in history and that remain influential today: mercantilism, economic liberalism, and structuralism. Chapter 5 introduces two important alternative perspectives (constructivism and feminism) to help students understand different IPE questions and events. Note that the rational choice material of the last edition is available to instructors and students online at the IPE textbook website at www.upugetsoundintroipe.com.

Part II of the text examines the web of relationships or structures that tie together a variety of international actors including nations and their citizens with international organizations, nongovernmental organizations, and other groups. Chapter 6 focuses on the production and international trade structure. Chapter 7 provides an outline of the international monetary and finance structure and problems, which in Chapter 8 are applied to Third World debt and the current global financial crisis. Chapter 9 focuses on a number of recent developments in the international security structure including shifts from national to individual security concerns and the possibility of a transition from a unipolar to a multipolar balance of power. Chapter 10 examines struggles among international actors over knowledge and technology, with particular attention to intellectual property rights.

In Part III, Chapter 11 examines the problem of development and some of the different strategies that many of the less developed countries have used to "grow" their economies and modernize their political institutions. It also serves as theoretical background for Chapter 12 dealing with the European Union where the experiment in regional integration has resulted in many tensions and transformations of markets, states, and societies. Chapter 13 is a new chapter that focuses on an array of issues associated with some of the postsocialist economies in general but India and China in particular as they try to transform and incorporate a bigger role for markets in their national political economies. Chapter 14 covers the Middle East and North Africa, regions fraught with what seem like insurmountable development and security problems.

Finally, in Part IV, as part of an effort to understand a number of important global problems and issues, Chapter 15 covers illicit activities involving trafficking of people, drugs, and other items. Chapter 16 examines the increasingly dynamic and problematic issue of the movement of people in the international political economy—in this case through tourism and migration. Chapter 17 examines the important role of transnational corporations in the international political economy. Chapters 18, 19, and 20 discuss the interconnections between global food, energy, and environmental problems, again employing many of the same analytical tools developed earlier in the book.

All the chapters end with a list of key terms that are in bold print in the chapter, discussion questions, and suggested readings. The recommended websites have also been transferred to the text website at **www.upugetsoundintroipe.com**, where they can be updated more often. The website will also include a list of recommended videos and documentaries faculty and students can use to gain more detailed background and ideas about different topics.

SUPPLEMENTS

Longman is pleased to offer several resources to qualified adopters of *Introduction to International Political Economy* and their students that will make teaching and learning from this book even more effective and enjoyable.

For Instructors

MyPoliSciKit Video Case Studies. Featuring video from major news sources and providing reporting and insight on recent world affairs, this DVD series helps instructors integrate current events into their courses by letting them use the clips as lecture launchers or discussion starters.

Instructor's Manual/Test Bank. This resource includes learning objectives, lecture outlines, multiple-choice questions, and essay questions for each chapter. Available exclusively at the Instructor Resource Center (IRC), an online hub that allows instructors to quickly download book-specific supplements. Please visit the IRC welcome page at **www.pearsonhighered.com/irc** to register for access.

For Students

MySearchLab Need help with a paper? MySearchLab saves time and improves results by offering start-to-finish guidance on the research/writing process and full-text access to academic journals and periodicals. To learn more, please visit www.mysearchlab.com or contact your Pearson representative. To order MySearchLab with this book, use ISBN 0205798616.

***Longman Atlas of World Issues* (0-321-22465-5).** Introduced and selected by Robert J. Art of Brandeis University and excerpted from the acclaimed Penguin Atlas Series, the Longman Atlas of World Issues is designed to help students understand the geography and major issues facing the world today, such as terrorism, debt, and HIV/AIDS. These thematic, full-color maps examine forces shaping politics today at a global level. Explanatory information accompanies each map to help students better grasp the concepts being shown and how they affect our world today. Available at no additional charge when packaged with this book.

Goode's World Atlas (0-321-65200-2) First published by Rand McNally in 1923, Goode's World Atlas has set the standard for college reference atlases. It features hundreds of physical, political, and thematic maps as well as graphs, tables, and a pronouncing index. Available at a discount when packaged with this book.

ACKNOWLEDGMENTS

This textbook is truly a cooperative effort. We would like to thank all of the people at Pearson Education who have been so helpful to us, including our editor Vikram Mukhija and editorial assistant Toni Magyar for their suggestions, and most of all for their patience throughout this process. We would like to thank University of Puget Sound Deans Kris Bartanen and Sarah Moore for funding student research assistance. We would also like to thank and recognize Professors Pierre Ly, Cynthia Howson, and Kristine Kalanges for providing valuable comments and suggestions in this edition of the text. Nazir Olangian, Elizabeth Butt, Kirsten Schlewitz, Georgina Allen, Rahul Madhavan, Ryan Cunningham, Jess Martin, Drew Cameron, and Dave Peters did research and/or provided editorial assistance on various chapters of the text. A number of people in our local communities supported us every day by way of amenities and encouragement: Jill Killen, Elthea Karr, and the gang at Cloud City Coffee in Seattle; Tom Stevens for use of the Rum Shack where Dave and Beau could work in peace; and Paul Rudnick, Ed Jones, Oscar Velasco-Schmitz, Bill Hochberg, John Domer, *sensei* Joe Blenis, Josh Woodfin, and Roberta Melcore, who engaged us in provocative discussions and introspection along the way. And we could not have written this book without the many ideas, critiques, and feedback of our IPE students at the University of Puget Sound.

Finally, Dave would like to thank his sons David Erin and Brendan for their comments and support, and his wife, Kristi Hendrickson, for her editorial assistance, patience, and loving support throughout the project. Brad would like to thank Joanne, Harry, and Noelle for their incredible patience, encouragement, and love.

Our thanks, also, to the reviewers: Olufemi Babarinde, Thunderbird School of Global Management; Jill Crystal, Auburn University; Anthony Gadzey, Auburn University; Julie George, Queens College City University of New York; John Liscano, Napa Valley Community College; Joel Ostrow, Benedictine University; Raju Parakkal, Florida International University; Mark Rupert, Syracuse University; Houman Sadri, University of Central Florida; Mitchell P. Smith, University of Oklahoma; and Stephen Twing, Frostburg State University.

We dedicate this edition of the text to all those people everywhere who have suffered and lost so much because of the global financial crisis. We also dedicate it to Professor Michael J. Carey, formerly of Loyola-Marymount University in Los Angeles, who left this world in the summer of 2009. Dedicated teacher, true friend, author, poet, critic, measured cynic, and ally (he'd like that word) of the University of Puget Sound IPE program, Mike read and critiqued many of the chapters in all editions of this text. More importantly, he stood for the values and ideals we hope this book will contribute to in the development of the lives of students who read it.

DAVID N. BALAAM
AND BRADFORD L. DILLMAN
SEATTLE AND TACOMA, WASHINGTON

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Introduction to International Political Economy

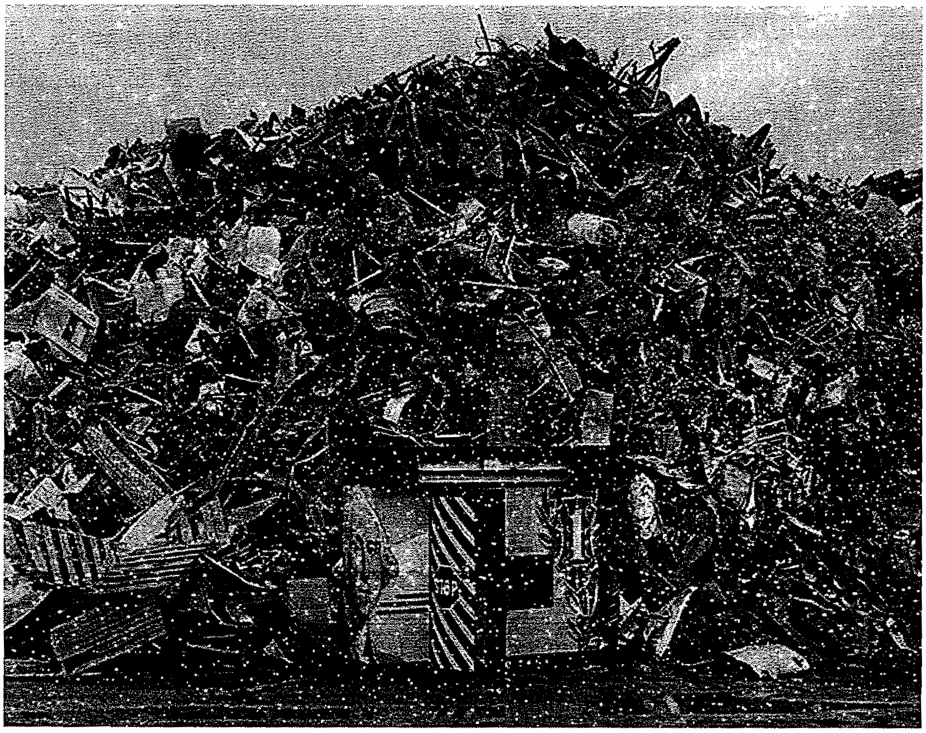
PART I

Perspectives on International Political Economy

The first chapter of the text deals with the fundamental nature of international political economy (IPE) and some analytical issues related to its multidimensional character. Chapters 2 through 4 are the core chapters of the text that explore the history and policies associated with the three dominant IPE perspectives, namely economic liberalism, mercantilism, and structuralism. These theoretical tools are useful in understanding many of the political, economic, and social issues in the global economy of the past as well as the present. Chapter 5 develops two alternative IPE perspectives—constructivism and feminism—that derive, in part, from the three main outlooks under study.

CHAPTER 1

What is International Political Economy?



What it all comes down to.

Chris Jordan

When a philosopher has once laid hold of a favorite principle, which perhaps accounts for many natural effects, he extends the same principle over the whole creation, and reduces to it every phenomenon, through by the most violent and absurd reasoning. Our own mind being narrow and contracted, we cannot extend our conception to the variety and extent of nature . . .

David Hume, "The Sceptic"

THE DARKNESS ON THE EDGE OF TOWN

What are the chances you will find a good paying job —or any job for that matter— when you graduate from college in the next few years? Have your folks lost their jobs, the family home, or a big chunk of their retirement savings? How are you adjusting to the current financial crisis that started in 2007? Forced to cut spending on clothes, vacation, or dinners out with your friends? Or, maybe things haven't been that bad for you, yet! Whatever your situation, are you confused when you hear the words *hedge fund*, *debt swap*, *CDO*, *subprime mortgage*, *AIG*, *Bear Stearns*, *Goldman Sachs*, *Wall Street vs. Main Street*, *the TARP*, *the G-20*, and *the IMF*? When the names *Milton Friedman*, *John Maynard Keynes*, *Timothy Geitner*, *Larry Summers*, or even *Bernie Madoff* are mentioned, do you know the role of these individuals in the financial crisis?

As we write in the fall of 2009, the world is in the grip of a severe global financial crisis brought on when some of the world's biggest banks and financial institutions went bankrupt. Reading the headlines of any major newspaper—a growing number of which have closed their doors—has left many wondering if the world is on the brink of some sort of global economic catastrophe, if not a second Great Depression. The U.S. banking and financial crisis that began in September of 2007 has spread throughout most developed and developing nations. The effects of the global financial crisis have made many people feel tense, fearful, and depressed.

The financial crisis is alleged to have contributed to

- massive numbers of mortgage defaults and the failure of many major banks and financial institutions all over the world (see Chapter 8).
- high unemployment rates in most countries.
- growing demand for trade protectionist measures in states (see Chapter 6).
- undermining of development gains in poor countries, many of whom are questioning the economic liberal development strategies promoted by the industrialized nations (see Chapter 11).
- intensification of ethnic, religious, and class conflicts in many parts of the Middle East, South and Southeast Asia, and Africa (see Chapter 9).
- conflicts between many states over issues like food and hunger, energy, and environmental protection (see Chapters 18–20).
- severe weakening of the humanitarian efforts of many international organizations (IOs) and nongovernmental organizations (NGOs) (see Chapters 9, 11, 19, and 20).
- acceleration of migration within states and immigration between states (see Chapter 16).
- delaying investment in alternative energy resources (see Chapter 19).

The International Monetary Fund (IMF) reports that the advanced countries are already in a deep recession. In the United States alone, the unemployment rate reached over 10 percent, or 15 million people without a job. Economic growth has also slowed in most industrialized nations but declined rapidly in Brazil, Russia, and a number of countries in Southeast Asia and Latin America. The economy is beginning to recover in China, but many states have lost the capacity to earn income by exporting goods because consumers have less money to spend on purchasing imports, and their countries are raising trade barriers to protect their own producers.

People the world over have lost their homes and welfare benefits because of unemployment and have been forced to move in with family or friends. Many lost their medical insurance or pension funds, or have delayed their retirement. In many countries, the crisis has reduced funds in local government treasuries, resulting in dramatic cuts in local health care, education, police, and social services. These trends have also heightened concerns about terrorism, poverty, inequality, famine, immigration, HIV/AIDS and other diseases, and increased energy and environmental problems. In China and many other developing countries, thousands of industries closed down, driving many workers back to the countryside they had left to escape poverty.

Since the last edition of this text, the events surrounding the latest financial crisis have become even more monumental than the end of the Cold War in 1990 or the 9/11 attacks on the New York Twin Towers and the Pentagon. While the 9/11 attacks certainly caused a good deal of fear around the world, the current crisis has penetrated much deeper into most societies, transforming economies and lives in unexpected ways. Despite the measures adopted by officials to deal with the crisis, many still fear that the current "deep recession" could easily turn into a second Great Depression. As the first Great Depression did in 1929 when the New York stock market crashed, the current financial crisis has undermined people's trust and confidence in national and international political institutions that have promoted capitalism and democracy.

It is no wonder that the current crisis has generated a fierce debate about its primary causes, potential solutions, and the implications it has for the future global political economy. Each of these aspects of the crisis centers on the interrelationship of the state, market, and society in different nations. One of the arguments we make in this edition of the text is that to adequately describe, explain, and understand the current global financial crisis—or any of the other issues covered in the different chapters—we must use an analytical approach that synthesizes methods and insights derived from economics, political science, and sociology as conditioned by an understanding of history and philosophy.

As discussed in more detail below, the IPE method is an attempt to synthesize analytical elements of separate academic disciplines to better explain complex, real-world problems that span physical and intellectual boundaries. While this statement might sound a bit formal and confusing at this point, keep in mind that we do not think you need to be an economics major or a finance expert to understand the basic parameters of the current global financial crisis and what it means for your future. This book is written for students who have almost no background in political science, economics, or sociology, as well as for those who want to review an assortment of topics in preparation for graduate school.

In the next section, as a warm-up to more details about the financial crisis later in the book, we briefly outline and discuss basic developments that set off the crisis. We will then examine the issue of how to study IPE—its three distinct analytical perspectives and a number of methodological issues with which IPE students should become acquainted. All the chapters in the book cover a variety of important theoretical and policy issues that have connections to the financial crisis. In this way we hope to provide students with the tools they need to study these and similar issues now and in the future, so that they might better understand different dimensions of the problems and then make some reasoned judgments about how to solve them.

Later in this chapter, we define and discuss the popular phenomenon of globalization as a way to introduce students to many of the political-economic conditions that led up to the global financial crisis. Many IPE experts have asserted that the economic liberal ideas behind globalization (discussed below) may have contributed to the crisis. Likewise, opinions differ, however, on whether or not the crisis may signal the end of laissez-faire economic liberal ideas and policies associated with globalization, or even the end of capitalism itself.

We then outline the text's 13 major themes and preview the topics covered in the book. Finally, we conclude with a brief discussion of what we feel are some of the most important ideas to take away from the book. Instructors may want to have their students read one or both of the last two sections of this chapter now or come back to either of them later in the class.

THE MAGIC OF THE MARKET?—OR—POOF, YOU'RE A GONER!

In 2001 the dot-com bust in the United States had captured headlines when a large number of hi-tech firms went broke almost overnight. In late summer of 2008, most people worldwide were caught off guard when another economic bubble burst. This time it was some of the world's most reputable "big" banks and investment institutions who found themselves on the verge of collapse, taking a big chunk out of the value of many people's retirement funds and other investments. Banks such as Morgan Chase, Bank of America, and Wells Fargo soon merged with other banks, while Lehman Brothers, Bear Stearns, Merrill Lynch, and Wachovia fell by the wayside. The global insurance firm American Insurance Group (AIG) was also on the verge of bankruptcy, which threatened to leave most big banks without financial protection. The financial crisis quickly spread into most developed and developing nations, generating what many regard as the worst financial crisis the world has seen since the Great Depression of the 1930s.

Why did so many banks fail so quickly? The answers are many and complicated (and covered in more detail in Chapters 2 and 8). Many people point to the connection between overvalued U.S. homes and bank failure as the main source of the problem. In the 1990s, many mortgage companies and big banks that dominated the New York Stock Exchange adopted a variety of programs to attract new home-buyers into the fast-growing home real estate markets. In an environment of increasingly relaxed banking regulations, some companies created new "exotic" loan products such as ARMs (adjustable rate mortgages), "interest only" mortgages, and loans with "teaser rates" to attract first-time buyers and especially those who otherwise might not have been able to purchase a home (so-called **NINJAs**—people with no income, no jobs, and no assets).

Many critics also charge that the lack of state regulation during a period of a laissez-faire outlook about the state's role in the economy (see Chapter 2) made it easy for loan agents to *intentionally* sign up mortgage customers they knew would have difficulty making their monthly mortgage payments. Lenders were often less interested in the qualifications of the borrower than in "making the deal" to collect lucrative sign-up fees and improve the bank's rating in the eyes of investors. Moreover, many borrowers believed that as the economy continued to grow, the market value on homes would increase and they would be in a better position to borrow against the increased future value of their houses. Later when they "refinanced" their homes at a higher market value, they might also obtain a lower interest rate, which would allow them to pocket the difference between the new value of the home and what they owed on it under the old loan. With their "profit," they could pay off credit cards, take trips, buy more expensive cars, or save for their kids' college education.

These practices led to higher home values, which then fed growing speculation in housing and real estate markets. While the United States spearheaded this movement, it gradually caught on and became a part of many Western and Eastern European economic development policies. Speculation by developers and foreign investors translated into increased demand for U.S., British, Spanish, Irish, Icelandic, Lithuanian, Estonian, and other assests throughout the world.

Things got messy and opaque when banks and lenders packaged risky home loans in bundles and then resold them as **securities** (something whose value is protected against a loss in value) to other banks, **hedge funds**, and foreign financial institutions. Investors throughout the international financial system saw these securities as good investments with the potential for high returns. But these complex financial instruments (often referred to as "innovations") concealed the weakness of many of the underlying mortgages that made up the securities. All the money chasing these securities and other kinds of investments derived from them increased the market value of real estate, which led global investors to believe (mistakenly) that their assets were safe and a "can't lose" bet.

Whatever Goes Up Must Come Down!

Eventually it became clear that many of the assets owned by investors were overvalued, and as everyone tried to sell, the market was flooded with overvalued "toxic assets," which further drove down home values in a negative feedback loop. By September 2008, most of the big banks had billions of dollars worth of toxic assets in mainly home mortgages on their books. Likewise, many of them were overleveraged—loaning out more money than they had in reserves to cover their loans. As conditions worsened, investors simply voted with their feet, either withdrawing from the market or seeking more secure ventures elsewhere. Meanwhile big banks were no longer willing to loan to one another, or to "main street" banks—those in local neighborhoods—that routinely loan capital to small businesses. Local businesses began downsizing or shutting the door for good. You have probably seen many of these places in your neighborhood.

As the crisis worsened in the United States, it spread elsewhere because big banks had become so interconnected (interdependent) with other banks in the major industrialized nations. Manufacturers and service providers started laying off or firing large numbers of people. As personal incomes dropped, consumers cut spending significantly. Declines in tax revenues meant that local governments had to cut spending on schools and social services. One out of ten homeowners in the United States could not make payments on their homes. Mortgage and bank defaults rose to record levels in England, Ireland, Iceland, Italy, and Eastern Europe. Many banks were stuck with properties they were forced to auction off at huge losses. Under these circumstances, most of the big banks could not borrow enough capital to make loans for new borrowers, which led to the depreciation in their credit ratings.

What had started as a home mortgage crisis in the United States morphed into a *global* financial (credit) crisis where capital became scarce when big banks refused to loan to almost anyone, for any reason. The Bush and the new Obama administrations both believed that if the U.S. government failed to do something, the global financial system would suffer a total meltdown, resulting in a deep, drawn-out recession or depression. With the United States' encouragement, many states did adopt a variety of measures—so-called "stimulus" packages—to restart their economies. These rescue packages fly in the face of many of the ideas associated with the popular economic liberal ideology that has shaped state–market relations since the early 1980s (discussed below and in Chapter 2). They also angered many ordinary folks who felt that the bailouts rewarded the very same financial elites who caused the crisis in the first place.

In the next few chapters (and in Chapter 8) we will encounter more discussion of the current financial crisis. Other factors such as greed, corruption, and even economic liberalism have been put forward as causes of the crisis. Many have questioned the appropriateness of the U.S. "wildcat" version of capitalism—and even capitalism itself. Some critics claim that the principles and policies that produced this shadow of darkness that has beset the world are, paradoxically, the very same principles and policies that policy makers are trying to preserve through economic recovery programs.

THE WHAT, WHY, AND HOW OF IPE

Our discussion of the financial crisis and its consequences makes clear that today's complex issues can no longer be easily described, analyzed, and understood by using any *single* set of disciplinary methods and concepts. Those who study IPE are, in essence, breaking down the analytical and conceptual boundaries between politics, economics, and sociology to produce a unique explanatory framework. Below are several examples of how traditional academic disciplines might try to explain the world financial crisis by focusing on different actors and interests:

- *International Relations:* How much has the financial crisis detracted from the ability of states to pay for military defense? How has the crisis affected the conditions of war or terrorism in weaker or poor states?
- *International Economics:* How has the crisis impacted foreign investment, international trade, and the values of different currencies?
- *Comparative Politics:* What is the capability of political institutions within different nations to respond to the needs of the unemployed, elderly, or poor?
- *Sociology:* What is the impact of the crisis on consumption trends for different groups such as the wealthy, middle class, labor, or the poor?

- *Anthropology:* How have different societies in history dealt with crises related to how they allocate scarce resources? And how have these crises impacted their cultures, values, and societal norms?

Scholars from different disciplines who focus on a narrow range of methods and issues enhance intellectual specialization and the analytical efficiency that goes with it. But each discipline offers an *incomplete* explanation of global events. Specialization promotes a sort of scholarly blindness or distorted view that comes from using one set of analytical methods and concepts to explain what most decidely is a complex problem that could benefit from analysis offered by a multi-disciplinary perspective.

What is International Political Economy (IPE)?

When defining IPE, we first make a distinction between the term "international political economy" and the acronym IPE. The former refers to what we study—commonly referred to as a *subject area* or field of inquiry that involves tensions amongst a variety of state, market, and societal actors and institutions. In this text we tend to focus on a variety of either "international" (between or among nation-states) or "transnational" (across the national borders of two or more states) actors and issues. Increasingly today, however, instead of *international political economy* more analysts use the term "global political economy" to explain problems such as AIDS or hunger that have spread over the entire world, and not just a few nations. In this book, we often use these two terms interchangeably.

Second, the acronym IPE connotes a *method of inquiry* that is multidisciplinary. IPE fashions the tools of analysis of its antecedent disciplines so as to be able to more accurately describe and explain the ever-changing relationships between states, markets, and societies across history and in different geographical areas. What are some of the central elements of the antecedent fields of study that contribute to what we refer to as IPE? First, IPE includes a *political* dimension that accounts for the use of power by a variety of actors including individuals, domestic groups, states (acting as single units), international organizations, NGOs, and transnational corporations (TNCs). All these actors make decisions about the distribution of tangible things such as taxes or intangible things such as security. In almost all cases, politics also involves the making of *rules* pertaining to *how* states and societies achieve their goals. Another aspect of politics is the kind of public and private, formal and informal, *institutions* that have the authority to pursue different goals. These institutions vary from country to country and region to region within states, and from group to group in different societies.

Politics also puts a good deal of emphasis on how much *power* actors have to attain a variety of goals, many of which conflict with those of other actors. Many international relations theorists view the international system as exhibiting a potential state of anarchy or war at any time. In Chapter 9 we examine some of the instruments such as military weapons and economic leverage that states often use to help secure themselves in a world where security cannot be guaranteed by any political actor.

Second, IPE involves an *economic* dimension that deals with how scarce resources are distributed among individuals, groups, and nation-states. A variety of public and private institutions routinely allocate resources on a day-to-day basis in local markets where we shop. Today, markets are not just a place where people go to buy or exchange something face-to-face with the product's maker. The market can also be thought of as a *driving force* that shapes human behavior when consumers spend their money or invest in something. These depersonalized transactions are part of what has become a sophisticated global economy that links trading on stock exchanges with other economic activities all over the world. Charles Lindblom also makes an interesting case that the economy is actually nothing more than a system for coordinating social behavior! What people eat, their occupation, and even what they do when not working are all organized around different agricultural, labor, and relaxation markets. In effect, markets often perform a social "coordinating without a coordinator" function.[1]

Third, the work of such notables as Robert Heilbroner, Lester Thurow, and Charles Lindblom helps us realize that IPE does *not* reflect enough the *societal* dimension of different international problems.[2] A growing number of IPE scholars argue that states and markets do not exist in a social vacuum. There are usually many different social groups *within* a state that share an identity, norms, behaviors, and associations based on tribal ties, ethnicity, religion, or gender. Likewise, a variety of transnational groups (referred to as **global civil society**) have interests that cut *across* national boundaries. A host of NGOs have attempted to pressure local, national, and international organizations on issues such as climate change, refugees, migrant workers, and gender-based exploitation. All of these groups are purveyors of ideas that potentially generate tensions between them and other groups but that play a major role in shaping global social, political, and economic behavior.

How to Study IPE: Contrasting Perspectives and Methodologies

The three dominant perspective of IPE are mercantilism, economic liberalism, and structuralism. Each perspective focuses on the relationships between a variety of political, economic, and social actors and institutions. A strict distinction between these institutions is quite arbitrary and has been imposed by disciplinary tradition, at times making it difficult to appreciate their connections to one another. Each perspective emphasizes different values, actors, and solutions to policy problems but also obscures some important elements highlighted by the other two perspectives.

Economic liberalism (particularly "neoliberalism"—see Chapter 2) is most closely associated with the study of markets and the rational behavior of different actors within them. A major concern for all economic liberals is the state's role in the market and other parts of the economy. Later we will explain why there is an increasing gap between **orthodox economic liberals** (OELs), who champion free markets and free trade, and **heterodox interventionist liberals** (HILs), who support more state regulation and trade protection to sustain the market. Increasingly, HILs have stressed that markets work best when they are embedded in (connected to) society and when the state intervenes to resolve problems that markets alone cannot handle. In fact, many HILs acknowledge that markets are the *source* of many of these problems.

As we discuss in Chapter 2, many liberal values and ideas are the ideological foundation of globalism and the globalization campaign. They are derived from notable thinkers such as Adam Smith, David Ricardo, John Maynard Keynes, Friedrich Hayek, and Milton Friedman. The so-called laissez-faire principle that the state should leave the economy alone is attributed to Adam Smith in his famous book *The Wealth of Nations.*[3] More recently, liberal ideas have been associated with former President Ronald Reagan and his acolytes, who contended that economic growth is best achieved when the state severely limits its involvement (interference) in the economy.

Under pure market conditions (i.e., the absence of state intervention or social influences), people are assumed to behave rationally (see Chapter 2). That is, they will naturally seek to maximize their gains and limit their losses by producing and selling things. This desire to exchange is a strong motive behind their behavior, along with pressure to generate wealth by competing with others for sales in local and international markets. According to OELs, people *should* strongly value *economic efficiency,* the ability to use and distribute resources effectively and with little waste. Why is efficiency so important? Efficiency requires that society's scarce resources be put to their best use. When an economy is inefficient, scarce resources go unused or could be used in other ways that would be more beneficial to society such as in support of education and health care. This idea has been applied to the new global economy and is one of the basic principles behind globalization.

Mercantilism (also called economic nationalism) is most closely associated with political science, and especially the political philosophy of **Realism,** which focuses on state efforts to accumulate wealth and power to protect its society from physical harm or the influence of other states (see Chapters 3 and 9). In theory, the state is a legal entity and an autonomous system of institutions that governs a specific geographic territory and population or "nation." Since the mid-seventeenth century, the state has been the dominant actor in the international community based on the principle that it has the authority to exercise **sovereignty** (final authority) over its own affairs.

States use two types of power to protect themselves. **Hard power** refers to tangible military and economic assets employed to compel, coerce, influence, fend off, or defeat enemies and other competitors. **Soft power** is comprised of selective tools that reflect and project a country's cultural values, beliefs, and ideals. These instruments include films, cultural exports and exchanges, information, and diplomacy that convince others that the ideas you sponsor are legitimate and are the ones you want them to share and adopt. Soft power can in many ways be more effective than hard power because soft power rests on persuasion and mutual exchange.[4] For example, Nobel Peace Prize recipient Barack Obama orchestrated a resurgence in public support for the United States in the rest of the world through a discourse emphasizing multilateral cooperation.

Structuralism is rooted in Marxist analysis but not limited to it (see Chapter 4). It looks at IPE issues mainly in terms of how different class segments of society are shaped by the dominant *economic* structure. It is most closely associated with the methods of analysis employed by many sociologists. Structuralists emphasize that markets have never existed in a social vacuum. Some combination of social, economic, and political forces establishes, regulates, and preserves them, and as we will see in the case of the financial crisis, even the standards used to judge the effectiveness of markets and market systems reflect the dominant values and beliefs of those forces.

The Benefits of IPE

Each perspective in IPE acts like a lens that focuses on different actors, issues, and developments in the global political economy. Each viewpoint always sheds light on some aspects of a problem particularly well, but casts a shadow on other important aspects. By using a *combination* of the three dominant IPE methods and concepts (outlined in Table 1-1 below), we can move to the "big picture"—the most comprehensive and compelling explanation of global processes and patterns.

Not surprisingly, an analytical problem arises out of an attempt to mix together the three different disciplinary perspectives. Because each discipline has its own set of analytical concepts, core beliefs, values, and methodologies, the analytical boundaries between economics, politics, and sociology make it difficult to establish a *single* explanation to any IPE problem. Does this weaken the utility of IPE? Not at all!

We must recognize that IPE is not a "hard science"; it may never establish a comprehensive theory with easily testable propositions about cause and effect. The world is a messy laboratory. Social science has always reflected this in its explanations of human behavior. IPE today represents an effort to *return* to the kind of analysis done by political theorists and social scientists *before* the study of human social behavior became fragmented into the discrete fields of political science, economics, and sociology. Both Adam Smith and Karl Marx, for example, considered themselves to be political-economists in the broadest sense of the term. One of our goals is to point out ways in which by mixing the elements of different disciplines we are better able to explain different aspects of the global political economy.

One of the ways of doing this is to think of the antecedent disciplines of IPE as tall grain silos standing very near to one another. Since the end of the Cold War in particular, these silos have been leaning into one another and sloshing their grain together. Just as new varieties of plants are produced by splicing parts of them together, the mixing of disciplinary grains has produced a productive and powerful hybrid field of study called IPE.

So what does the new mixture look like? To help answer this question, Susan Strange suggests that we focus on a number of common analytical and conceptual issues that cut across disciplinary boundaries. For her, the starting point for mixing states, markets, and society is to focus on the question of *qui bono?*: Who benefits from complex interactions in the international political economy? In a complementary fashion, we can follow the example of Pietra Rivoli in her book *The Travels of a T-Shirt in the Global Economy* and conduct a "commodity chain" study.[5] Rivoli traces a t-shirt from the time the cotton in it is grown in West Texas, to textile manufacturing in China, to sales in the United States, and then on to Africa, where many donated t-shirts end up as goods sold cheaply in local markets. Her work examines the *process* by which her husband's favorite

TABLE 1-1

Conflicting Political Economic Perspectives about State–Market Relations in Capitalist Societies

	Monetarism (Orthodox Economic Liberals)	Keynesian (Heterodox Interventionist Economic Liberals)	Developmental State Model (Mercantilism)	Socialism (Structuralism)	Social Democracy (Structuralism)
Main Ideas about Capitalism	"Laissez-faire"; minimal state intervention and regulation of the economy	The state primes (injects money—liquidity) into the economy to restore confidence in it and to stabilize it	The state plays a proactive role in the economy to guide and protect its major industries	The state controls (is?) the economy. Prices set by state officials. Emphasis on state planning and agenda setting	The government cooperates with businesses to promote economic growth and distribution
Values	Economic efficiency, technology, open and integrated international markets, globalization	Efficiency mixed with a variety of state political and social objectives	National security, state-managed economy, relative equality	Equality	Equity and relative equality
Thinkers	Adam Smith, David Ricardo, Friedrich Hayek, Milton Friedman, "the Chicago School"	John Stuart Mills, John Maynard Keynes, Robert Reich, Joseph Stiglitz, Dani Rodrik, Jeff Sachs	Friedrich List, Alexander Hamilton, Ha-Joon Chang	Karl Marx, Vladimir Lenin, Mao Zedong, Fidel Castro	James Galbraith, Robert Kuttner
Policy Tools	Preferably few. Monetary and fiscal policies necessary at times to help market function well. Free trade	States use monetary and fiscal policies. Promote "fair trade" policies that include some protectionist measures	Protectionist industrial and trade policies oftentimes necessary to make markets work and enhance national wealth and welfare	Monetary, fiscal, and fair trade policies that redistribute income to everyone in society	States use monetary and fiscal policies to redistribute income
Trade Policy Experts	Doug Irwin, Martin Wolf	Deepak Lal, Jagdish Bhagwati	Ha-Joon Chang	Walden Bello, Benjamin Barber	Amartya Sen
State Examples	Hong Kong, U.S., Great Britain	Germany, India, Mexico	Japan, South Korea	Former East Germany, China before 1982	Sweden

t-shirt is made, transported, marketed, and then resold. In so doing she raises many issues that involve politics (the power of special interest groups to affect production and trade rules), markets (for t-shirts in the United States and all over the world), and different societies (how t-shirt manufacturing has changed the lives of factory workers in China and small African businessmen). Rivoli documents her work with plenty of hard evidence and raises a variety of ethical and human rights questions.

We believe that Strange and Rivoli offer two very good ways for students to start to think about the nature and different dimensions of IPE. It is not sufficient to just examine and explain something from several different angles or perspectives. We must also key in on who benefits or loses from the processes we observe; how actors acquire and use their political power and economic resources; and the relationships between different groups in different societies.

IPE gives students the freedom to select an analytical approach or combination of approaches they feel best suits a particular issue. It is important to note that most of the time the way one explains a problem depends on the questions asked about it, the data available, and the theoretical or ideological outlook of the analyst herself. Benjamin J. Cohen, for example, sheds light on this issue in his discussion of the "transatlantic divide" between the way scholars in the United States and Great Britain tend to view IPE.[6] U.S. universities tend to prefer IPE theories organized around issues of causation. Emphasis is placed on asking questions for which there is "hard" data. The goal is to test theories with statistical techniques and empirical evidence to determine what causes particular "pattern of relations." However, many British schools tend to think of IPE in terms of problems that are not as easy to quantify or for which statistical tests are not very useful. Their methods are rooted more in historical and philosophical understanding and centered on normative issues such as ethics, equity, and social justice.

In conclusion of this section, we can say then that IPE attempts to blend together distinct perspectives to produce a more holistic explanation of something. It is more flexible than most disciplines because it asks the analyst to choose why and how something should be studied and with what tools. Hopefully, with a multidimensional outlook we can conduct better analysis that may result in better and more effective solutions to global problems.

The Four Levels of Analysis

When it comes to explaining issues, IPE theorists have applied the concept of the **level of analysis** to their research. In his famous book on the causes of war, *Man, the State, and War,*[7] Kenneth Waltz argues that explanations for causes of international conflict are located on different stages of an *analytical scale of increasing complexity,* ranging from individual behavior and choices (the individual level), to factors within states (the state/societal level), to something stemming from the interconnection of states (the interstate level). More recently, many have argued that there is also a fourth global level that account for such factors as globalization (discussed below) that can also be identified as causing specific problems.

The characteristics of the different levels of analysis are as follows:

> *The Global Level.* This is the broadest, most comprehensive level of analysis. Explanations focus on how important global factors like changes in technology, commodity prices, and climate, for example, create constraints on and opportunities for *all* governments and societies.
>
> *The Interstate Level.* This level emphasizes how the relative balance of political, military, and economic power *between* states affects the probablity of war, prospects for cooperation, rules related to transnational corporations, or the ways in which governments exercise leverage over their allies and states with mutual interests.
>
> *The State/Societal Level.* Paradoxically, because the focus *narrows* to factors within states, explanations contain *more* description and explantory factors. At this level, we emphasize how lobbying by socio-economic groups, electoral pressures, and culture influence the foreign policies of countries. In addition, we focus on how different types of governments and decision-making processes *within* a state shape the way that the state interacts with others. For example, these factors help explain why some countries are highly protectionist or why democracies almost never go to war against other democracies.
>
> *The Individual Level.* This is the *narrowest* level and yet it contains the *biggest* number of factors that explain why individuals (usually state leaders) choose certain policies or behave in particular ways. This level emphasizes the *psychology* and *choices* made by policy makers. For example, we might speculate that French President Nicolas Sarkozy tends to not go along with G-20 recommendations to deal with the financial crisis because as French presidents are want to do, he is suspicious that Great Britain and Germany will benefit from them at France's expense. Or, in terms of his *personality,* Sarkozy does not like to be upstaged in front of other European leaders.

The four levels of analysis help us *organize* our thoughts about the different causes of, explanations for, and solutions to a particular problem. Like the three IPE perspectives, *each* level pinpoints a distinct but *limited* explanation for why something occurred. For example, global warming can be linked as much to U.S. resistance to the Kyoto Treaty as to the ineluctably rising demand for energy due to a rising global population. Thus, one of the paradoxes of the level of analysis problem is that to get a *bigger and more complex picture* of a problem, one is tempted to look at all the levels for possible answers. However, mixing the levels usually produces no *single* satisfactory answer to a problem. What to do? The level of analysis problem teaches us that in order to arrive at a satisfactory explanation, students and researchers must be very conscientious when it comes to how they frame questions, what data they look at, and what they *expect* to find.

Figure 1-1 highlights the four levels of analysis and their connection to another conceptual organizing device we deal with next.

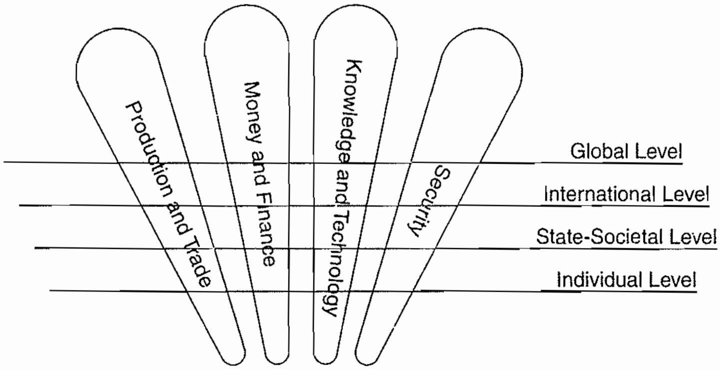


FIGURE 1-1
The Levels of Analysis and Four Structures.

Susan Strange's Four IPE Structures

In the text we will often refer to Susan Strange's four *structures* of production and trade, security, money and finance, and knowledge and technology. For Strange, these "networks," configurations, or "webs" are complex arrangements that function as the *underlying foundations* of the international political economy. Each contains a number of state and nonstate institutions, organizations, and other actors who determine the rules and processes that govern access to trade, finance, knowledge, and security.

The "rules of the game" in each structure take the form of signed conventions, informal and formal agreements, or "bargains." They act as girders and trusses that hold together each of these four major structures. As one might expect, each IPE structure is often filled with tension because different actors are constantly trying to preserve, challenge, or change the rules of the structure to better reflect their own interests, points of view, or values. For example, at times the outlook of actors in production and trade may be more economic liberal oriented whereas at other times more protectionist.

Finally, issues in one structure often impact issues in another, often generating a good deal of tension and even conflict between a wide range of actors. According to Strange, much of the tension in these structures is related to trying to "shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises . . . (and) people have to operate."[8] In our discussion of the four structures below, you can see examples of how these structures connect to the levels of analysis discussed above. We have pinpointed in brackets the causal factors and forces at different levels.

The four **IPE structures** are as follows:

The Security Structure. Feeling safe from the threats and actions of other states and nonstate actors is perhaps the most basic human need. At the global level, the security structure is comprised of those persons, states, international organizations, and NGOs that contribute to or provide safety for all people everywhere. In Chapter 9 we will see why many experts claim that the demise of the Soviet Union and the end of the Cold War [*interstate level changes*] led to an *increase* in the number of small conventional wars *between* states along with insurgencies *within* nations, especially in developing nations. The 9/11 attacks on the New York Trade Center also led to profound changes in the informal rules of the security structure when George W. Bush's administration [*an individual level factor*] decided to shift away from multilateralism and tried to impose its own version of hegemonic-unilateral leadership on the rest of world.

The Production and Trade Structure. The issue of who produces what, for whom, and on what terms lies at the heart of the international political economy. Making things and then selling them to other nations [*a global-level process*] earns countries and their industries huge sums of money, which ultimately can quite easily shift the global distribution of wealth and power. As we will see in Chapter 6, in recent decades there have been dramatic changes in international trade rules [*an interstate level factor*] that have resulted in a shift in the manufacturing of consumer goods such as electronics and automobiles away from the United States and Western Europe. Many of the corporations that make these items have moved to newly emerging economies such as South Korea, Mexico, Brazil, China, the Czech Republic, Hungary, Poland, and Vietnam [*a global level process*]. During the 1990s, many of the governments of these emerging economies sought to cooperate with foreign investors to promote the production of a range of goods and services. At the same time, production conditions in many of these countries led to criticism of human rights violations related to sweatshops in many of their assembly facilities [*a state/domestic level factor*]. As emerging economies have earned more income but also had to deal with the effects of the current financial crisis, some have been reluctant to agree to new open market trade policies in the negotiations over new rules of the World Trade Organization (WTO) because of pressure from vested interest groups [*a state/societal level factor*] (see Chapter 6).

The Finance and Monetary Structure. With perhaps the most abstract set of linkages between nations, this structure determines who has access to money, when, and on what terms, and thus how certain resources are distributed between nations. In this respect, money is often viewed as a means, not an end in itself. Money generates an obligation between people or states. International money flows [*a global level factor*] pay for trade and serve as the means of financial investment in a factory or a farm in another country. Financial bargains also reflect rules and obligations, as money moves from one nation to another in the form of loans that must be repaid.

Recently, the global financial and monetary structure has been marked by relaxed international regulation of the movement of "hot money" chasing quick profits from one country to another. Many believe that unregulated financial markets were in part responsible for financial crises in the 1990s in Mexico, parts of Asia and Latin America, and Russia, as well as for the current financial crisis (see Chapter 8). Some critics also charge that unregulated capitalism associated with increasing globalization may be partly responsible for breeding both poverty and support for terrorists in some of the depressed areas of the world.

The Knowledge and Technology Structure. Knowledge and technology are sources of wealth and power for those who use them effectively. Nations with poor access to industrial technology related to scientific discoveries, medical procedures, or new communications systems, for example, find themselves at a disadvantage relative to others [*an interstate level phenomenon*]. Increasingly in the world today, the bargains made in the security, production and trade, and finance and monetary structures depend on access to knowledge in its several forms.

The connection between technology and terrorism tightens by the day. Newspapers are full of stories about weapons of mass destruction (WMD). New technologies have revolutionized the size of weapons and the effects they have when put to use [*a global level factor*]. Many weapons can easily be transported in a backpack or a briefcase. The ultimate miniature weapon may no longer be an atomic bomb or a chemical mixture, but a few grams of anthrax on a letter.

PUTTING THE PIECES TOGETHER: GLOBALIZATION, THE FINANCIAL CRISIS, AND STATE-MARKET-SOCIETAL RELATIONS

One of the terms students will encounter throughout the book is **globalization**. In this section, we define this popular concept and use the different IPE perspectives to explain who it benefits, why, and its relationship to a variety of issues including the recent financial crisis. Our discussion of globalization here is important because it has framed the four structures of the international political economy outlined above. Many of the rules and processes related to trade, money, technology, and even security reflect a variety of ideas and policies associated with this popular concept. Globalization has brought about a significant change in the way many experts and officials think about the international political economy. It has both strengthened and weakened the power of many institutions and actors along the way.

The term "globalization" began appearing in the IPE lexicon in 1985 to describe the growing **interdependence** (interconnections) amongst people and states all over the world that resulted from new information and communications technologies and the spread of Western (U.S.) ideas and culture. Globalization also accounted for the increased dependency of a nation's gross domestic product (GDP) on trade and other economic activities outside the state. Even though technically levels of globalization were higher around World War I, beginning in the 1990s the world seemed to be going through another phase of major global transformation that involved more intense connections with other states and their societies. Many

IPE analysts suggested that a shift had occurred from a predominately Cold War, military-oriented world order (1947–1990), where states were preoccupied with territorial security and war, to something more akin to a truly global world order in the 1990s dominated by economic issues. Many academics, journalists, and public officials labeled this nearly 25-year period of history "globalization."

Many people trace the origins of globalization to the early 1980s when U.S. President Ronald Reagan and Great Britain's Prime Minister Margaret Thatcher popularized the ideas and policies associated with economic liberalism and free trade. In the later part of the 1980s and throughout most of the 1990s, many of the newly industrializing states in Southeast Asia grew quickly and steadily. Many of these states had turned their trade policies outward by adopting export-led growth strategies and integrating themselves into what many referred to as the new "global economy." During this period, the United States, Great Britain, and other industrialized nations engaged in a campaign to promote globalization with the explicit and implicit promise that together with capitalism, globalization would increase economic growth while laying the groundwork for democracy the world over.

In the 1990s, many government officials, businesspeople, academics, and media pundits in the industrialized nations remained ethusiastic about the potential economic benefits to be gained by interconnecting people the world over in new, different, and profound ways. Columnist Thomas Friedman, for one, made globalization out to be a siren song (addiction) that could not be denied. Globalization is usually characterized as

- An *economic process* that reflects accelerated and intense interconnections based on new technologies and communications systems and the mobility of trade and capital
- The *integration* of national and regional markets into a single global market
- A *political process* that weakens state authority and replaces it with deregulated market outcomes
- A *cultural process* that reflects a densely growing network of complex cultural interconnections and interdependencies in modern society.

Some analysts further claim that globalization[9]

- Is an *inevitable* occurrence that has produced a new form of capitalism—hypercapitalism
- Is a process for which *nobody is in charge*
- *Benefits* everyone, especially economically, and
- Furthers the spread of *democracy* in the world.

For good or for bad, globalization connected people by reaching around the world farther, faster, deeper, and more cheaply through an array of new communications and information technologies that included the Internet, fiber optics, and a host of other exotic communications devices. Globalization emphasizes increased production and the free flow of huge amounts of capital in search of investment opportunities and new markets around the world. *Speed* was the new and necessary major feature of twenty-first-century communications, commerce, travel, and innovation. Along with economic growth and personal wealth comes the demand for Western (read U.S.) mass consumer products such as electronic goods, music, clothing, and food.

For Friedman and economic liberal state officials, globalization manifested the power of unregulated and integrated markets to trump politics and greatly benefit society. In his popular book *The Lexus and the Olive Tree,*[10] Friedman asserted that globalization often required a "golden straightjacket"—a set of political restrictions or undesirable state policies that must be adopted and implemented if states want to realize globalization's benefits. Globalism, which stands for the economic liberal ideas behind globalization, became synonymous with production efficiency, the free flow of currency (capital mobility), free trade, open markets, and individual empowerment. The payoff would be a "triumph of market" that produced economic prosperity and democracy everywhere in the world.

Friedman has gone on to argue that today an even more intense and competitive version of globalization—hyperglobalization—both reflects and fosters yet a new brand or phase of capitalism that drives individuals, states, and TNCs to continually produce new and better products. In his latest book *The World is Flat,*[11] he argues that new technological developments are *in the process of* leveling the relationship of individuals to their states and to one another. Leveling generates new opportunities for individuals to compete with people in their own society and with those in other countries. In short, despite a few shortcomings, globalization is here to stay and should be embraced. Not surprisingly, globalization shaped the development strategies of developing countries (see Chapter 11) and has remained quite popular with elites and large numbers of the masses in the developed nations as well. Many state officials and leaders of international organizations claimed that developing nations would grow out of their debt and prosper if they adopted neoliberal policies and integrated into the global economy. Because of its emphasis on economic growth, globalization was supposed to help create more peaceful relations between states that traded with one another, especially if U.S. hegemony (leadership) promoted it as an attractive option for the world's poor and downtrodden, who might otherwise support rogue states and terrorists. Globalization was also expected to help transform the global society by increasing flows of people across borders that might eventually lead to a better understanding between different groups.

As globalization grew in popularity, so did local resistance (in some parts of the world referred to as *jihad*)[12] to many of its effects. In the 1990s, the antiglobalization movement gained momentum on a global scale. Many NGOs and other public-interest groups pitched their cause in newspaper articles, on their websites, and in journal articles. Much of their focus was directed at, among other things, sweatshop production conditions in many poor countries, damage to the environment, and income distribution issues.[13] Many of these groups formed coalitions with labor, environmental, and peace activists and held massive demonstrations that often turned violent in major cities such as Seattle, Washington, DC, Salzburg, Genoa, and Prague. Protests were aimed at WTO, IMF, and World Bank policies that reflected support for the "Washington Consensus" (see Chapter 8) about the benefits of globalization. Issues surrounding globalization have decisively affected local, regional, and even national elections.[14] Others even argue that antiglobalization might have been a motive behind the 9/11 terrorist attacks on the United States.[15]

For many people living in poorer countries, globalization was merely a shibboleth for a "wildcat" version of capitalism that meant higher standards of living and consumer consumption for a few but an increase in the misery for a vast majority of people. For Ignacio Ramonet and many others, society had become a slave to the market, which operates like clockwork, driven by economic and Social Darwinism, leading to excessive competition and consumption and the necessity of people to adapt to market conditions, at the risk of becoming social misfits and slowing the global economy.[16]

Many HILs, structuralists, mercantilists, and even Thomas Friedman himself became concerned about the extent to which globalization was having a homogenizing effect on cultures the world over when they become consumers of U.S. labels—from Big Macs and iMacs to Mickey Mouse—along with U.S. business practices. When markets trump politics and society, predictably the outcome often is devastating for the masses of poorer people. Friedman acknowledged that globalization alone would not automatically achieve success for everyone. In fact, he suggested that if it increased the rich–poor gap or left too many behind, it would likely generate opposition and be viewed as a destructive force in the world.

By the turn of the twenty-first century, it became clear that most developing nations were not growing out of poverty as expected. Many of the Asian Tigers (Singapore, Hong Kong, Taiwan, and South Korea—see Chapter 11), Southeast Asian economies such as Malaysia, Indonesia, and Thailand, and a few other newly industrializing countries (NICs) did experience tremendous national and per-capita growth. And yet a number of newly emerging economies in Asia and other parts of the world experienced a series of financial crises of their own (see Chapter 8) in the second half of the 1990s. Unfettered (unchained) markets tended to help the well off in these societies, while the gap between rich and poor expanded.

In a tacit admission that globalization was not delivering on its promises, the United Nations (UN) in 2000 established Millennium Development Goals (MDGs) directed at increasing foreign aid for poorer nations, halving global hunger, reducing debt, and fighting diseases like AIDS (see Chapter 11). Nor has globalization produced world peace or even less conflict as economic liberals suggested it would. After 9/11 many became more critical of globalization for its role in intensifying tensions between the western industrialized nations and many Islamic countries in the Middle East, Asia, and Africa. Finally, globalization was often criticized for contributing to poverty, which many linked to increasing numbers of conventional and nonconventional wars in developing regions—especially in "failed states" such as Sudan and Somalia (see Chapter 9).

As explained in Chapters 19 and 20 many HILs, structuralists, and realists became concerned that neoliberal ideas and pro-globalization policies were responsible for many of the global environmental problems that face us today. One aspect of this issue is that everyone on earth supposedly makes short-term rational economic choices that have led to a series of energy and environmental catastrophes that already may not be reversible. Many would like to reform capitalism and redesign globalization such that people would curtail the excessive use of the earth's resources. Many scholars expect major problems in adjusting to a sustainable level of resource use in the industrialized nations—at the same time that China, India, and other developing nations make increasing demands on the resources of "Spaceship Earth."

Finally, the current global financial crisis has generated still more (intense) criticism of globalization and its economic liberal oriented ideas, values, and institutions. As we write in the fall of 2009, a few pundits are claiming that there are signs that "green shoots" are beginning to appear that herald recovery from the recent financial crisis. And yet unemployment numbers still continue to rise in many countries. Others believe that recuperation is not likely for yet another two to three years. Some have suggested that until the financial crisis is adequately dealt with, globalization and globalism will continue to come under severe criticism, not only from anti-globalization protestors but also from a number of economic liberal academics and policy officials who feel that more *managed* globalization would better serve everyone.

OUTLINE OF THE TEXT'S MAIN THEMES

As students read through the book, they will encounter a variety of theoretical and policy issues. Each chapter ends with a brief discussion of the connection between the chapter topic, the financial crisis, and some of the main themes of the book (discussed below). As we noted at the outset of this chapter, instructors and students can choose to either skip the rest of this chapter and read it later as a conclusion or read it now as an overview of what they can expect by way of topic coverage and many of the major themes of the text.

The main themes highlighted in the text are the following:

- *Globalization:* Efforts to manage its negative externalities and impacts on the environment, resources, and society (discussed throughout the text).
- Tensions between *market fundamentalism and protectionism* and efforts to re-embed the market into society and its cultural institutions (see especially Chapters 2–4).
- Tensions between rising *production* and *distribution* of gains (see especially Chapters 4, 6, 11, and 19).
- Tensions between a state's *domestic needs and its international obligations* (throughout the text).
- Balancing *security and freedom* (see especially Chapter 9).
- How *social groups* influence markets and states (see especially Chapters 5 and 16).
- *Global inequality* between and within countries (see especially Chapter 11).
- How the rise of *China, India,* and other newly industrializing countries is fundamentally reshaping the global economy (see Chapter 13).
- *Development and transformation:* strategies and dilemmas (see especially Chapters 11–14).
- *Regionalism* as a development strategy many countries, such as those in the European Union, use to maintain wealth and power (see Chapters 6 and 11).
- The issue of *hegemony or leadership* over the global political economy (see especially Chapter 9).
- *Global governance,* management, and systemic order provided by a variety of institutions, along with resistance to them (throughout the text).
- The *increasing analytical and policy linkages* of issues to one another (see especially Chapters 18–20).

In Chapters 2–5, we cover each of the three dominant IPE perspectives and two alternative theories: feminism and constructivism. A number of cross-cutting themes of these chapters are related to different outlooks about *globalization* and the financial crisis. The financial crisis in particular has helped to sharpen the debate about what *is* and what *should be* the proper balance among the state, society, and the economy. To many journalists and academics, the dispute pitted the supporters of the laissez-faire version of liberalism, namely, OELs (see Chapter 2), against supporters of the ideas of John Maynard Keynes (HILs), who 75 years ago recommended state interventionist policies to deal with the Great Depression.

Chapter 3 covers many of the ideas of mercantilists, some of whom are critical of globalization and concerned about protecting society from the vagaries of the market. Likewise, in Chapter 4 we will encounter more critical views of economic liberalism and globalization from a (Marxist) structuralist vantage point related to issues of exploitation and equity. At a deeper level, though, these three chapters in particular raise questions not only about such themes as the tensions between *market fundamentals and protectionism* but also about *production and distribution* and *global inequality.* In fact, all the other chapters of the book shed some light on these same themes.

In Chapter 5, we discuss why many have argued that constructivism should be regarded as a fourth dominant IPE perspective. Constructivism reminds us of the power of *ideas* to shape the interests and actions of governments and market actors. Social groups, civil society, and NGOs usually lack substantial material resources, but they still influence the global political economy profoundly by spreading new norms and ideas, framing problems in new ways, and reinterpreting the causes of global processes. Similarly, feminist scholars point out that a full understanding of the four IPE structures—how the rules of trade, finance, security, and knowledge were formed and their consequences—requires much more attention to gender relations and the position of women in society.

Please note that the rational-choice ideas discussed in the previous edition of the text have been moved to the textbook blogsite at www.upugetsoundintroipe.com, along with the figures related to supply and demand and the discussion of economic assumptions and policy tenets.

Chapters 6–8 cover the global production and trade and monetary structures which govern international economic intercourse, foreign exchange convertibility, and the movement of capital throughout the world. These topics all involve tensions related to a state's *domestic needs* (which are often to protect domestic jobs and industries) versus its *international obligations* to honor conventions and treaties that are supposed to sustain open markets. Chapter 6 covers global trade and regional trade groups such as the European Union and the North American Free Trade Area (NAFTA) that can be viewed as attempts to expand free trade on a regional basis without throwing open all domestic markets to the threat of global competition. Bilateral and multilateral agreements continue to be popular because of the potential income trade can generate.

In Chapters 7 and 8, we explain why the global financial structure has become so crisis prone as of late. The rules of the international finance and monetary structure have *discouraged* capital controls and allowed for and even *encouraged* currency and other forms of investment speculation of the type that led to the current financial crisis. In Chapter 8 we explain the connection between the financial crisis and the global balance of payments problem. Many of the newly emerging economies including Saudi Arabia and China have built up huge capital reserves and run big trade surpluses. Some of these funds were invested in U.S. government securities and stock markets, fueling a borrowing binge in the United States before the crisis.

In Chapter 9, we explain why the global security agenda has been expanding in terms of actors who shape its rules and conventions and the issues this global structure has dealt with since the end of the Cold War in 1990. Phone calls, e-mail messages, library and bank records, and numerous other databases are routinely monitored in many countries for suspicious activity that could be connected to terrorist plots. Although many of these measures remain acceptable to the majority of people, many civil society groups have been front and center in condemning limits on *personal freedoms* and threats to privacy. *Globalization, distribution issues, and inequality* have also contributed to tensions within states between ethnic and religious groups. Open markets have contributed to security threats by facilitating the spread of WMDs and small arms and creating more opportunities for black market activities (see Chapter 14). For the sake of *national security*, many business firms that deal in national defense goods such as parts for submarines, missile guidance systems, or nuclear reactors have not been keen on national or international (UN) security regulations that might stifle their sales of more advanced weapons systems.

Chapter 10 focuses on the global knowledge and technology structure and keys in on the controversial issue of intellectual property rights (IPRs). Much of the debate about IPRs centers on rules that give transnational corporations unprecedented control over new technologies and cultural products. Developing nations in particular criticize these rules for interfering with their efforts to preserve biological diversity, educate the poor, and provide affordable health care to all. Individuals and companies throughout the world regularly defy these rules by engaging in piracy, counterfeiting, and patent infringement.

Chapter 11—a pivotal part of the book—focuses on *development and the transformation of society*. Most development studies focus on economic growth and a series of political, economic, and social issues associated with achieving it. We cover three development strategies that match the three dominant IPE perspectives, and one more—Self-Reliance—which has become the most popular model because it combines elements of economic liberalism, mercantilism, and structuralism. For many emerging economies and poorer nations, development involves not just production for the sake of economic growth but also the question of how to achieve a more *equitable distribution of income and nontangible benefits* in different societies such as India, China, and the Middle East. This chapter also examines some of the efforts by states, IOs, and NGOs to solve a host of problems related to Third World poverty and humanitarian relief efforts.

Chapter 12 analyzes conditions in the EU, which has been hit hard by the financial crisis. Many of its members are questioning the old assertion that economic growth can be achieved via political, economic, and social integration. While many like integration, it has become harder to *preserve state rights* while simultaneously *meeting community obligations*. The EU's institutions have struggled to reconcile the interests of new and older members and to find common policies that meet the needs of countries at different levels of development. Yet many point out that the EU has the potential to be the world's largest economy (and even a potential global hegemon).

In Chapter 13, we examine how, growing like gangbusters in the last 15 years, China and India have managed the social disruption that accompanies economic development and how they have flexed their muscles in the international economy. In China, the global financial crisis led to the closure of many state and private industries, laying off of workers, and threats to the export obsession of the communist political elites. Even though the financial crisis generated a good deal of harm to the Chinese economy and society, China's recent stimulus spending has helped it survive the global crisis. Meanwhile, its leaders are grappling with massive pollution, inequality, and society's insistence that companies and elites be more accountable. India's recent success may be due in part to it insulating itself from the global economy and slowly integrating back into it. Many speculate that its relatively *protectionist policies* have helped it weather the recent financial crisis and lead the recovery of the global economy.

Chapter 14 covers the Middle East, which exhibits many of the themes of the text when it comes to *production and distribution, inequality,* the role of *society* in the market, *regional conflict,* and *development.* However, the Middle East is too often portrayed as an exotic part of the world with a disproportionate amount of conflict, age-old tensions, terrorism, and dictatorship. While some parts of the region suffer from these problems, most of the region is deeply integrated into the global economy, playing a critical role in international finance, energy markets, and even environmental problems. With the notable exceptions of Syria and Iran, most of the governments in the Middle East have close military ties with Western countries.

Chapter 15 deals with many of the reasons why states and IOs have great difficulty dealing with a large illicit market where important goods and services, such as drugs, arms, and women to be sexually exploited, are trafficked across national borders. The chapter links illicit activities to the *transformation of social order* and the inability of states to enforce regulations, leaving some parts of the world in near anarchy.

Chapter 16 deals with some of the same themes, especially those related to *transformation of societies.* Migration sometimes occurs with the help of people smugglers, and it also exposes tensions concerning rules that govern the movement of people across borders. Ironically, while developments in the global economy may have contributed to migration, they have also improved opportunities for tourism in many of the very countries migrants have left to seek a better life. The chapter also shows that markets are ever separate from the people who work in them and form the human connections that make it possible for exchanges of goods, services, and labor to occur between countries.

Chapter 17 deals with transnational corporations (TNCs) and their role in the global political economy. They were placed in this part of the book for strategic reasons, as many of the issues covered in the second part of the text deal with how such corporations' investments transfer capital, technology, equipment, goods, and people between nations. Specifically, many TNCs play a role in generating and sustaining growth in least developed countries (LDCs). Much controversy surrounds how much they transform societies and affect the lives, opportunities, and work conditions of hundreds of millions of people. Moreover, TNCs have the power to exacerbate or lessen inequality as they shift wealth and power between countries, which is why states constantly try to impose conditions on their behavior.

The last three chapters of the book deal with the related issues of food and hunger, energy, and the environment (18–20). All three issues involve *production and distribution, market fundamentals versus protection, and domestic needs versus international obligations*. Many experts view all of them as aspects of global security that go beyond national and even regional security to present the world with some of the most serious threats to nature and all of humanity. The financial crisis has made food, energy, and environment problems increasingly harder to separate from one another. Markets alone have proved incapable of mitigating the problems of hunger, environmental unsustainability, and climate change.

CONCLUSION

Standing on the precipice

One way to think of recent developments in the international political economy in the past 200 years at least is to see most states and societies engaged in an effort to develop economically. For most people in developed parts of the world, history really only began during the industrial revolution. Since then many states have employed a mixture of mercantilist and economic liberal ideas and policies to achieve tremendous economic development, while much of the world has been unable to attain anything near that objective. What seems clearer to us all the time is that development, as we have conceived it, may not be realized for many societies. Furthermore, it is not something that ends once a nation looks like a modern industrialized country. Instead, development is an ongoing process of perpetual political, economic, and social transformation in all societies, regardless of their economic development status. As discussed below, there are good reasons to shift the definition of development away from quantifying economic growth.

Meanwhile two other major global developments are currently impacting states and societies in ways unimagined even 30 years ago. The first pertains to major shifts in the distribution of global wealth and power. Most of the security headlines of the early 2000s dealt with terrorism and state efforts to combat it after 9/11. Many experts and state officials have had to come to grips with the idea that the war on terrorism may not be "winnable" in any real sense of the term. For a variety of reasons related to the availability of certain technologies, porous state borders, and increased frustrations related to poverty and underdevelopment, state and personal insecurities may in fact be increasing.

For the major powers, the Cold War seemed to be *passé*, yet the tendency for the U.S., Russia, China, the EU, and even Japan has been to fall back into viewing the global political economy from a familiar realist outlook that emphasizes power and conflict. Interestingly, not only terrorism but also the emergence of India and China as global powers now challenges many state officials to suggest that the global center of the balance of power is shifting even faster than expected as a reflection of many planned and unexpected changes in the world economy.

This shift could very well increase North–South tensions and, as we have seen, has already complicated and weakened global governance when it comes to solving problems such as trade, hunger, energy, and climate change.

India and China, taken together, share about a third of the world's population. Optimists in the North see this as a huge potential market, but pessimists see enormous (often labeled unfair) economic competition that raises the stakes in any North–South negotiations. In the UN Copenhagen climate summit (see Chapter 20) many experts were upset that it did not go far enough to deal with global warming and other related issues. At the core of the negotiations, however, were the intransigent national interests of developed nations, opposed by rising powers such as China, India, and Brazil, that now find themselves positioned between richer and poorer nations. While optimists viewed the Copenhagen accords as acknowledgment of a serious problem, it remains to be seen if efforts to adopt more specific measures to deal with the interconnected issues of earth's limited resources and energy issues can be reconciled with the goal of economic growth that exacerbates these issues.

Finally, a third recent major shift in the global political economy, which has been bubbling up from within states and communities, relates to the benefits and costs associated with globalization. Clearly, the global financial crisis not only generated more skepticism about government bailouts and free markets but also resulted in renewed support for more government intervention to save both individual national economies and the entire international finance system. This development raises another major issue we touch on throughout the book: If globalization and economic liberal values and policies have proved *not* to be politically and economically beneficial to all, how is the *global political economy to be managed or governed* without generating even bigger problems?

Many mercantilists and realists would point out that solutions to such issues are not likely to be separated from the interests of states. Likewise, many structuralists would question the extent to which reform of globalization is even possible without profoundly changing the neoliberal principles and values that are its foundation. It would seem obvious then that because of the interconnectedness of states, institutions, and societies at all levels, international institutions *must* play some role in solving international problems. Paradoxically, precisely at a time when the global political economy could use more cooperation to solve an assortment of interrelated issues, we suggest that the compulsion of actors to cooperate for the sake of providing **global** governance remains weak. Dealing with the global financial crisis, among other important global issues, is just one such case.

For many experts, the problem comes down to either fixing economic liberalism or finding another perspective that blends some alternative theories together in such a way as to produce something more pragmatic. In the meantime, as we find in cases of migration and refugees, civil society is rapidly changing and making demands for democracy and human rights, which are harder than ever for regimes to suppress. We find that illicit markets reveal the limits of state sovereignty, international cooperation, and even compassion for the most vulnerable people in the world.

We end this chapter with two questions for you to contemplate throughout the text. First, are the political-economic insitutions of states and societies able to deal with the conflicting tendencies of making economic growth and security the highest priorities of states without destroying the earth's capacity to sustain development? Second, is it time for the popular economic liberal perspective to be replaced by something else that can reconcile industrialization and commercial activity with the shared need to provide proper stewardship of the earth and its natural resources?

We hope these two questions are the best ones to ask given where we are today. It would be interesting to know your views on them.

KEY TERMS

NINJAs 4
securities 5
hedge funds 5
international political economy (IPE) 7
global civil society 8
economic liberalism 8
orthodox economic liberals 8
heterodox interventionist liberals 8
mercantilism 9
realism 9
state 9
nation 9
sovereignty 9
hard power 9
soft power 9
structuralism 9
the level of analysis 12
IPE structures 14
security structure 14
production and trade structure 15
finance and monetary structure 15
knowledge and technology structure 16
globalization 16
interdependence 16
globalism 18
global governance 25

DISCUSSION QUESTIONS

1. Pick a recent news article that focuses on some international or global problem, and give examples of how and where states, markets, and societies interact and at times conflict with one another. How hard is it to determine the analytical boundaries between the state, market, and society in this case?
2. Review the basic elements and features of the IPE approach: the three main theoretical perspectives, the four structures, the levels of analysis, and the types of power. Which ones do you feel you understand well and which ones need more work? Discuss the connection between each of the three theoretical perspectives and your own values related to IPE.
3. Define and outline the major features of globalization. Explain the connection between economic liberal ideas and globalization. Which of the three IPE perspectives (or combination of perspectives) about globalization do you agree with most? Explain why.
4. Based on what you have learned so far in this chapter and from reading newspapers, etc., outline a few things you know about the connection between globalization, the financial crisis, and capitalism. Do you agree with those who suggest that the financial crisis raises serious concerns about the viability of capitalism? Explain.
5. If you read the section on the main themes of the book as a conclusion to the class, discuss any three major themes that come up in two topics of your choice, either in two chapters or throughout the text.

SUGGESTED READINGS

Thomas L. Friedman. *The Lexus and the Olive Tree: Understanding Globalization.* New York: Farrar, Straus and Girous, 1999.

Robert Gilpin. Especially chap. 1 in *The Political Economy of International Relations.* Princeton, NJ: Princeton University Press, 1987.

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Pietra Rivoli. *The Travels of a T-Shirt in the Global Economy: An Economist Examines the Markets, Power, and Politics of World Trade,* 2nd ed. Hoboken, NJ: John Wiley, 2009.

Joseph Stiglitz. *Globalization and Its Discontents.* New York: W. W. Norton, 2004.

Susan Strange. *States and Markets: An Introduction to International Political Economy.* New York: Basil Blackwell, 1988.

Kenneth N. Waltz. *Man, the State, and War: A Theoretical Analysis.* New York: Columbia University Press, 1959.

NOTES

1. See Charles Lindblom, "The Market Ascendant" in his *The Market System* (New Haven, CN: Yale University Press, 2001), p. 14.
2. See Robert Heilbroner and Lester Thurow, "Capitalism: Where Do We Come From?" in their *Economics Explained* (New York: Simon & Schuster, 1994).
3. See Adam Smith, *The Wealth of Nations* (London: Methuen & Co. Ltd., 1904).
4. For a detailed discussion of soft power and its utility in the international political economy, see Joseph Nye, *Soft Power: The Means of Success in World Politics* (New York: Public Affairs, 2006).
5. See Pietra Rivoli, *The Travels of a T-Shirt in the Global Economy: An Economist Examines the Markets, Power, and Politics of World Trade*, 2nd ed. (Hoboken, NJ: John Wiley & Sons, 2009).
6. See Benjamin J. Cohen, "The Transatlantic Divide: Why are American and British IPE so Different?" *Review of International Political Economy, 14* (May 2007), pp. 197–219.
7. Kenneth N. Waltz, *Man, the State, and War: A Theoretical Analysis* (New York: Columbia University Press, 1959). Waltz wrote about three "images" rather than three "levels," and both terms are used in discussions of this concept. The recent focus on globalization has generated a good deal of attention on a global level of analysis.
8. See Susan Strange, *States and Markets: An Introduction to International Political Economy* (New York: Basil Blackwell, 1988), pp. 24–25.
9. For a more detailed overview and discussion of globalization and globalism, see Manfred Steger, Globalisms: The Great Ideological Struggle of the Twenty-First Century, 3rd edition, (Lanham, Md: Rowman & Littlefield).
10. See Thomas Friedman, *The Lexus and the Olive Tree: Understanding Globalization* (New York: Farrar, Straus & Giroux, 1999).
11. Thomas Friedman, *The World Is Flat: A Brief History of the Twenty-First Century* (New York: Farrar, Straus & Giroux, 2005).
12. The term is used in this broad manner by Benjamin Barber, *McWorld vs. Jihad* (New York: Ballantine Books, 1995, 2002).
13. See, for example, many of the articles in Robin Broad, ed., *Global Backlash: Citizen Initiatives for a Just World Economy* (Boulder, CO: Rowman & Littlefield, 2002).
14. See, for example, Jorge Castañeda, "Latin America's Turn to the Left," *Foreign Affairs, 85* (May/June 2006), pp. 28–43.
15. It should be noted that many historians point out that if globalization is measured as the connections of an economy to economies outside of itself, globalization was actually greater before, during, and after World War I. Also, a relatively small number of academics and experts do not believe in the existence of globalization at all. Often referred to as "globaloney" types, they do not view the phenomenon as novel; instead, many of them view globalization as merely another marketing tool that capitalists use to sell things. See, for example, Michael Veseth's aptly titled *Globaloney: Unraveling the Myths of Globalization* (New York: Rowman & Littlefield, 2005).
16. See Thomas Friedman and Ignacio Ramonet, "Dueling Globalization: A Debate Between Thomas Friedman and Ignacio Ramonet," *Foreign Policy, 116* (Fall 1999), pp. 110–127.

CHAPTER 2

"Laissez-Faire": The Economic Liberal Perspective[1]

Someone has to clean up the mess.

Getty Images

Like many other terms in international political economy (IPE), the generic term liberalism suffers from something of a personality disorder. The term means different things in different contexts. In the United States today, for example, a liberal is generally regarded as one who believes in an *active* role for the state in society, such as helping the poor and funding programs to address social problems. Since the mid-1980s, someone who has been thought of more narrowly as an *economic liberal* believes *almost* (but not exactly) the opposite. For economic liberals (also referred to as neoliberals),[2] the state should play a *limited*, if not *constricted*, role in the economy and society. In other words, today's economic liberals have much in common with people who are usually referred to as "conservatives" in the United States, Europe, Canada, and Australia.

This chapter traces the historical rise of economic liberalism in eighteenth- and nineteenth-century England and in the United States and Europe in the twentieth century. We outline some of the basic tenets of capitalism, a focal point of liberal thought. Throughout the chapter, we also discuss the views about state–market–society relations of some of the most famous liberal political economists: Adam Smith, David Ricardo, John Maynard Keynes, Friedrich Hayek, Milton Friedman, and recent supporters of globalization.

The chapter ends with an explanation of the popularity of globalization, which helped divide orthodox economic liberals (OELs) from heterodox interventionist liberals (HILs) (see Chapter 1). Finally, we contrast the views of OELs and HILs on the recent financial crisis, focusing on the extent to which the crisis has weakened the precepts and policies associated with economic liberalism.

The appendix "The Market Model, Market-Based Resource Allocation, Economic Efficiency, Efficiency Versus Equity," which appears in the Instructor's Manual and at http://www.upugetsoundintroipe.com, lays out the characteristics of a formal market model, develops the notion of efficiency, and then contrasts efficiency with equity. Students are encouraged to review the model in some detail to understand the basic assumptions many economists make about the role of the market in a liberal society.

There are four main theses in this chapter. First, economic liberal ideas continue to evolve as a reflection of changes in the economy and the power and influence of actors and institutions. Second, economic liberalism gained renewed popularity due to its association with the laissez-faire Reagan and Thatcher administrations, culminating in the globalization campaign of the 1990s. Third, since then orthodox economic liberalism has increasingly come under attack for its failure to predict or sufficiently deal with such things as the financial crisis and poverty in LDCs. Fourth and finally, we end with the suggestion that although weakened, laissez-faire ideas and policies are likely to remain popular in the United States and many other nations.

ROOTS OF THE ECONOMIC LIBERAL PERSPECTIVE

The liberal perspective today reveals many insights about political economy that mercantilists miss or do not address. Essentially, the broad term "liberalism" means "liberty under the law."[3] Liberalism focuses on the side of human nature that is competitive in a constructive way and is guided by reason, not emotions. Although liberals believe that people are fundamentally self-interested, they do not see this as a disadvantage because competing interests in society can engage one another constructively. This contrasts with the mercantilist view, which, as we will see in Chapter 3, dwells on the side of human nature that is more aggressive, combative, and suspicious.

Classical economic liberalism is rooted in reactions to important trends in Europe in the seventeenth and eighteenth centuries. François Quesnay (1694–1774) led a group of French philosophers called the Physiocrats or *les Économistes*.

Quesnay condemned government interference in the market, holding that, with few exceptions, it brought harm to society. The Physiocrats' motto was *laissez-faire, laissez-passer,* meaning "let be, let pass," but said in the spirit of telling the state, "Hands off! Leave us alone!" This became the theme of Adam Smith (1723–1790), a Scottish contemporary of Quesnay who is generally regarded as the father of modern economics. Smith and many since him including David Ricardo, Friedrich Hayek, and Milton Friedman display respect, admiration, and almost affection for the market, juxtaposed with different degrees of distaste for the state, or at least for its abusive potential.

In his famous book *The Wealth of Nations*, Smith opposed the mercantilist state of the eighteenth century, established on the principle that the nation is best served when state power is used to create wealth, which produces more power and national security (see Chapter 3). For classical economic liberals, individual freedom in the marketplace represents the best alternative to potentially abusive state power when it comes to the allocation of resources or organizing economic activity. However, for Smith the term "state" meant Britain's Parliament, which represented the interests of the landed gentry, not those of the entrepreneurs and citizens of the growing industrial centers. Not until the 1830s was Parliament reformed enough to redistribute political power more widely. As a Scot without land, who therefore could not vote, Smith had some reason to question the power structure of his time.

Smith also believed in the cooperative, constructive side of human nature. For him, the best interest of all of society is served by (rational) individual choices, which when observed from afar appear as an "invisible hand" that guides the economy and promotes the common good. He wrote:

> He [the typical citizen] generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its own produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, directed by an invisible hand to promote an end which was no part of his intention.[4]

Smith was writing at a time when the production system known as capitalism was replacing feudalism. He was the first to develop a comprehensive portrait of capitalism in *The Wealth of Nations*, originally published in 1776. What follows is a brief overview of some of the ideals and tenets of capitalism based in large part on Smith's work—or at least the way many economic liberals (both OELs and HILs) today interpret his work.

The Tenets of Capitalism

The five main elements of capitalism are as follows:

- Markets *coordinate* society's economic activities
- Extensive markets exist for the exchange of land, labor, commodities, and money

- Competition *regulates* economic activity; consumer self-interests motivate economic activity
- Freedom of enterprise
- Private property

The first three tenets address the nature and behavior of markets. In the modern market, products and services are commodified—that is, a market price is established for goods and services as a result of producers setting prices for their goods and buyers paying for them. The political scientist Charles Lindblom makes an elaborate case for how markets *organize* and *coordinate* society today in ways quite different from the past.[5] Whereas before capitalism the economy was organized to serve society, today markets organize most of our lives in ways we are not aware of. Markets not only determine our jobs but also shape our choices about travel, entertainment, and food.

Another feature of capitalism is the existence of markets for land, labor, and money. The economic historian and anthropologist Karl Polanyi wrote extensively about how modern capitalism gradually came about in seventeenth-century Great Britain when land was privatized, people moved off the countryside and into small factories, and capital (money) was generated by trade. Land, labor, and capital were all commodified, which provided the financial foundation and labor for the industrial revolution and the society that today we recognize as capitalist.[6]

When economists say that competition *regulates* economic activity, they are referring to the ways in which markets convert the pursuit of consumer self-interests into an outcome that inevitably benefits all of society. According to Smith, the pursuit of individual self-interest does not lead to civil disorder or even anarchy; rather, *self-interest serves society's interests*. Smith famously said, "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our necessities but of their advantages."[7]

In a capitalist economy, self-interest drives individuals to make rational choices that best serve their own needs and desires. However, it is competition that *constrains* and *disciplines* self-interest and prevents it from becoming destructive to the interests of others. Under ideal circumstances, producers must compete with others, which forces them to charge reasonable prices and provide quality goods to their customers, or lose their business. Consumers also face competition from other consumers who may be willing to pay more for a product. Even if producers might want to push prices high to satisfy their narrow economic interests, and buyers might want to push prices low for the same reason, the force of competition keeps the pursuit of self-interest from going to the extreme.

Capitalism assumes that price competition also results in the *efficient* allocation of resources among competing uses. When economists say that markets coordinate society's economic activity, they generally mean that no one (especially the state) should be in charge of how resources are allocated. Market coordination entails a decentralized (spread out) resource allocation process guided by the tastes and preferences of individual consumers.

For capitalists, government intervention in the market generally distorts resource reallocation and frustrates the coordination function we have described. Competition also requires firms to be production efficient, in the sense that it pays to adopt cost-saving innovations in the production of goods and to remain on the cutting edge of product and process innovation, the delivery of services, and the management of resources. The leaders of even the most powerful firms such as Microsoft, Ericsson, or Petrobas must keep one step ahead of technologically audacious newcomers if they wish to retain their share of the market.

The last two tenets of capitalism deal with the role of the state in establishing freedom of enterprise and private property. Freedom of enterprise means that individuals are free to start up any new business enterprise without state permission, thereby channeling resources to the production of goods and services that are in high demand while simultaneously intensifying competitive pressures in these industries. When individuals are free to make their own career choices, they naturally prepare for and seek out careers or lines of employment in which they are likely to be most productive. Likewise, as economic circumstances change, labor resources will be rapidly redeployed to growing sectors of the economy as individuals take advantage of new opportunities.

Capitalists are adamant that the owner of a resource is legally entitled to the income that flows from the resource. The income of those who own capital is usually in the form of profits (as opposed to wages). Capital goods—plants, equipment, and tools that workers need—are the important subset of all commodities that are required to produce other commodities. In a capitalist economy, the owners pay for the costs of production—the wages of the workers, the raw materials, and all intermediate goods used in production—and then sell the finished commodities on the market. Whatever is left over, the difference between the revenue and the costs, belongs to the capitalists. This is a legal right of ownership, referred to as capitalist property rights. A capitalist may completely own a business, a local bar, or a high-tech start-up, for example. But many of the largest enterprises are corporations where ownership is distributed in the form of stocks, which can be bought and sold on a stock market.

When property rights are less clear, the incentive to use resources efficiently diminishes. Private property—clear title to land, for example—also encourages the owner to make investments in improving the land and provides the owner the collateral with which to obtain the credit necessary to do so. Consequently, the resource owner makes every effort to ensure that the resource is used efficiently.

Freedom of enterprise allows entrepreneurs to test new ideas in the marketplace. In a dynamic world of changing tastes and preferences, the availability of resources and new technologies foments product and production process innovation. In such an environment, entrepreneurs must rapidly redeploy their resources to changing circumstances when new opportunities arise. Freedom of enterprise also allows firms to increase or reduce their labor force as necessary. Because firms can easily expand and contract, the associated risk of changes is minimized, and competition is consequently enhanced.

What Smith is most known for, then, is the view that ideally a capitalist economy is self-motivating, self-coordinating, and self-regulating. Consumers determine how resources will be allocated; self-interest motivates entrepreneurs to develop and firms and their workers to produce the goods and services consumers desire; the market coordinates economic activity by communicating the ever-changing tastes and preferences of consumers to producers; and competition ensures that the pursuit of self-interest serves social (consumer) interests.

Smith, the Cynic and Moralist

Yet many historians and philosophers have come to view Smith as a more complex, nuanced philosopher, rather than associating him with only the "invisible hand" of the market, a phrase used only once in *The Wealth of Nations*. In fact, many of the ideas in his other major work, *The Theory of Moral Sentiments,* appear to contradict the more orthodox economic liberal ideas with which he is most often associated. We group Smith's caveats about the tenets of capitalism into three interrelated categories: the role of the state, the motives and behavior of capitalists related to preservation of the market, and a variety of moral issues.

Smith is clear that the state has some necessary and legitimate functions in society, especially with regard to defending the country, policing, building public works, preventing the spread of diseases, enforcing contracts, keeping the market functioning, and helping to achieve individual rights. However, he is also quite adamant in his distrust of businesspeople and capitalists. Another of his famous quotes is that "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."[8] The pursuit of self-interest by a monopoly producer, for example, often leads to restricted output, higher prices for goods, and a consequent loss of social welfare. Smith also distrusted bankers and noted that employers always sought to keep wages low: "When the regulation . . . is in favor of the workmen, it is always just and equitable; but it is sometimes otherwise when in favor of the masters."[9]

How do businesspeople get these advantages? Smith believed that merchants often had a disproportionate influence over the Parliament and could press their "private interests." These special interests often solicited the power of the state to allow them to disregard competitive pressures and to convince those in power that "what they wanted was identical to the general interest."[10] Manufacturers often easily influenced the legislature such that they acquired the exclusive use of licenses, franchises, tariffs, and quotas. Often their trading companies gained the sole right to sell products, keeping market prices above the natural price.

An example today is in the area of intellectual property rights, where companies like IBM, Samsung, Pfizer, and many others have convinced governments to strongly protect patents, which are legal, temporary monopolies on inventions allowing a manufacturer to prevent others from using the invention without the manufacturer's permission. In 2007 alone, IBM and Samsung together won more than 5,800 patents. Pfizer has a patent on Lipitor, the world's most popular drug, which by the end of 2008 had an astonishing $12 billion in cumulative sales (the drug goes off patent in 2010). Large-scale firms attempt to marshal the necessary resources and the power to control the markets for their new products with patents and copyrights. The risks of introducing new products, given the huge investments and time lags involved, are mitigated if these firms are *guaranteed* captive markets and consumer acceptance. Thus, many successful firms invest heavily in shaping and molding consumer tastes and preferences via expensive, sophisticated, and sometimes subtle marketing campaigns. At the same time, corporations hire major lobbying firms to press the U.S. Congress or English parliament for legislation that would help preserve their competitive advantage over other industries.

A comprehensive understanding of Smith's concerns about the role of the state in the economy and his unease about the integrity of capitalists elicits something more subtle than the dictum of laissez-faire universally associated with him. On the one hand, he *opposed* having the state try to direct investments because it might be counterproductive and unnecessary. And yet he *supported* the state exercising vigilance and enforcing competition policies to preserve competition and help the market work properly. Today we would say that in capitalist economies Smith feared **rent-seeking** (the manipulation of the state to rig the market in such a way as to reward powerful business interests with high prices and high profits). For Smith, absent competition, the invisible hand can no longer make competition work for the benefit of all society. While Smith leaves open the question of more specific issues about the how, when, and why of state regulation (an issue explored in more detail in Chapter 3), it is clear that he viewed the state (the *visible* hand?) as necessary if there was to be competition, lest capitalists themselves or powerful political interests represented by the state, destroyed the market.

Unlike *The Wealth of Nations*, Smith's book *The Theory of Moral Sentiments* has been largely overlooked until recently. His views in it reflect his ambition to proactively structure the market in such a way that commercial activity would produce righteous and prudent people. As the labor force grew in size, he argued that the welfare of "servants, laborers, and workmen of different kinds" should be the prime concern of economic policy. Sounding a bit like Marx (see Chapter 4), Smith argued that "no society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable."[11]

For Smith, the passion to pursue self-interest leads mercantilists to cutthroat competition in which winners create losers. On the other hand, economic liberals also pursue their self-interests, but their passions are *restrained* by competition that prevents anyone from gaining too much power that could lead to coercion. Serving one's own interests in a competitive society means competing to best serve *the interests of others*, to behave honestly, and to gain a reputation for *fairness*. In a world of intense competition, commercial society was a way to channel self-interest into a less morally corrupt society than during feudalism.

THE TRANSFORMATION OF LIBERAL IDEAS AND POLICIES

Adam Smith's writings were part of a broader intellectual movement that engendered intense economic and political change in society. Classical liberals, in general, at the time are represented by the writings of John Locke (1632–1704) in England and Thomas Jefferson (1743–1826) in the United States. Economic theorists tend to think of laissez-faire in terms of markets. However, this philosophy also implies that citizens need to possess certain negative rights (freedoms *from* state authority, such as freedom from unlawful arrest), positive rights (which include unalienable rights and freedoms *to* take certain actions, such as freedom of speech or freedom of the press), and the right of democratic participation in government, without which positive and negative freedom cannot be guaranteed.[12] These classical liberal political ideas are embedded firmly in the U.S. Declaration of Independence and the Bill of Rights, which were becoming well known about the same time as Adam Smith's notion of consumer freedom.

Economic liberals tend to focus on the domain in which nation-states show their cooperative, peaceful, constructive natures through harmonious competition. As we will see in Chapter 6, international trade is seen as being mutually advantageous, not cutthroat competition for wealth and power. What is true about individuals is also true about states. As Smith wrote, "What is prudence in the conduct of every family can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our industry, employed in a way in which we have some advantage."[13] Smith generally opposed most state restrictions on free international markets. He condemned the tariffs that mercantilists used to concentrate wealth and power. "Such taxes, when they have grown up to a certain height, are a curse equal to the barrenness of the earth and the inclemency of the heavens."[14] However, Smith *did* support the mercantilist Navigation Acts that protected British industries by requiring their goods be shipped to British colonies in British vessels, an act of mercantilism (see Chapter 3).

David Ricardo (1772–1823) followed Smith in adopting the classical economic liberal view of international affairs. He pursued successful careers in business, economics, and as a Member of Parliament. Ricardo was a particular champion of free trade, which made him part of the minority in Britain's Parliament in his day. He opposed the Corn Laws (see the box below "Britain's Corn Laws"), which restricted agricultural trade. About trade, Ricardo was one of the first to explore some of the precepts of a natural (scientific) law about trade. He argued:

> Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. The pursuit of individual advantage is admirably connected with the universal good of the whole. By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labour most effectively and most economically: while, by increasing the general mass of productions, it diffuses general benefit, and binds together, by one common tie of interest and intercourse, the universal society of nations throughout the civilized world.[15]

BRITAIN'S CORN LAWS

Britain's Parliament enacted the Corn Laws in 1815, soon after the defeat of Napoleon ended 12 long years of war. The Corn Laws were a system of tariffs and regulations that restricted food imports into Great Britain. The battle over the Corn Laws, which lasted from their inception until they were finally repealed in 1846, is a classic IPE case study in the conflict between liberalism and mercantilism, market and state.

Why would Britain seek to limit imports of food from the United States and other countries? The "official" argument was that Britain needed to be self-sufficient in food, and the Corn Laws were a way to ensure that it did not become dependent on uncertain foreign supplies. This sort of argument carried some weight at the time, given Britain's wartime experiences (although Napoleon never attempted to cut off food supplies to Great Britain).

There were other reasons for Parliament's support of the Corn Laws, however. The right to vote in Parliament was not universal, and members were chosen based on rural landholdings, not on the distribution of population. The result was that Parliament represented the largely agricultural interests of the landed estates, which were an important source of both power and wealth in the seventeenth and eighteenth centuries. The growing industrial cities and towns, which were increasingly the engine of wealth in the nineteenth century, were not represented in Parliament to a proportional degree.

Seen in this light, it is clear that the Corn Laws were in the economic interests of the members of Parliament and their allies. They were detrimental, however, to the rising industrial interests in two ways. First, by forcing food prices up, the Corn Laws indirectly forced employers to increase the wages they paid workers. This increased production costs and squeezed profits. Second, by reducing Britain's imports from other countries, the Corn Laws indirectly limited Britain's manufactured exports to these markets. The United States, for example, counted on sales of agricultural goods to Britain to generate the cash to pay for imported manufactured goods. Without agricultural exports, the United States could not afford as many British imports.

Clearly, the industrialists favored repeal of the Corn Laws, but they lacked the political power to achieve their goal. However, the Parliamentary Reform Act of 1832 revised the system of parliamentary representation but also reduced the power of the landed elites who had previously dominated the government, and increased the power of emerging industrial center representatives. The 1832 Reform Act began the political process that eventually abolished the Corn Laws by weakening their political base of support.

In an act of high political drama, the Corn Laws were repealed in 1846, which changed the course of British trade policy for a generation. Although this act is often seen as the triumph of liberal views over old-fashioned mercantilism, it is perhaps better seen as the victory of the masses over the agricultural oligarchy. Britain's population had grown quickly during the first half of the nineteenth century, and agricultural self-sufficiency was increasingly difficult, even with rising farm productivity. Crop failures in Ireland (the potato famine) in the 1840s left Parliament with little choice: Either repeal the Corn Laws or face famine, death, and food riots.

The repeal of the Corn Laws was accompanied by a boom in the Victorian economy. Cheaper food and bigger export markets fueled a rapid short-term expansion of the British economy. Britain embraced a liberal view of trade for the rest of the century. Given its place in the global political economy as the "workshop of the world," liberal policies were the most effective way to build national wealth and power. Other nations, however, felt exploited or threatened by Britain's power and adopted mercantilist policies in self-defense.

The Corn Laws illustrate the dynamic interaction between state and market. Changes in the wealth-producing structure of the economy (from farm to industry, from country to city) led eventually to a change in the distribution of state power. The transition was not smooth, however, and took a long time—important points to remember as we consider countries that have tried to open their economies and societies today. The case also illustrates that the market can be dominated by particular groups and is not apolitical or asocial, but reflects important social and cultural power.

For Ricardo, free commerce makes nations efficient, and efficiency is a quality that liberals value almost as highly as liberty. Individual success is "admirably connected" with "universal good"—like Smith, no conflict among people or nations is envisioned here. The free international market stimulates industry, encourages innovation, and creates a "general benefit" by raising production. In IPE jargon, economic liberals view the outcomes of state, market, and society relations as a **positive-sum** game, in which everyone can potentially get more by making bargains with others as opposed to not trading with them. Market exchanges of goods and services are mutually advantageous to both parties. Mercantilists, on the other hand, tend to view life as a **zero-sum** game, in which gains by one person or group necessarily come at the expense of others (see Chapter 3).

Sounding more like a social scientist than a philosopher, Ricardo argued that these positive-sum payoffs of trade bind together the nations of the world by a common thread of interest and intercourse. As is often argued by those who support globalization today, free individual actions in the production, finance, and knowledge structures create such strong ties of mutual advantage among nations that the need for a tie of security is irrelevant, or nearly so. Through open markets, the nations of the world are becoming part of a "universal society" united, not separated, by their national interests, weakening or entirely eliminating reasons for war.

JOHN STUART MILL AND THE EVOLUTION OF THE LIBERAL PERSPECTIVE

Political economy is a dynamic field, and the liberal view has evolved over the years as the nature of state–market–societal interaction has changed to reflect changing cultural values and ideas. A critical person in the intellectual development of liberalism was John Stuart Mill (1806–1873), who inherited the liberalism of Smith and Ricardo. His textbook, *Principles of Political Economy with Some of Their Applications to Social Philosophy* (1848) (published the same year as Marx's *The Communist Manifesto*), helped define liberalism for half a century.

Mill held that liberal ideas behind what had emerged as full-blown capitalism in Europe had been an important *destructive* force in the eighteenth century—even if they were also the intellectual foundation of the revolutions and reforms that weakened central authority and strengthened individual liberty in the United States and Europe. He developed a philosophy of social progress based on "moral and spiritual progress rather than the mere accumulation of wealth."[16] Mill doubted the extent to which the competitive process and economic freedom inherent in capitalism would turn the most powerful human motive—the pursuit of self-interest—into the service of society's welfare. At the time, many people were working in factories but living in much more wretched conditions than those that existed in Smith's and Ricardo's times. Whole families worked six days a week for more than eight hours a day. Many were routinely laid off with little notice.

Mill acknowledged the problems created by the market's inherent inequality of outcomes. He proposed that to achieve social progress, the state *should take* definitive action to supplement the market, correcting for its failures or weaknesses. He advocated *selective* state action in some areas, such as educating children and assisting the poor, when individual initiative might be inadequate in promoting social welfare. In general, Mill supported as much decentralization as was consistent with reasonable efficiency; the slogan was "centralize information, decentralize power." He believed parents had a duty to educate their children, and might be legally compelled to do so, but it was obviously intolerable to make them pay for this education if they were already poor. It was also dangerous for the state to take over education as a centralized activity. Thus, some state action—grants for people to pay for private school and the operation of "model schools," for example—was the suggested remedy.[17]

Mill's views on education and other social issues reflect the evolution of liberalism in his time. The guiding principle was still laissez-faire: When in doubt, state interference was to be avoided. However, within a political economy based on the connection of markets to individuals and society, some limited government actions were desirable. The questions for Mill, as for liberal thinkers since his time, are: when, how, and how far is government's *visible* hand justified as an assistant to or replacement for the invisible hand of the market? How far can the state go before its interference with individual rights and liberties is abusive?

Note: To understand many of the fundamental assumptions and principles in formal economic thought, students and instructors who are not well versed in formal economic theory may refer to the appendix to the chapter, which is located in the Instructor's Manual and on the University of Puget Sound IPE website at http://www.upugetsoundintroipe.com. It develops the concepts of economic efficiency and distinguishes between equity and efficiency.

JOHN MAYNARD KEYNES AND THE GREAT DEPRESSION

One of the most influential political economists of the twentieth century was John Maynard Keynes (1883–1946)—pronounced "canes," or "keinz" if you are British—who stands out in the evolution of liberalism for developing a subtle and compelling strain of liberalism called the Keynesian theory of economics, or sometimes referred to as Keynesianism. Much like Mill who was concerned with the negative impact of markets on society, Keynes's ideas were increasingly popular in the 1930s up through the Great Depression and World War II until the early 1970s. As was the case in the 1930s, in the face of the current financial crisis many experts have become critical of the popular laissez-faire outlook and looked back to ideas of Keynes to explain the crisis and provide a variety of solutions to it.

A civil servant, writer, farmer, lecturer, and Director of the Bank of England, Keynes is known for refuting some of the basic principles of economic liberalism. He believed that the Great Depression was evidence that the invisible hand of the market sometimes errs in catastrophic ways. As early as 1926, he wrote:

> Let us clear from the ground the metaphysical or general principles upon which, from time to time, laissez-faire has been founded. It is *not* true that individuals

> possess a prescriptive "Natural liberty" in their economic activities. There is *no* "compact" conferring perpetual rights on those who Have or on those who Acquire. The world is *not* so governed from above that private and social interest always coincide. . . . Nor is it true that self-interest generally *is* enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does *not* show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately.[18]

Keynes suggested that the laissez-faire version of classical liberalism can hardly offer an explanation of booms and busts because according to that model, such disruptions should not even occur. Remember that for OELs the market translates the rational and selfish behavior of individual actors (consumers, workers, firms, etc.) into an outcome that is socially optimal. The market is also seen as a self-correcting institution so that deviations from full employment—something that resulted from an outside "shock" to the system—should set in motion changes in prices, including wages and interest rates, that will quickly restore full employment.

In Keynes's view, the cause of recessions and depressions is that individuals tend to make decisions that are particularly unwise when faced with situations in which the future is *uncertain* and there is no effective way to share risks or coordinate otherwise chaotic actions. Keynes emphasizes that it *is* possible for individuals to behave rationally and in their individual self-interest, and yet for the *collective result* to be both irrational and destructive—a clear failure of the invisible hand. The stock market crash of 1929, the Asian crisis of 1997, and the current global financial crisis demonstrate what can happen when investors are spooked and stampede out of the market (see Chapter 8).

In these conditions, people often predict a very bleak future or at least find it difficult to "think rationally" about the future, leading to what Keynes calls a **paradox of thrift**. What is the rational thing to do when one is threatened by unemployment? One rational response to uncertainty about your future income is to spend less and save more, to build up a cushion of funds in case you need them later (just as many people are doing today in the financial crisis). But if everyone spends less, then less is purchased, less is produced, fewer workers are needed, and income declines. Furthermore, the recession and unemployment that everyone feared *will* come to pass is in fact *sustained* by the very actions that individuals took to protect themselves from this eventuality. Keynes also worried about speculation in the international economy and the damage it could do if it was not regulated in some fashion. These conditions, then, make financial markets fragile and prone to economic disaster.

For Keynes, the solution (referred to as **Keynesianism**) is to combine state and market influences in a way that, in the spirit of Adam Smith, still relies on the "invisible hand" but supports a *larger but still limited* sphere of constructive state action. For Keynes, to offset its collective irrationality, society should direct "intelligence through some appropriate organ of action over many of the inner intricacies of private business, yet it would leave private initiative and enterprise unhindered."[19] That appropriate organ is the state. According to Keynes, the problem was to "work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life."[20]

During the Great Depression, many states used a combination of monetary and fiscal policy to sustain wages for labor and to stimulate economic growth. Because businesses were afraid to invest, instead of worrying about inflation, states temporarily ran a deficit so as to encourage production and consumption. In the United States, President Franklin Roosevelt adopted many other Keynesian policy suggestions including public works projects to stimulate employment, unemployment insurance, bank deposit insurance to improve investor confidence in banks, and social security.

Keynes also made clear that the state should use its power to improve the market, but *not* along the aggressive, nationalistic lines of mercantilism. He worried that under the strain of the Great Depression people could easily turn toward an ideology like Fascism or Nazism for solutions to their problems. He found communism and the Soviet regime repressive and their disregard for individual freedom intolerable. In contrast to his archrival Hayek, Keynes argued that a liberal system is one that respects individual freedom, not one that limits it for the sake of security. Much like Adam Smith, he argued that economics is a tool *not* to be divorced from issues related to how it can serve society. Beyond all else, Keynes was a moral humanist who wanted to get beyond the problem of accumulating wealth, which he viewed as "a somewhat disgusting morbidity," to a society where most people could instead spend their leisure time contemplating and living a good life.

The Keynesian Compromise: Reconciling State and International Interests

Keynes is also noted for the role he played in helping to reconstruct Western Europe after World War II and establishing the new international economic order. At a meeting of the Allied nations at Bretton Woods, New Hampshire, in 1944 two new institutions were created to manage the postwar economy: the IMF and the World Bank. Three years later, the General Agreement on Tariffs and Trade (GATT) was created to manage international trade. Keynes headed the British delegation, and the institutional result, though not his plan, certainly reflected many of his ideas.

One of the problems that arose from the meeting was how to square two objectives the Allies agreed were necessary to restore stability and economic growth to the international economy while helping states recover from the war. On the one hand, Keynes believed that on the domestic front positive government action was both useful and necessary to deal with problems the invisible hand did not solve. At the same time, he himself envisioned a liberal or open international system in which market forces and free-trade policies would play major roles in each state's foreign economic policy objectives. The **Keynesian compromise** was the idea that management of the international economy would be conducted through peaceful cooperation of states represented in the three Bretton Woods institutions based on embedded (entrenched) Keynesian ideas about the international political economy. States would work to *gradually* reduce their state regulatory policies so as to open their national economies as they recovered and became more competitive. The result was that domestic trade protection and capital controls became accepted exceptions to economic liberal polices in international negotiations.

The Keynesian flavor of **embedded liberalism**—strong international markets subject to social and political restraints and regulations reflecting domestic priorities—became the mainstream IPE view in the industrialized world from the 1930s into the 1970s, as many industrialized nations used state power to supplement, strengthen, and stabilize the market economy within the liberal Bretton Woods system of international institutions. In the early days of the Cold War, the international economy opened slowly generating a tremendous amount of economic productivity and growth. The mid-1960s were regarded as a "golden age" of steady economic growth in both the United States and Western Europe. In places such as Great Britain, France, West Germany, Sweden, and other nations, the role of the state was emphasized to a greater degree, creating something akin to a democratic-socialist system. In the United States, state policy became much more activist than in previous decades. The U.S. federal government played a very active role in the economy at home and abroad through such varied areas as space exploration, promoting civil rights, implementing the "Great Society" antipoverty programs, helping the elderly with Medicare medical insurance, and regulating business.

Many political economists argue that this post–World War II system worked well because the United States covered many of the expenses associated with maintaining the global monetary system and providing for the defense that each of the allies would have had to pay for alone. As a result, Japan and Western Europe could spend more for their recovery while benefiting from a system of open trade, sound money, and peace and security that stimulated the growth of markets everywhere. More generally, **hegemonic stability** theory is the idea that international markets work best when a **hegemon** (a single dominant state) accepts the costs associated with keeping them open for the benefit of both itself and its allies by providing them with certain international **public** goods at its own expense.[21]

But as time went on, U.S., West European, and Japanese interests changed, and as they did, hegemony gradually became more expensive for all involved to sustain (or put up with depending on one's perspective). By the late 1960s, states were driven by their domestic agendas to either sustain or increase the protection of their industries and growing economies. Economic growth gradually shifted wealth and power away from the United States and toward Western Europe and Japan, changing the fundamental (cooperative) relationship of the United States to its allies. At the same time, the United States felt strongly that the costs of fighting the war in Vietnam were becoming prohibitive without more allied financial and political support. It became more difficult to keep the international trade, monetary, and financial systems open.

THE RESURGENCE OF CLASSICAL LIBERALISM

In the late 1960s, President Nixon and others attacked Keynesianism and the cost of President Johnson's Great Society program, seeking to put more emphasis on economic growth instead of stability. As discussed in Chapter 7, in 1973 the United States replaced its fixed exchange rate system with a flexible exchange rate system, which led to increased speculation on currencies and more money circulating in the international economy. That same year OPEC (Organization of the Petroleum Exporting Countries) oil price hikes led to an economic recession in the industrialized nations, but also massive amounts of OPEC's earnings recycled back into Western banks. Meanwhile, many Western European states, Japan, Brazil, Taiwan, and South Korea were competing with the United States for new trade markets. Keynesian policies to deal with the recession generated stagflation—the coexistence of low growth and high inflation, which were not supposed to occur together.

In this environment of low economic growth and increasing competitiveness, Keynes's ideas were gradually replaced by those of the Austrian Friedrich Hayek (1899–1992) and Milton Friedman (1912–2006). Their more orthodox economic liberal policy ideals and values featured "minimally fettered" capitalism—or a *limited* state role in the economy. These increasingly popular ideas laid the intellectual groundwork for what became a distinct variation of liberalism, otherwise known as economic liberalism or **neoliberalism**.

Hayek's most influential work, *The Road to Serfdom*, explored growing state influence that he felt represented a fundamental threat to individual liberty. In his view, the growing role of government to provide greater economic security was nothing more than the first step on a slippery slope to socialism or fascism. He warned against reliance on "national planners" who promised to create economic utopias by supplanting competition with a government-directed system of production, pricing, and redistribution. Drawing on older theories of economic liberalism, Hayek argued that the only way to have security *and* freedom was to limit the role of government and draw security from the opportunity the market provides to free individuals.

Contrasting the "collectivist" ideas of socialism with the virtues of an economy with real freedom, he wrote:

> . . . The virtues which are held less and less in esteem . . . are precisely those on which Anglo-Saxons justly prided themselves and in which they were generally recognized to excel. These virtues were independence and self-reliance, individual initiative and local responsibility, the successful reliance on voluntary activity, noninterference with one's neighbor and tolerance of the different, and a healthy suspicion of power and authority. Almost all the traditions and institutions which . . . have molded the national character and the whole moral climate of England and America are those which the progress of collectivism and its centralistic tendencies are progressively destroying.[22]

Echoing Hayek's foundation, Milton Friedman wrestled with the problem of keeping government from becoming a "Frankenstein that would destroy the very freedom we establish it to protect." According to Friedman, government "is an instrument through which we can exercise our freedom; yet by concentrating power in political hands, it is also a threat to *freedom*."[23] In his book *Capitalism and Freedom*, he consciously returns to the classical liberalism of Adam Smith. Friedman stresses the classical liberal view that the market preserves and protects liberty. A state that takes its citizens' freedom through anything more than absolutely necessary action is no better than one that seizes their freedom guided by mercantilist, socialist, or fascist notions of security. Capitalism, with its free competitive market, naturally diffuses power and so preserves freedom.

REAGAN, THATCHER, AND THE NEOLIBERALS

In the early 1980s, the classical economic liberal view of IPE reasserted itself even more forcefully through a movement called neoliberalism. Prime Minister Margaret Thatcher of Great Britain and U.S. President Ronald Reagan were the chief practitioners of policies that owed much more to Smith, Hayek, and Friedman than to Mill or Keynes. Thatcher's motto was TINA—"There Is No Alternative" to economic liberal policies.

Neoliberalism emphasizes economic growth over stability. President Reagan promoted "supply-side economics," which is the idea that lower taxes instead of increased spending by government would increase the money supply and generate its own demand, unleashing capital to businesses and consumers. The top income tax rate in the United States was cut in stages from 70 percent in 1980 to 33 percent in 1986.

Other features of "Reaganomics" (as it was popularly known then) were *deregulation* of banking, energy, investment, and trade markets (i.e., promoting free trade). Many national telecommunications, airline, and trucking industries were *privatized* (sold off to wealthy individuals or corporations) to allow for greater competition and freedom to set prices. Some public housing in Britain was privatized, and welfare programs in both the U.S. and Great Britain were "rolled back" (shrunk). Many neoliberals argued that the state was too big and not to be trusted. Echoing Smith, they maintained that its interests reflected powerful special interests, whereas the market was a neutral tool that redistributes income to those who are most efficient, innovative, and hard working. Although these policies might lead to greater income inequality, economic growth at the top of society would gradually "trickle down" to benefit labor and society's masses. Finally, the rule of thumb for both popular leaders was that the state was to minimally interfere in all areas of public policy except security, where both advocated a strong anticommunist stance.

As we discussed in Chapter 1, in the mid-1980s the United States began promoting globalization—the extension of economic liberal principles the world over—as a process that would expand economic growth and bring democracy to those nations integrated into this capitalist structure. Emphasizing the role of *unfettered* markets (unchained by the state), globalization promised to enhance production efficiency, spread new technologies and communication systems, and generate jobs in response to increased demand.

An integrated global economy was also expected to benefit millions of people trapped in poverty in developing nations. In the late 1980s, the "Washington Consensus" about the benefits of economic liberal policies and their connection to democracy was promoted in the policies of the GATT, the IMF, and the World Bank. The success of these laissez-faire policies in the United States and Great Britain, combined with the collapse of communism in Eastern Europe in 1990, led some leaders in the faster-growing developing economies in Southeast Asia and Latin America to support more market-friendly policies. Most of the ex-communist regimes of Eastern Europe replaced centralized, inefficient state planning with more market-oriented development strategies.

THE 1990s AND 2000s: NEOLIBERALISM AND GLOBALIZATION UNDER ATTACK

Many attribute the global economic recovery after 1992 to deregulation and privatization, which became widespread policies in most parts of the world. It became commonplace to read that neoliberalism was practically and theoretically "triumphant." The Clinton administration continued to emphasize neoliberal ideas, negotiating a plethora of free-trade deals such as NAFTA and helping create the WTO (see Chapter 6). Neoliberal-style capitalism and open markets continued to be directly linked to U.S. economic and military interests. Some Central and Eastern Europe states became members of the European Union's (EU) single market. Mexico, India, and China all adopted pro-market "reforms," encouraged foreign investment, and massively boosted trade with the United States.

However, in the mid-1990s neoliberalism encountered increasing criticism, especially by anti-globalization protestors who accused it of causing violations of human rights, damaging the environment, depriving poorer countries of effective representation in international economic organizations, and fostering sweatshops in developing countries. Mass anti-globalization protests in major cities—capped by the "Battle of Seattle" in the spring of 1999—demonstrated that many civil society groups had lost faith in laissez-faire capitalism. Major recessions in Mexico in 1994, Russia in 1996, and throughout much of Southeast and East Asia in 1997 and 1998 led many officials in developing countries to question the merits of weakening regulations and encouraging massive capital flows across borders. And yet overall support for globalization among Western policy makers, business elites, and economists remained strong.

By the mid-2000s, some public officials and intellectual *supporters* of globalization began to address potential problems with rapid, unregulated globalization. A good number of these critics were *not* inherently opposed to economic liberal ideas, but merely wanted today's IPE to be *managed better*. For example, Joseph Stiglitz, the former chief economist of the World Bank and Nobel Prize winner in Economics, has criticized IMF policies for making it difficult for many developing nations to get out of debt and benefit from globalization.[24] Economist Dani Rodrik has pointed out that too much economic integration, free trade, and unfettered capital flows pose a threat to democratic politics. Markets, he argues, have to be "embedded in non-market institutions in order to work well."[25] They will not be viewed as legitimate unless they reflect individual countries' national values, social understandings, and political realities such as voters' unwillingness to accept rampant inequality and limits on sovereignty.

Thomas Friedman, whose influential 2005 book *The World Is Flat* was something of a paean to globalization, also began to address some problems with neoliberalism—especially environmental damage. While acknowledging that open markets and technological change are bringing unprecedented opportunities for the rise of new middle classes in China and India, in his 2008 book *Flat, Hot and Crowded* Friedman deals with the costs due to loss of biodiversity, climate change, and energy shortages. Sounding more like a mercantilist, he suggests that governments need to create incentives for technological innovation leading to widespread renewable energy.[26] In fact, in a chapter called "China for a Day (But Not for Two)," he muses that the United States should have a day of authoritarian government to force the country to adopt good energy policies and energy efficiency standards—and then revert back to democracy and free-market capitalism!

Another scholar who recognizes unsustainable consequences of global neoliberalism is David Colander, an economist at Middlebury College. He argues that in a global economy, the operation of what economists call the "law of one price" means that wages and prices in the world *in the long run* would become more equalized as technology and capital spread more production and outsourcing to other countries. As a result, the United States would gain less and less from trade, wages would inevitably go down, and growth would decline as the United States loses its comparative advantage in most industries. Moreover, Colander believes that trade and outsourcing—which have benefited the majority *in the short run*—will soon cause the United States "to enter into a period of long-run relative structural decline, which will be marked by economic malaise and a continued loss of good jobs."[27]

And even liberal development economists by the mid-2000s were starting to acknowledge the problems that neoliberalism either caused or seemed to be incapable of solving in developing countries. Former World Bank economist William Easterly criticizes Western institutions for promoting policies and doling out foreign aid that utterly failed to help the poorest countries get out of poverty. The UN, the World Bank, the IMF, and others were imposing market-based policies on countries that lacked the social and political institutions like good government, accountable leaders, and uncorrupt courts to actually make markets work properly.[28] Easterly argues that poor countries need to be allowed to develop their own institutions to support a market system, even using protectionism and relying on innovative NGOs.

From a different angle, former World Bank director of research Paul Collier defends globalization for creating huge opportunities for about four billion people in developing countries. Yet at the same time he criticizes it for leaving a billion people stuck in a poverty trap. This bottom billion are stymied by political, economic, and geographical problems that markets alone cannot overcome: civil war, natural resource abundance that undermines democracy, and being landlocked. Instead of more globalization as the way out, Collier advocates some decidedly state interventionist help: military intervention in some failed states to restore order, allowing temporary trade protection, and setting up new international charters to promote norms and standards (through international pressure) that help reformers in the poorest countries.[29]

Thus, by the mid-2000s, a unique confluence of economic liberal scholars and anti-globalization activists pointed to the mounting problems and unintended consequences of neoliberal-inspired globalization. They proposed different solutions but shared the idea that the global economy needed some kind of better regulation and governance. Without always explicitly saying so, they recognized the idea that markets need to be embedded in social and political institutions in order to have legitimacy and to resolve fundamental human problems. In the short run, unfettered global markets failed to help the world's poorest and were destroying the environment. In the long run, through outsourcing and environmental degradation, they might even undermine the prosperity of those developed countries that uncritically worshipped them. It would take the global financial crisis that started in 2007 to convince policy makers that neither more globalization nor incremental, piecemeal reforms to globalization were enough to save economies from the tsunami of contradictions that neoliberalism had created.

The Financial Crisis: A Stake in the Heart or Just a Scratch?

(Note: This section focuses on the ideological debate between OELs and HILs, and not the specifics of the financial crisis itself. Before reading this section, instructors and students may want to read the more detailed coverage of the crisis in Chapter 8.)

While there had been many grumblings about neoliberal globalization, no single event in recent history has seemingly undermined economic liberalism as much as has the recent financial crisis, which produced the most severe economic collapse since the Great Depression. At one particular moment in time the public could hear the hammer drive the stake further into the gap between laissez-faire and market interventionist supporters when the shaken former Chairman of the Federal Reserve Alan Greenspan gave testimony before the U.S. Congress in October 2008. He admitted that his faith in the self-regulating nature of financial markets had been misplaced—that "those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief."[30] Greenspan also admitted that he made a "big mistake" and blamed his state of incredulity on a "flaw in the (economic) model" that defines how the world works.

The deep global recession seemed to shake the faith of even some of the most ardent proponents of free market capitalism. Before the crisis, Greenspan himself regularly assured Congress that financial markets and new complex financial instruments (derivatives) were self-regulating, and that rational, profit-maximizing financial actors would take all necessary precautions to ensure that excessive risk-taking and insufficient due diligence (regarding mortgage lending) would not be tolerated (although in 1996 he had famously cautioned about "irrational exuberance" in the stock market).

In retrospect, it appears that many banks and investment firms in capital deficit countries such as the United States and in parts of the European Union were more than willing to *incur excessive economic risk*, and that many institutions, state officials, and individuals egged them on. In fact, in an environment of free-wheeling "wildcat" capitalism, the beauty of high-yielding types of investments was that the original investors *profited* handsomely from the original deals they made, while the *risks* associated with these types of instruments were spread out to new investors and mortgage holders.[31] These schemes actually worked and made purchasing an expensive asset seem reasonable and reinforcing, virtually institutionalizing excessive risk-taking.

Until the financial crisis, many U.S. and British officials felt that the state should have a laissez-faire outlook of limited regulation and essentially let the banks police themselves. Today, many state officials and experts the world over have suggested that they had no recourse but to bail out their banks and other financial institutions. Certainly, Presidents Bush and Obama have believed it; neither felt he could afford the possibility of being wrong because the political and economic stakes were so high. Their drastic measures were not so much to save greedy and unethical bank officials whose improprieties generated huge profits for their institutions, but to stabilize the financial system and correct the policies that threatened to destroy it. For the most part the debate about state regulation of major banks and other financial institutions remains centered on who should do the bailing out and how much money should be spent on it.

So how did this happen? Why did banks take on so much risk? How could the ideas associated with neoliberalism that had proved to be scientifically correct and so popular seem to go down in flames? Or have they? In this section, we examine some of the connections between neoliberal theories, globalization, and the financial crisis.

An Outdated Economic Theory and Ideology

As noted earlier, Keynes was adamant that markets are prone to failure, with the Great Depression being a prime example of that reality. Since his time, many governments became better at dealing with smaller recessions that were considered a normal part of the business cycle. Using a variety of fiscal and monetary tools, they could tinker with supply and demand to right the economy through choppy waters. Milton Friedman and other monetarists associated with the so-called Chicago School emphasized that the nation's money supply was the key to inflation and that the market is a self-correcting mechanism. A companion theory, the Efficient Market Hypothesis, claimed that "at every moment, *shares price themselves* in the market through attracting the input of all information relevant to their value."[32]

Policies based on these outlooks about the validity of free markets complemented by weak state deregulation seemed to work for some time in the developed countries. Fed Chairman Greenspan criticized excessive state regulation of banks, and together with investors seemed to view recessions in the United States as a thing of the past. Furthermore, he and many banking institutions also seemed to regard investments by other nations in the United States—which helped finance U.S. spending and trade deficits—as evidence of the correctness of an ideology that had spread throughout the international economy.

In the crisis aftermath, the economic liberal news journal *The Economist* uncharacteristically accused the "dismal science" of economics of being "seduced by their models" that are, however, full of holes, especially when it comes to quantifying fundamentals such as preferences, technology, and resources that do not fit the real world. Essentially, these models assume an equilibrium in markets when in fact (as Keynes maintained) many markets exhibit uncertainties (or disequilibrium). The result has been a focus on mathematical and deductive methods that encourage the belief that risk can be carefully managed. While these ideas have sounded simplistic, they have also been confusing—and "policymakers often fall back on highest order principles and broadest presumptions."[33] According to *The Economist*, macroeconomists in academia and within central banks have been too preoccupied with fighting inflation and too cavalier about recurring asset bubbles in markets.

In effect, some argue that free market theorists have underestimated distortions in markets, overestimated markets' ability to self-adjust, and failed to account for the long-term problems resulting from markets' short-term incentives. They have also suggested that the financial crises could shake up the discipline of economics and force it to rethink some of its basic scientific assumptions. However, indications are that it has not very much yet. A recent study of economic curricula points to the entrenchment of rational-choice assumptions and a bias toward teaching the benefits of free markets.[34] Of course, many OEL-oriented faculty defend their discipline and offer alternative interpretations of market theory.[35]

What factors account for the continued popularity and tenacity of laissez-faire ideas outside academia? First, behavioral economist Robert Schiller suggests that "group think" among politicians and officials in the finance and business sectors is part of the reason for the entrenchment of theories that are slow to change. Similarly, economist James Galbraith suggests that laissez-faire is a "doctrine that serves as a legitimizing myth."[36] It outlines the rules and boundaries of the debate; clarifies those opposed to it; and restricts the flow of information and alternative ideas about it. Second, many believe that "letting the market decide" public policy is a correct and simple recommendation based on an "objective" study of the market. Laissez-faire policies have also been much easier to understand as opposed to the "messy" role of politics, social values, and civil society in determining the appropriate distribution of resources both inside and between countries.

Third, free market models have focused on generating economic growth instead of social stability and relative equality of income distribution. Ironically, the *promise* of greater wealth, faster growth, better jobs, and cheaper prices has been easier for the public (i.e., the masses) to buy into than the alternative of higher taxes for more social programs, slower growth for environmental sustainability, and collective sacrifice today to benefit future generations. Fourth, laissez-faire has been heavily supported by the wealthy, whom people tend to admire, who dominate the media, and who provide crucial financing to political parties throughout the industrialized democracies.

Fifth, Simon Johnson, the former Chief Economist for the IMF, has argued that over the years a financial oligarchy has developed in the United States composed of private firms and actors that call the shots in Washington in a way that serves their interests even at the expense of the public. They are an interconnected group of politically powerful people who move back and forth between Wall Street and Washington (and some university offices), "amassing a kind of cultural capital—a belief" that "large financial institutions and free-flowing capital markets were crucial to America's position in the world."[37]

We Are All Keynesians Now (Again! At Least for a While?)

The financial crisis has brought to the fore a division between economic liberals. In this section, we contrast some of their recent arguments to demonstrate the richness of the debate, the different views about the role of the state and globalization, and the re-emergence of Keynesian thought among HILs. For most HILs, Keynes has been a key figure because he explained uncertainty—exclusive of rational expectations—and justified efforts to manage the economy in such a way as to serve the broader interest of society instead of the wealthy. The crisis has led HILs to assert that states must act to save the financial system and even capitalism itself. Interestingly, some OELs agree. For example, in a recent *Financial Times* piece titled "The Seeds of Its Own Destruction," the predictable OEL Martin Wolf acknowledges that "the era of financial liberalization has ended and that the state can be expected to play a bigger role in rescuing banks and adopting other interventionist measures."[38]

A few of the most often-discussed HIL proposals (discussed in more detail in Chapter 8) are as follows:

- Spend more to grow the economy, without worrying too much about inflation. It is more important to create jobs
- Invest more in new technology for energy and transportation, infrastructure, education, and health care
- Impose tougher regulations on banks related to derivatives, deposit requirements, pay, and bonuses
- Break up big banks to increase competition
- Better manage globalization, but without stopping it

Most HILs agree on the need to increase government spending and expand the powers of existing regulatory institutions at the national and international levels. As Keynes would suggest, the financial system requires a sophisticated and effective regulatory and legal framework that only the state can provide—a state strong enough to enforce those laws but without stifling the profit motive, economic freedom, and individual liberty.

Most HILs are *not* opposed to globalization per se, but would like to see policies and programs that distribute the wealth it produces to the masses in industrialized nations and poorer people in developing nations. They recognize the need to reform institutions like the World Bank, the IMF, and the WTO to get away from a "one-size-fits-all mentality" of how economies should be run and of what rules countries have to follow. Related to this is a new emphasis on creating "policy space" for developing countries (at least in the short run) to be more protectionist, restrict capital flows somewhat, and have more lax rules on intellectual property rights. Presumably, this will allow them to grow faster and buffer them somewhat from global instabilities in currencies, investment flows, and commodity prices. HILs note that China and India have fared much better during the financial crisis precisely because these two have *not* fully adopted neoliberalism.

HILs also believe that the developed countries must actively help developing countries in ways they have not before. They emphasize that developed countries need to drop their remaining protectionist barriers to key LDC exports like textiles and agricultural goods and stop subsidizing their own industries. They need to allow more immigration from poorer countries. It would also be in their interest to forgive excessive debt held by poorer countries and increase foreign aid massively. HILs favor inducing countries to adopt more free market reform and democracy by offering them assistance rather than pressuring them.

Many HILs are open to the possibility of creating a different economy and social system, something that shifts the state-market formula to the left—akin to social democracies in Western Europe (see the "Ordoliberalism" box below). A number of HIL scholars have found that Nordic countries and other nations that have some of the highest openness to the international economy (measured by the ratio of trade to GDP) also have some of the highest public expenditures on social programs (measured by the ratio of spending to GDP). This suggests, contrary to OELs, that high government spending is compatible with being open to and benefiting from global market participation. HILs also tend to accept—and even justify—the maintenance of different models of national capitalism within a broader global free market economy. Coordination between these different national systems of capitalism is more important than harmonizing all of their institutions and policies. In other words, when it comes to designing global institutions and rules, Dani Rodrik stresses the need for maintaining "escape clauses" and "opt-outs" so that individual countries can benefit from globalization in a way that is most consistent with their political realities, cultural needs, and resource constraints.[39]

ORDOLIBERALISM AND THE SOCIAL MARKET ECONOMY

Economic liberalism had been largely discredited in Europe by the 1920s. Economic liberalism, particularly in Germany's post–World War I Weimar Republic, had come to be associated with economic chaos, political corruption, and the exploitation of the working class.[a] In response to this perception and to Hitler's consequent rise to power, a small group of academics at Freiburg University developed a new conception of liberalism they called *ordoliberalism*. Walter Eucken (1891–1950), Franz Böhm (1895–1977), and Hans Grossman-Doerth (1894–1944) founded this school of thought. Ordoliberals believe that the failings of liberalism resulted from the failure of nineteenth-and twentieth-century *laissez-faire* policy makers to appreciate Adam Smith's insight that the market is embedded in legal and political systems.

Ordoliberal thought reflects the humanist values of classical liberalism, including the protection of human dignity and personal freedom. Ordoliberals espouse the classical liberal notions that private decision making should guide resource allocation, that competition is the source of economic well-being, and that economic and political freedom are inextricable. Like classical liberals, they also believe that individuals must be protected from excessive state power and that political power should be dispersed through democratic processes that maximize participation in public decision making. Ordoliberals also emphasize that individual freedoms must be protected from private power in the form of monopoly control of markets and influence used to create special privileges that rig markets in favor of those dominant firms.

Ordoliberals believe that the market process will support and promote liberal values only if appropriate rules governing the market process (property law, contract law, trade law, competition policy, etc.) are established by the state. *Ordo*, from the Latin, means "order." The rules governing the market process should be "constitutional" rules immune from political manipulation that reflect the shared liberal values of society. With such a framework in place, the market process will reinforce the economic and political freedoms so central to the liberal conception of the good society. With such a framework in place, the efforts of powerful firms to subvert the market process (via price controls, import restrictions, subsidies, restrictive licenses, etc.) will be deemed "unconstitutional." Politicians will be in a strong position to resist the special pleadings of powerful interest groups, and the power of the state in general to influence market outcomes will be severely restricted. A privilege-free economy will be the highly desirable result.

Ordoliberal thought has had a profound influence on economic and political policy in the European Union. Current European competition policy clearly incorporates ordoliberal principles. It severely restricts the behavior of dominant firms—particularly, any practices that might inhibit the entry of small- or medium-sized rivals. By maintaining open markets, European competition authorities hope to foster economic freedom in the form of freedom of entry, thereby enhancing economic opportunity, promoting competition, and diffusing economic and political power. Microsoft's antitrust problems in Europe can be better understood in this light.[b]

Ordoliberalism does have an inherent ethical stance. Market outcomes generated within an appropriate legal and political framework are nondiscriminating, privilege-free outcomes and are likely to be just outcomes.[c] Ordoliberals recognize, however, that some income redistribution will likely be called for, given the limited productivity of some individuals—often due to circumstances beyond their control.

Other German intellectuals, principally Alfred Müller-Armack (1901–1978), accepted key ordoliberal principles but challenged the ordoliberal notion that market outcomes are just outcomes. Müller-Armack argued that supplemental "social" policies are necessary to ensure that market outcomes will indeed be consistent with a "good" society. Further, these supplementary rules might indeed affect specific market outcomes so as to privilege certain segments of society. Müller-Armack is credited with developing the basis of the "social" market economy that characterizes many modern European states.[d]

References

[a]The discussion of ordoliberalism in this and the following paragraphs is based largely on David J. Gerber, "Constitutionalizing the Economy: German Neo-Liberalism, Competition Policy and the 'New' Europe," *The American Journal of Comparative Law*, 42 (1994), pp. 25–88.

[b]"Microsoft on Trial," *The Economist*, April 28, 2006, www.economist.com/agenda/displaystory.cfm?story_id=E1_GRSDSRP.

[c]Victor J. Vanberg, "The Freiburg School: Walter Eucken and Ordoliberalism," Walter Eucken Institute, Freiburg Discussion Papers on Constitutional Economics, November 2004, p. 2.

[d]Ibid.

As HILs have adopted a more nuanced set of assumptions about global state–market relations, OELs have been less accepting of this foray back into Keynesianism. As we write, it appears that the Obama administration has sided more with HILs than OELs by trying to adopt more regulations so that the system cannot "go back to the way it was." Why? It may be that the president fears a backlash in the next election if he does nothing to reform Wall Street. A number of Democratic lawmakers share his more interventionist views. However, many powerful Congress people and members of the financial sector share the outlook of OELs. Alex Berenson goes even deeper to suggest that Americans are by nature "basically conservative people" who distrust the state, but who also have an "appetite for risk."[40] While Europeans might prefer social democracy, an oligarchy of wealthy elites in the United States prefers a wilder version of capitalism.[41] Also distasteful to most Americans are the new crop of populist-socialist societies in Venezuela, Bolivia, Chile, and Ecuador that have made a wider distribution of goods and services to the masses one of their key political objectives.

In light of these factors and others, OELs prefer to keep the main laissez-faire characteristics of the free market, subject to a few, more passive reforms. They propose to

- limit government support for banks, infrastructure projects, and social welfare programs
- decrease regulation of many parts of the economy

- cut taxes of the wealthy and middle class to stimulate economic growth
- foster *more* globalization, which is good for the United States and the world.

When it comes to the financial crisis, many OELs argue that it was the fault of government, not banks. The Federal Reserve created the housing bubble beginning in 2001 by dropping interest rates that decreased the cost of borrowing. This put more money into the hands of homebuyers who could not afford payments in the long run. OELs also argue that the crisis was an exceptional event in the history of capitalism, one that occurs very infrequently—due more to flaws in human nature than flaws in capitalism itself.

Globalization has also proved to be a good thing, given the growth it produced in the industrialized states and the number of people it has lifted out of poverty in developing nations. OELs would like to see the United States push for a resumption of the Doha Round trade negotiations to lower more trade barriers in agriculture, services, and government procurement. They also believe that the United States needs to lower its out-of-control budget deficit, with the goal of reducing its trade deficit and increasing national savings. They fear that big stimulus spending by world governments will generate inflation and more debt future generations will have to pay off (by consuming less). In addition, OELs want governments to rapidly deleverage the commitments they have made to banks and industries, returning bailed out companies and assets to private control.

At this point in time, most experts and policy officials tend to agree that there is no clear set of policies that can solve the financial crisis in the near future. Capitalism and its dominant economic liberal foundation are likely to continue to be intellectually and politically challenged. Despite their problems, nothing has so far emerged to replace them, as many fear that the alternatives are potentially worse. Many of the more successful developing countries such as China, India, and Brazil remain sanguine about the benefits of "free market" capitalism. It remains to be seen if these states can effectively manage and sustain state-market-society relations in ways that benefit their societies.

CONCLUSION

Economic Liberalism Today

This chapter has explained how the ideas and values associated with the economic liberal version of liberalism have changed in recent history to reflect major historical, political, economic, and social developments. Political economists Smith, Ricardo, Mill, Keynes, Hayek, Milton, and others have debated the relationship of the state to the economy, and today there is an emerging split between orthodox and heterodox liberals when it comes to this issue.

Although capitalism took centuries to unfold, it has unleashed market forces that both reflect and influence consumers' demand for certain items along with how these items are produced. Capitalism has spread over large parts of the world. Countries on every continent have introduced market-oriented reforms in pursuit of a better life for their citizens. The free-trade paradigm at the heart of globalization profoundly shapes global production and distribution.

During the Great Depression, a split emerged between those HILs who supported a positive role for the state in the economy and those OELs who saw the state's role in the economy and society as decidedly negative. In the 1980s, the chasm widened even more. Globalization and the current financial crisis have led to serious criticisms of neoliberal ideals and neoliberal faith in markets. Many HILs maintain that some state intervention serves the public interest, especially when it protects social groups and countries from the negative effects of the seemingly Darwinian global economy. Despite their differences, both orthodox and heterodox liberal perspectives seek to answer the same two fundamental questions: What values should markets serve, and whose interests should they promote?

In Chapters 3 and 4, we will explain two other IPE perspectives—mercantilism and structuralism—and present some of the many explanations they offer for these same sorts of theoretical issues and practical dilemmas.

KEY TERMS

economic liberalism 29
heterodox interventionist liberals (HILs) 29
orthodox economic liberals (OELs) 29
rent-seeking 34
Corn Laws 35
positive-sum game 37
zero-sum game 37
Keynesian theory 38
paradox of thrift 39
Keynesianism 39
Keynesian compromise 40
embedded liberalism 41
hegemonic stability theory 41
hegemon 41
public goods 41
neoliberalism 42
Reaganomics 43

DISCUSSION QUESTIONS

1. Explain Adam Smith's concept of the "invisible hand." What roles do self-interest and competition play in this concept?
2. Now that you have read the chapter, how would you characterize the view of Adam Smith? Is he the economic liberal many people assume he is? Write a five-sentence paragraph summing up his main outlook about political economy.
3. Explain how the Corn Laws debate in nineteenth-century Britain illustrates the conflict between mercantilist and economic liberal views of international trade. Which side of the debate do you favor? Explain.
4. John Stuart Mill and John Maynard Keynes thought that government could play a positive role in correcting problems in the market. Discuss the specific types of "market failures" that Mill and Keynes perceived and the types of government actions they advocated.
5. Ronald Reagan and Margaret Thatcher are often cited for their support of neoliberal ideas and policies. Summarize those ideas and policies and discuss how they differ from those of their economic liberal predecessors. Finally, explain why you think they are still popular today. Or are they?
6. Explain how OELs and HILs are similar and different in terms of values, ideas, and policies. Which do you favor? Explain.
7. Based on what you know about the current financial crisis, do you agree with the suggestion that the crisis has seriously undermined economic liberal ideas and policies? Explain.

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NOTES

1. Ross Singleton has been the chief architect of this chapter since the first edition of the text. Richard Anderson-Connolly also worked on this edition of the chapter.
2. In this book we use the term *neoconservatives* or "neocons" to refer to members of the George W. Bush administration (and its supporters) who had a decidedly unilateral outlook about the world and U.S. power and capabilities to manage it (see Chapter 9).
3. Ralf Dahrendorf, "Liberalism," in John Eatwell, Murray Milgate, and Peter Newman, eds., *The Invisible Hand: The New Palgrave* (New York: W. W. Norton, 1989), p. 183.
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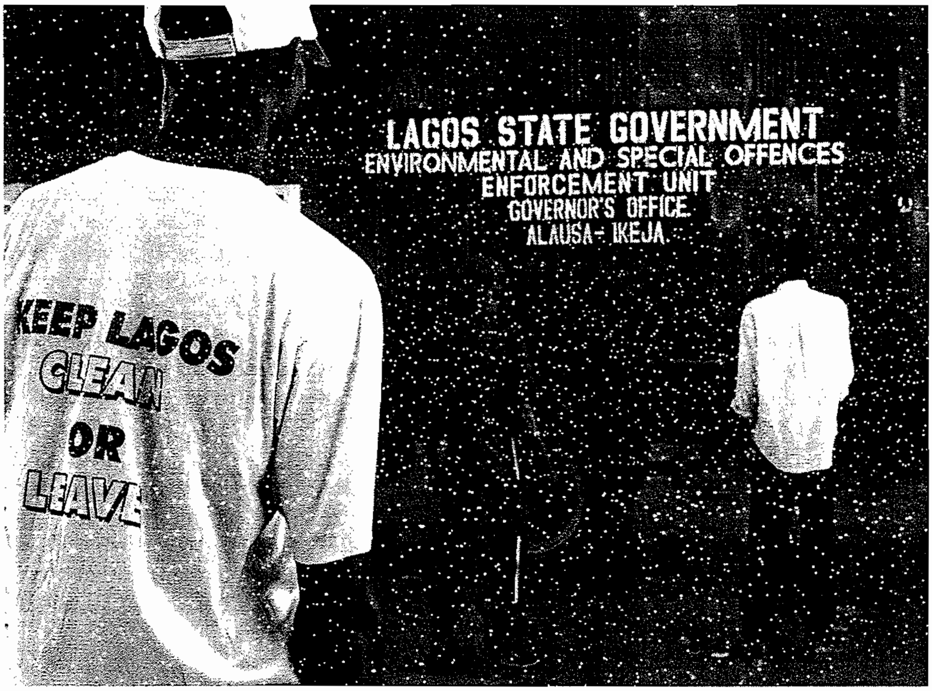
CHAPTER

3

Wealth and Power: The Mercantilist Perspective



The state in action.

Jacob Silberberg

Our economic rights are leaking away. . . . If we want to recover these rights . . . we must quickly employ state power to promote industry, use machinery in production, give employment to the workers of the nation. . . .[1]

Sun Yat-sen, 1920

In Chapter 2, we noted how the financial crisis has generated a shift in outlook by many economic liberal state officials and experts toward the view that the state *must* play a bigger role in regulating banks, speculators, and financial markets in general. Many officials worry that in the highly integrated global economy, the financial crisis threatens their state's national security by undermining their ability to secure themselves physically and psychologically against a variety of political and economic threats. Many state officials are also concerned about their capacity to deal with many of the unacceptable political and social costs of the crisis such as unemployment, the loss of health care, and damage to the environment.

Mercantilism is the oldest and psychologically most deeply embedded of the three IPE perspectives. It accounts for one of the basic compulsions of all people and nation-states: to create and sustain wealth and power in order to preserve and protect the nation's security and independence from any number of real and imagined threats. Historically, classical **mercantilism** connoted efforts by states to promote exports and limit imports, thereby generating trade surpluses that would enhance state wealth and power while protecting certain groups within society.

Realism is closely related to mercantilism in that it also emphasizes state efforts to achieve security (which are explored in more detail in Chapter 9). While mercantilists usually focus on economic threats to a state, realists emphasize a wider variety of physical threats—and encourage the use of both military and economic instruments to defend the state or deter military attacks on it. Of course, in today's interconnected and globalized international political economy, it gets harder all the time to separate economic from military threats to nation-states. Today, **neomercantilism** accounts for a more complex world marked by intensive interdependence and globalization where states use a wider variety of instruments—especially economic ones—to protect their societies.

In this chapter, we explore many of the political-philosophical ideas associated with classical mercantilism, realism, and neomercantilism. The chapter follows a chronology that covers how and why mercantilist ideas evolved from the sixteenth century until today. We then discuss a number of neomercantilist policies related to the debate about how much the state should or should not interfere in markets in the face of globalization and the recent financial crisis.

We stress five theses in this chapter. First, historically, mercantilism is rooted in the desire for protection by both the individual and the state. Second, the history of mercantilism demonstrates that states have been and will always be compelled to regulate markets, and that there are no beneficial effects of markets without the state's willingness to allow, sustain, and manage them. Third, states that pursue economic liberal objectives that include opening markets and promoting free trade do so when those objectives coincide with state national interests. Fourth, paradoxically, globalization has *not* reduced the compulsion of states to protect themselves as economic liberals suggested it would. Rather, globalization has actually further *entrenched* national insecurities due to the increased tensions and conflicts it generates. Finally, mercantilists usually argue that states are finding it hard to cooperate with one another and with other global actors to solve problems such as the recent financial crisis.

MERCANTILISM AS HISTORY AND PHILOSOPHY

The history of mercantilism varies a good deal from that of economic liberal history (see Chapter 2). The classical mercantilist period of history is inextricably linked to the rise of the modern nation-state in Europe during the sixteenth through nineteenth centuries. During this period in Western Europe, the idea of state building and intervention in the economy for the sake of making the nation-state secure dominated political-economic thought. A nation is a collection of people who, on the basis of ethnic background, language, and history—or some other set of factors—define themselves as members of an extended political community.[2] The state is viewed as a legal entity, theoretically free from interference by other nations, which monopolizes the means of physical force in its society and exercises sovereignty (final political authority) over the people of a well-defined territory.[3] The political philosophy of mercantilism suggested why and how nation-states could generate the wealth and power needed to protect their societies and evolving economies from external threats.

The economic historian Charles Tilly emphasizes that war was the primary factor that motivated monarchs and other officials to organize their societies and adopt measures that would help secure the nation. Around the fifteenth century, small fiefdoms were compelled to form larger state units in order to be better able to protect themselves against other states.[4] Warrior-kings created bureaucratic agencies that performed a variety of functions related to keeping a budget, using money, and collecting taxes.[5] To control the nobles who often performed these functions in different locales, kings declared themselves the manifestation of state authority (what Louis XIV meant when he said: *le stat c'est moi*—I am the state). Many kings conceded absolute property rights and limits on their power to nobles in return for their support in staffing the king's armies and assessing and collecting taxes. Some historians suggest that these agreements eventually led to the creation of "people parliaments," which were the genesis of modern democracy and constitutionalism when they secured more rights for peasants.

Over the next century, what we commonly recognize as nation-states emerged, albeit in a very uneven fashion. France, for instance, was already a "nation-state" in the fifteenth century, soon to be followed by England, Holland, Spain, and Sweden. (Germany and Italy would not be consolidated into national entities until later in the nineteenth century.) The Cambridge economist Ha-Joon Chang explores some of the many ways that the Tudor monarchs Henry VII and Elizabeth I pursued what today we would call an industrial policy (a state-planned strategy to promote certain businesses).[6] These measures include the land enclosure acts (1760–1820), monopoly rights for certain businesses, and industrial espionage. Henry VII used tariffs and export subsidies in support of Britain's effort to capture control of the woolen industry from Holland. He sent royal missions to locate suitable places in England to manufacture woolen goods. For the next 100 years, England employed an import substitution policy (i.e., it allowed no woolen imports in order to promote local production—see Chapter 11) to compete with and intentionally ruin woolen manufacturing in the Low Countries (Belgium and the Netherlands).[7]

The practice of mercantilism gained a full head of steam after the Thirty Years War ended in 1648. While gradually states came to be regarded as sovereign over the people within their territories, political authority became centralized in (national) state officials. Increased demands for security led to more efforts to extract income and resources from towns and cities. While agriculture had constituted the dominant source of income a century earlier, it was no longer enough. Monarchs and state officials increasingly looked to merchants and their trade as a much larger source of income for state treasuries. To promote economic growth, larger state bureaucracies set about connecting local and regional markets, establishing common currencies and weights, keeping records, and promoting infrastructural development. As a consequence, merchants acquired more property rights and rose to a higher social position, while increasing their investment in the economy.

Most accounts of the period suggest that the threat of war and violence marked the history of European states at the time. In the nascent European state system, no state could be counted on to guarantee the security of others, therefore each state could look only to itself and its own wealth and power to protect its domain. These situations often resulted in a **security dilemma** whereby other states were easily threatened by the first state's efforts to increase its war-making capabilities. State officials tended to have a **zero-sum** outlook about state power whereby *absolute gains by one state meant absolute losses by another*. Territorial defense was always considered the state's first priority because prosperity and peace were useless if the nation was not protected from foreign invaders or internal groups who might overthrow the state. But because it was expensive to raise, equip, and maintain armies and navies, wealth also came to be regarded as one of the essential ingredients for acheiving and preserving national security.

To many historians, mercantilism is also synonymous with the first wave of exploration and imperialism from 1648 to the end of the Napoleonic Wars in 1815. The search for gold and silver bullion by a variety of adventurers and conquerors helped fill state coffers. **Colonialism**, the occupation of another territory or state, backed by military power, was another important instrument states used to control trade and generate wealth and power. Colonies served as exclusive markets for the goods of the mother country and as sources of raw materials and cheap labor. The growing merchant class also supported a strong state that would protect its interests, and in return the state sanctioned monopolistic merchant control over certain industries that profited both merchants and the state via commercial trade. Many states employed subsidies to generate exports and promote the development of their colonial empires. The Dutch were quite successful, followed by the British who also created charter companies and supported commerce in urban centers where new technologies were employed to produce items to market and trade.

Economic historians Kenneth Pomeranz and Steven Topik have studied how the colonial powers beginning in the 1400s used these mercantilist policies to move up the global hierarchy.[8] They argue that the dominant powers regularly used violence and occupation to harness advantages for their own traders and government-chartered companies in the global market. Slavery was integral to their strategies of building cheap labor forces to extract raw materials like cotton, sugar, and tobacco from the New World. Britain forced China to open itself to opium exports from India so that Britain could balance its trade deficit with India. European powers competed with each other to control access to raw materials like cocoa, rubber, tea, and coffee, and they deliberately spread production of these commodities to areas under their control and ability to tax. For commercial gain and control of territory, they essentially committed genocide against indigenous peoples in the Americas and the Belgian Congo. In a rebuke of classical liberals who predicted that international commerce would lead to peace and prosperity, they state, "This rosy picture of the healthy effects of the spread of the market economy unfortunately hides the historic foundation of violence upon which it was built and the continuing use of force that persistently underlay it, particularly in the non-European world."[9] In other words, during the historical accumulation and redistribution of wealth, "Bloody hands and the invisible hand often worked in concert; in fact, they were often attached to the same body."[10]

Rather than emphasizing economic growth only through trade and colonialism, Prime Minister Walpole (1721–1742) continued his efforts to promote England's woolen industry as another source of revenue. The British sheep and textile industries increased the profitability of land and generated jobs along with the consumption of taxable goods. To protect British manufacturing, the government raised tariffs on competitive goods and subsidized exports. Competitive imports into Great Britain from its colonies were banned, including cloth from India that was superior to that of the British, which destroyed Irish mills and delayed the emergence of the U.S. textile industry. All of these efforts were directed at enhancing state wealth and power in an increasingly economically competitive and politically hostile environment. Without these state protectionist measures, Great Britain would not have been able to support its growing economic wealth and imperial power.

The Economic Liberal Challenge to Mercantilism

Between the 1840s and 1870s, economic liberal ideas attributed to Adam Smith and David Ricardo grew in popularity in Great Britain and gradually replaced mercantilism as the cornerstone of its political-economic outlook. Even then many policy makers accepted the idea that markets were self-adjusting and that the role of the state should be *laissez-faire*—to stay out of the market. What accounts for the rise of these economic liberal ideas (see Chapter 2) that challenged mercantilism?

Adam Smith's *The Wealth of Nations* was published in 1776, and it attacked mercantilism for restricting economic competition that led to production inefficiencies. Yet, it wasn't until the end of the Napoleonic Wars in 1815, when Great Britain became the most efficient producer of manufactured goods, that officials began to press for free trade. England finally adopted a free-trade policy in 1840 but did not completely eliminate its trade tariffs until 1860. A variety of accounts suggest that Great Britain adopted a free-trade policy only as more officials and thinkers made the case that free trade was better for Great Britain than mercantilism (see the box: "Britain's Corn Laws" in Chapter 2). Following on the heels of Smith, the famous businessman and Member of Parliament (MP) David Ricardo helped popularize the idea of **comparative** advantage—that even when a country can produce a variety of goods more efficiently than other countries, it should specialize in producing only a select number of items and trade with other countries for the other goods it needs.

Despite his reputation, Smith was not the doctrinaire defender of free enterprise as most of his followers presume. He did champion individual (consumer) liberty and worried that the state could mess up an economy, but he also had a bit of a protectionist side. He supported taxes on luxury carriages, alcohol, sugar, and tobacco. As many historians note, he favored the Navigation Acts that required that only English ships could transport goods between Great Britain and its colonial possessions. Both Smith and Ricardo also viewed free trade as a policy that would help manufacturers market woolen and other British products throughout the world. Ricardo himself accepted exceptions to free trade "within narrow limits" until they were no longer necessary.

Clearly, free trade was *not* an ideological end in itself. The noted economic historian Karl Polanyi argues that there is strong historical evidence that, contrary to the precepts of economic liberalism, economically liberal states *themselves* merely used free-trade policy as another tool to protect and support their own industries, while seeking to gain a competitive advantage over other states.[11] Theories of comparative advantage and free trade would have others specialize in growing and selling wheat to Great Britain, while buying expensive British manufactured goods. Britain also did not oppose the use of trade tariffs to help British companies acquire and sustain technological leads over others, especially in the case of textile manufacturing.[12] Interestingly, in the face of rising European and American competition by the late 1870s, wealthy British financiers and manufacturers joined working class groups in a growing **countermovement** *against* open market policies and in favor of market regulation and trade protection. A mercantilist historical outlook also emphasizes that as universal suffrage (the right to vote) spread in the late nineteenth century, the state came under pressure to provide more benefits to society.

Most historians note that with renewed emphasis on mercantilism after 1870, **economic nationalism** (people's strong sense of identification with and loyalty to their nation-state) became even more entrenched in interstate relations and helped generate a second wave of imperialism at the end of the century. Germany, Japan, and Italy arrived on the scene and began acquiring their own colonies. According to Polanyi, the retreat from economic liberalism in Great Britain significantly weakened the European balance of power system, which would be replaced by a bipolar structure that led to World War I in 1914.

Meanwhile on the Other Side of the Atlantic: Overlooked Protectionism in U.S. History

In the nineteenth century, emerging powers such as the United States and the German principalities protected themselves from what they perceived as Britain's aggressive economic liberal policies. Two important examples of contributions to mercantilist thought at the time came from the American **Alexander Hamilton** (1755–1804) and the German Friedrich List (1789–1846). In his *Report on the Subject of Manufactures* to the first Congress, Hamilton argued (in opposition to the ideas of Thomas Jefferson) that specialization in agricultural production was not in the best interest of the United States. Specializing in farming would not make the United States either economically or militarily powerful enough to compete with potential enemies, let alone compete with Britain's ability to manufacture a variety of industrial goods and services the new nation needed. In terms that are familiar even today, Hamilton argued for the protection of the United States' **infant industries** and a strong role for the state in promoting its own domestic industries.[13] He also favored export subsidies to make U.S. goods more competitive abroad and to offset subsidies granted by foreign states. Hamilton wrote:

> It is well known . . . that certain nations grant bounties [subsidies] on the exportation of particular commodities, to enable their own workmen to undersell and supplant all competitors in the countries to which those commodities are sent. Hence the undertakers of a new manufacture have to contend not only with the natural disadvantages of a new undertaking, but with the gratuities and remunerations which other governments bestow. To be enabled to contend with success, it is evident that the interference and aid of government are indispensable.[14]

The nineteenth-century German political economist **Friedrich List** was an even more vigorous proponent of mercantilist policies. Exiled from his home—ironically for his radical free-trade views—List came to the United States in 1825 and witnessed firsthand the results of Hamilton's economic nationalist policies. The United States was building itself up and achieving independence and security. In his essay "The Theory of the Powers of Production and the Theory of Values," he argued that "*the power of producing* [is] *infinitely more important than wealth itself.*"[15] In other words, it is more important to invest in the future ability to produce more than to consume the fruits of today's prosperity.

For List, the manufacturing of industrial goods along with investment in education and the development of new technology was more important than investment in agriculture alone. The production of a wide variety of goods and services was the most desirable basis for national wealth and power. List wrote that manufacturing and other occupations "develop and bring into action an incomparably greater variety and higher type of mental qualities and abilities than agriculture" and that "manufactures are at once the offspring, and at the same time the supporters and the nurses, of science and the arts."[16]

The writings of Hamilton and List incorporated a spirit of patriotic economic nationalism that was very much a reaction to Great Britain's economic liberal ideas and free-trade policies. List argued that these policies did not equally benefit exporters and importers; because British technology was more advanced and its labor more efficient than European labor, its goods were more attractive to the Europeans than those produced locally. List argued that in a "cosmopolitan" world there could be no free trade until states could compete with one another on an *equal footing*. To the extent that Great Britain opposed mercantilist policies, it was "kicking away the ladder" for other countries, preventing them from climbing the ladder of development with the same policies Great Britain itself had used to achieve its wealth and power. He recommended that until the United States and Europe had "caught up" with Great Britain, they had to protect their "infant" industries as a way to "level the playing field" with the British. He also suggested that Prussian and German city-states would benefit by forming a union (which they did some forty years later), whose combined economic and military might would be able to withstand Britain's power. Ironically, one of the motives of countries that formed the European Economic Community after World War II was to be able to better compete with the United States and Japan.

During the nineteenth century, the U.S. government encouraged people to go west, work hard, and establish property rights. Ideas of Manifest Destiny and economic expansion sanctioned by God left a big impression on the emerging national psyche. During the War of 1812, the U.S. Congress doubled tariffs, which became part of a U.S. economic development plan until World War II. From 1800 to 1848, a series of land treaties, wars, and negotiations expanded the territory of the United States to incorporate the Louisiana Territory, Florida, Oregon, Texas, and the Mexican concession. President Lincoln developed a canal system and raised tariffs to 50 percent, where they remained until World War I. After the Civil War, the Homestead Act of 1862 granted 160 acres to anyone who claimed and farmed it for five years. The army cleared (ethnically cleansed) the west of native Indian tribes. Congress subsidized railroads along with manufacturing, coal, iron, steel, banking, and real estate. While the Army Corps of Engineers helped build the country's infrastructure, a lenient immigration policy encouraged and rewarded mainly white settlers. All of these government-funded developments contributed to economic prosperity and helped the United States arrive on the world scene as a major economic power by the 1880s.[17]

In the area of trade policy, in 1913 Congress reduced trade tariffs, but it raised them back up to 37 percent by 1925 for manufactured goods, helping the United States become the fastest growing country in the world. Other countries were also growing behind tariff walls: Germany, Austria, Sweden, and France. At the onset of the Great Depression, the Smoot–Hawley Tariff Act raised average U.S. tariff rates to a record high of 48 percent. As many nations adopted similar policies to protect and promote their industries, it was inevitable that national interests would clash with "beggar-thy-neighbor" behavior. Many blame the Smoot–Hawley tariffs for contributing to the Great Depression and then World War II. However, according to Ha-Joon Chang, trade tariffs were not a radical departure from history. In the United States and many other countries, markets were never more than partially open, and trade was really not all that free.[18]

Keynes, the Great Depression, and the Postwar Order

Just as many today blame unregulated market forces, greed, and stupidity for causing the 2007 global financial crisis, many people in 1929 blamed banks and speculators for the stock market crash, which subsequently increased unemployment and poverty in many parts of the world. Many lost faith and confidence in market capitalism, which led to increasing support for Fascism and Nazism. Germany experienced rampant unemployment, which increased economic nationalism and the tendency of officials to see others as evil.[19] Many revolutionary movements emerged in Europe, Latin America, and Asia.

Recall from Chapter 2 that in the 1930s the ideas of John Maynard Keynes gained in popularity because of pressure on the state to respond to more voters and higher expectations, rendering the *laissez-faire* ideology no longer politically acceptable. Keynes offered more positive ideas about how the industrialized nations could restart their economies and deal with the social effects of the depression. Keynes believed that not only do markets sometimes fail but also that recessions and depressions can last a long time. To diffuse the tendency of people to support authoritarian leaders, Keynes argued that states should step in and prime the pump of the national economy to stimulate employment, deal with the negative social effects of the depression, and restore confidence in the capitalist system.

After World War II, Keynes's ideas also substantially shaped the design and role of the three Bretton Woods institutions—the GATT, the IMF, and the World Bank. Economic liberals tend to argue that after the war, under the leadership of the United States and in cooperation with its World War II allies (minus the Soviet Union and China), a new international political-economic order promoted a variety of economic liberal objectives. The GATT brought down trade barriers. (Interestingly, Keynes himself supported Great Britain continuing to use high trade tariffs to help its recovery and the recovery of its former colonies). The IMF helped eliminate currency discrimination. The World Bank helped European nations recover from the war, and later helped LDCs develop. U.S. officials proposed that under the leadership of the United States a *gradual* opening of international markets would also prevent the sort of mercantilist conflicts that had plagued states before World War II.

On the other hand, mercantilists (and their realist cousins) focus on a combination of political-economic objectives that these same institutions served. The economic liberal role of the Bretton Woods institutions could not be separated from the efforts of the United States and its allies to *sustain* capitalism within the pro-Western industrialized nations and to *defend* these capitalist countries by "containing" Soviet and international communism (see Chapter 9). Furthermore, there would be no economic liberal order without military power to back it up. The United States benefited from the use of the U.S. dollar as the world's key currency (see Chapter 7) and from the U.S. hegemonic role as provider of liquidity, finance, aid, and military protection to the Atlantic Alliance. Other collective goods that the United States provided its allies to earn their Cold War support included trade concessions (e.g., reduced import tariffs) and food aid.

Most mercantilists and realists would agree that the United States made a *political bargain* (the visible hand) with its Atlantic partners (plus Japan and later South Korea) whereby the United States let them be somewhat protectionist economically if they did what they could to contain communism. U.S. trade concessions involved sacrifices or costs that took the form of gradual gravitation of some jobs to lower-paid workers in Europe and Japan as they recovered after the war. For many allied policy makers at the time, a big concern was whether opening the international economy too quickly could hurt the recovery of Europe and Japan, making it possible for communism to gain a foothold there. This consideration was yet another reason to allow Europe and Japan to continue using a variety of international trade and domestic protectionist measures and to *gradually* open their markets until they were better able to compete with the United States.

THE ENTRENCHMENT OF NEOMERCANTILISM

In 1973, the Organization of Petroleum Exporting Countries (OPEC) oil cartel changed the face of the international political economy when it suddenly raised the price of oil by four times overnight, embargoed oil shipments to the United States and the Netherlands, and reduced oil shipments to the rest of the world by 25 percent (see Chapter 19). The resulting increase in the price of oil—followed by another price hike in 1979—and the transfer of massive amounts of currency to oil-rich countries were thought to have economically weakened the West and made OPEC a political and an economic power with which to reckon. Most of the major industrialized nations and many developing nations incurred major economic recessions. The dependence of the West on OPEC oil helped push the issue of *economic security* higher on the policy agenda of oil-importing nations everywhere in the world. Control over oil and its production suddenly became as important as solidarity among NATO alliance members (who split over how to manage the oil crisis).

Aside from the issue of oil dependency, at least two other factors produced a significant shift in the international political economic structure in the early 1970s. One was a change in the power structure of the world from bipolarity to multipolarity (see Chapter 9). After the United States withdrew from Vietnam in 1973, the Nixon administration implemented a pentagonal balance of power configuration, in part based on increasing interdependence between national markets. At the same time, many of the industrialized economies shifted away from Keynesian ideas about economic stability to more market-led economic growth strategies.

In response to the oil crisis and recession, the United States and many of its allies pushed for more emphasis on free trade and cooperation to open international markets in GATT negotiations and on a bilateral basis. As U.S. debt increased, trade was often looked to as a way to increase exports and generate jobs. States such as Japan and South Korea would take advantage of a more open international economy with bigger markets by adjusting their national growth strategies to focus on export-led growth.

Before World War II, many states had erected high tariff barriers, boycotted other states' exports, or even gone to war in response to other states' mercantilist policies. But by the 1970s, these measures were less politically useful and acceptable because their negative effects on society would be too costly. Increasing (complex) interdependence between the military, economic, and foreign policy interests of many states made it harder to be overtly protectionist or isolationist. In order to protect local producers and defend a variety of national, political, and economic interests, states turned to neomercantilism—a set of more subtle and craftily designed policies that had the effect of reducing their vulnerability to international competition without undermining their overall commitment to freer trade under the GATT. Many of the neomercantilist techniques were not explicitly prohibited by international trade agreements.

States used a variety of neomercantilist policies to generate economic growth, control the business cycle, and eliminate unemployment. These measures included government spending for various programs, regulation of industries, capital controls, and interest rates changes. Also, a variety of state industrial policies included subsidies for research and development, state-owned corporations, and state-distributed banking credits. Some states employed export subsidies to lower the price of goods, making them more attractive to importers. The United States and the European Community routinely subsidized their farmers and used export subsidies to reduce their commodity surpluses and to counter the subsidies of competitors for larger shares of export markets (see Chapter 6). By the 1980s, neomercantilist measures played an increasingly greater role in the arsenal of state measures to defend their societies and protect their interests.

An important example of neomercantilism in the 1970s was the U.S.-led campaign with many of the industrialized states to decrease their dependence on OPEC countries in order to enhance their economic security. The United States sponsored the development of a "strategic petroleum reserve" and promoted development of the North Slope oil fields in Alaska. Other national policies included tax breaks for people who adopted measures to cut home energy use, a 55-mile-per-hour automobile speed limit, daylight savings time, and state funds for the development of alternative energy resources. Congress imposed fuel mileage requirements on automobile manufacturers to push them to design more fuel-efficient cars. Even today, many states continue to wrestle with the issue of dependency on foreign oil by providing incentives to insulate homes, fund public transportation, and support the manufacturing of a variety of vehicles that run on biofuels, natural gas, or electricity.

Another example of neomercantilism in the 1970s was the increasing use of **nontariff barriers** (NTBs) (see Chapter 6) such as complex government regulations pertaining to health and safety standards, licensing and labeling requirements, and domestic content requirements that blocked imported goods or distributed them in favor of certain industries. Similarly, countries imposed **import quotas** that specified the quantity of a particular product that could be imported. The United States and the European Union still use import quotas on many agricultural items such as sugar to help their domestic producers compete with foreign producers. Another way to limit imports was through a Voluntary Export Agreement (VEA)—a negotiated quota or "gentlemen's agreement" between an exporter and an importer whereby the exporter "voluntarily" complies with the importer's "request" to limit exports, for fear that the importer may resort to imposing a more costly form of protection on the exporter's goods.

Japan was particularly successful at using neomercantilist policies to achieve its "economic miracle." By the late 1970s, many development experts concluded that Japan's success in export led-growth was partly due to heavy state involvement in the economy. Japan's state-dominated style of capitalism made use of an industrial policy whereby the government—especially the Ministry of International Trade and Industry (MITI)—cooperated with industry officials and Liberal Democratic Party (LDP) members to carefully guide the development of the economy.[20] Certain industries were selected to receive state and bank subsidies to make them more competitive with U.S. and European firms.

Japan complemented its protectionist trade measures with foreign direct investment and ownership of homeland businesses and industries. Clyde Prestowitz argues that Japan did more than support its most competitive industries; it also intentionally adopted an aggressive strategic trade policy. Because it lacked a natural comparative advantage in the production of certain products, it used a combination of state assistance and industry efforts to *purposefully* create such an advantage in favor of its industries.[21] Japan's success would later be emulated by the successful emerging economies, especially the Asian Tigers (South Korea, Hong Kong, Singapore, and Taiwan) and China.

Neomercantilism and the Globalization Campaign

As noted in Chapters 1 and 2, the 1980s and 1990s marked a period of greater interdependence and increasing popularity of economic liberal ideas. This set the stage for the launching of the globalization campaign that included in its objectives efforts to integrate states into a global economic capitalist-oriented systemic structure (see Chapter 2). While Reagan and Thatcher focused on market-oriented policies to produce more wealth and chipped away at the role of the state in the domestic economy, they simultaneously used political and military powers to advance their countries' interests in the global economy. All states faced a delicate balancing act of adapting to globalization but also moderating its negative effects on jobs and some national industries.

Globalization accelerated interdependence between states, which meant that there was greater political sensitivity to trade as it became a bigger proportion of GDP and affected more sectors of the economy. The policies that states adopted in response to this sensitivity often provoked disputes with trading partners. As the noted political economist Robert Gilpin argued, it was difficult for states to select the appropriate counter-responses without knowing what those states' intentions were. Gilpin made a useful distinction between **malevolent** and **benign mercantilist** intimidations. The former is a more hostile version of economic warfare and the expansionary economic policies nations employed to intentionally expand their territorial base and/or political and economic influence at the expense of other nations beyond what is regarded as reasonable to protect themselves. In contrast, benign mercantilism is more defensive in nature, as "it attempts to protect the economy against untoward economic and political forces."[22] Of course, the problem is how to discriminate between the two in an environment where the difference seems to be a matter of degree rather than of kind.

Reagan is famous for redirecting the Nixon–Kissinger multipolar system of the distribution of power of the 1970s back into a bipolar order of yesteryear that featured the Soviet Union as the "evil empire." In conjunction with this security goal, the Reagan Doctrine encouraged (some would say coerced) many LDCs to adopt not only the anticommunist cause but also the economic liberal policies of the IMF, the World Bank, and the GATT (see Chapters 6–8). The Reagan administration and many academics expected that as developing nations integrated into the international economy, they would grow faster and become more democratic.

President Reagan also mixed economic liberal and mercantilist objectives at the start of the Uruguay Round of multilateral trade negotiations in 1985. One economic liberal goal of these negotiations was to "level the playing field" by cutting NTBs and other trade restrictions, so that states could compete economically with one another following the same set of rules and policies. In the 1980s and 1990s, Japan's relations with the United States, Europe, and other countries became acrimonious at times because it kept running a huge trade surplus. The

United States and Europe blamed their trade deficits on Japan's aggressive export-led growth strategy and import restrictions. Japan maintained that it sought only to strengthen its own national security through the use of benign neomercantilist industrial policies.

President Reagan often threatened to use Super 301 legislation (see Chapter 6) to *punish* Japan and Brazil for dumping their products on the market or using export subsidies to unfairly compete with the United States. He also threatened NATO allies with trade sanctions if they continued to import natural gas from the Soviet Union. The United States gradually put more pressure on Brazil, Japan, South Korea, and many newly emerging economies to lower their trade barriers and open their markets to more foreign (especially U.S.) investment and competition. As we will see in the chapters to follow, U.S. efforts have not met with much success as most of these countries continue to run huge balance-of-trade surpluses compared to long-term U.S. trade deficits.

In cases like Japan and Europe, the United States often found itself limited in the amount of pressure it could put on its most important allies. At the time—as is the case with China and Saudi Arabia today (see Chapter 7)—the United States was dependent on Japan to buy its exports and invest in U.S. Treasury bonds and securities. And pressuring NATO allies about their dependence on the Soviet Union merely strengthened criticism of U.S. foreign policy in Europe.

The United States and Japan repeatedly confronted one another in a series of trade disputes over items such as automobiles, rice, beef, and semiconductors. The "U.S. Beef and Japanese National Security" box explains how the U.S. government continues to accuse Japan of engaging in malevolent mercantilism designed to weaken the economies of other nations. What one state regards as benign, another might interpret as malevolent behavior, especially when the policies of the first state inflict a good deal of stress and anxiety on the society of the second.

U.S. BEEF AND JAPANESE NATIONAL SECURITY

In 2003, the United States discovered its first known case of "mad cow disease" (or bovine spongiform encephalopathy [BSE]), a degenerative, fatal disease that affects the central nervous system of adult cattle. People who eat contaminated beef products from BSE-affected cattle can contract the life-threatening Creutzfeldt-Jacob disease. Japan, one of the largest importers of U.S. beef, placed a ban on U.S. beef beginning in 2003, costing the United States an estimated $1.4 billion annually. During the ban, public officials such as Senator Chuck Hagel (R, Nebraska) insisted that "U.S. beef is the safest and highest-quality in the world."[a] In 2005, the Japanese reopened their country's border to U.S. beef imports, only to close it again two months later when they detected spinal cords in a shipment of East Coast veal. Asian countries consider backbones to be at risk of mad cow disease because inner organs of the animal are most likely to harbor the disease.

In June 2006, Japan decided to lift the ban on U.S. beef imports, but under the condition that it be allowed to inspect meat-packing plants in the United States. A spokesman for the Texas and Southwestern Cattle Raisers Association remarked, "It's USDA's [the U.S. Department of Agriculture's] job to regulate our processing industry, not Japan's."[b] Another cattlemen's group argued that the United States was setting a precedent by allowing another country to inspect U.S. plants. The Japanese insisted that the beef they import be from cows less than 20 months old, as these would be less likely to have the disease. They also reached an agreement with the United States to conduct surprise inspections of U.S. plants, accompanying U.S. inspectors. In return, Japan agreed that in the event of another case, it would target individual shipments rather than banning all beef imports. Tyson Foods, the world's largest beef-processing company, accepted the terms of Japan's officials to inspect its plants, but other industry officials remained guarded about Japan's "empty promises and continued delays" in reopening the market.

This case of Japan's resistance to beef imports from the United States blurs the line between acceptable and unacceptable forms of protectionism. The core issue for Japan, the European Union, and many other nations is their authority to control the types of goods they allow into their nations, that is, their sovereign right to protect their societies from possibly unhealthy foods and commodities, including genetically modified ones. The loss of beef sales to Japan did not significantly affect the U.S. balance of trade, but the case had great symbolic importance and may set precedents.

The big questions in this case are the rationale for protection and acceptance of the motives behind the policies that banned beef. Scientists and the general public accepted the evidence that mad cow disease is a serious health risk. The U.S. public, the USDA, and many U.S. beef interests accept (even if grudgingly) the Japanese claim that U.S. beef may pose a threat to their society. However, it is harder to claim that the beef import ban was a conscious attempt to redirect trade to local producers or that the Japanese set out to damage or bring down the U.S. beef industry. Japan's insistence on inspections was more easily accepted as they opened their market to U.S. beef exports once again.

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Neomercantilism and the Financial Crisis

Since the early 1990s, the neomercantilist and competitive policies of some states raised the stakes for others that had to grapple with lost jobs and broken families, the loss of electoral support for legislators, and ultimately the real or imagined loss of national wealth and power. The benefits of globalization and complex interdependence did not trump societies' vulnerability and sensitivity to competitors. People found it increasingly harder to adjust to globalization's dislocations and the instability of markets. In these situations, state officials were often pressured to respond with countermeasures of their own—to "strike while the iron is hot"—for fear of otherwise sending a message of weakness or disinterest to foreign competitors. Political and economic competition *between* states has not ended; in fact, it has intensified in a more globalized world. In many cases, businesses have felt compelled to go abroad in search of cheaper labor, resources, and more markets. Outsourcing labor has become the economically efficient and rational thing to do.

Many neomercantilists go a step further and argue that globalization tends to *undermine* itself.[23] As more wealth and power are diffused around the world, more states and people have an investment in either protecting themselves from globalization's negative effects or sustaining its positive effects. Both situations require state power and instruments that in effect (re)invigorate states that are in danger of losing their power and authority.[24]

For mercantilists, the recent global financial crisis is a good example of how laissez-faire ideas and globalization have undermined themselves (see Chapters 2 and 8). The crisis has increased tensions, hostilities, and conflicts between states, many of whom blame the United States for almost bringing down the global financial system. This has sparked renewed interest in protectionist and national security-oriented perspectives everywhere in the world. Many experts agree that the financial crisis has already uprooted many political, economic, and social institutions—challenging social values and other cultural idiosyncrasies in ways that may yet generate more tensions and even in some cases war.

The crisis has fueled illegal economies, weakened the dollar, and increased U.S. dependence on China and other emerging economies. Many countries have used it as an excuse to postpone or avoid dealing with potentially catastrophic energy and environmental issues. It has tended to shift order away from U.S. hegemony to a more multilateral system.[25] The United States has even reverted to some blatant forms of protection, as when in 2009 it slapped a 35 percent tariff on tires imported from China.

The financial crisis has also had tremendous implications for the attractiveness of neoliberal and democratic ideas associated with capitalism in many developing nations. It has undermined the idea that the U.S. economy is a model for the world. At the same time, it has convinced some countries that the United States is trying to maintain its wealth and power at the expense of others. The growth of populist movements in Latin America,[26] along with the entrenchment of authoritarian regimes in many parts of the world, cannot be separated from issues of protection from globalization and the associated financial turmoil.

LDC NEOMERCANTILIST POLICIES

As we will see in other chapters of this book, developing nations—just like developed countries—have been searching for a more pragmatic and subtle mix of policies that accounts for not only the interests of the market but also those of society and the state. They have continued to adopt neomercantilist measures in response to international economic competition and what some officials regard as malevolent threats.

Cambridge University economist Ha-Joon Chang is one expert who explains some of the important reasons why many developing nations like Malaysia, Brazil, and China have continued to adopt neomercantilist trade policies as part of their development campaigns. According to Chang, developing countries have wanted to "catch up" with the richer and more technologically advanced countries (see Chapter 11). However, many have found that if while trying to "climb up the ladder" they accept the same rules as the leading countries, they may never get to the top of the ladder. As we outlined in Chapter 2, many IOs that reflect the interests of the major powers have worked to do away with a variety of protectionist measures. Making a case similar to List's, Chang believes that developing nations need a (temporary) handicap of sorts.

Chang uses an analogy in sports to make the point. When players or conditions for each team are unequal, we often object that the competition is unfair and that there needs to be a "level playing field." Just as we separate athletes by age and weight, it is only fair to allow developing countries to use some tools to compete more "fairly" with developed states that have many economic advantages and who originally made the rules in favor of their interests.

For many developing nations, trade protection not only plays a vital role in generating income but also helps in protecting local producers from foreign competition. And yet, as noted in Chapter 6, developing nations played almost no role in multilateral negotiations after World War II that produced the General Agreement on Tariffs and Trade (GATT). It is important to note that early GATT agreements reflected the interests of the developed nations in trade rules—which included preserving trade protection while only gradually curtailing the use of import tariffs on industrial products. In the early 1990s, a number of developing nations did play a role in converting the GATT into the WTO in the Uruguay Round from 1986 to 1994. However, by then the basic principles and norms of the international trade regime were set and difficult to change.

While most developing countries signed on to the new WTO agreement in 1994 that introduced new liberal norms for agricultural trade subsidies, trade in services, NTBs, and intellectual property rights (IPRs), they did not benefit as much from the final agreement as they had hoped they would. This laid the foundation for their unwillingness later on to reach a new deal in the Doha round (see Chapter 6). They also redoubled efforts to form a number of their own negotiating coalitions to overcome what they feel are unfair trade rules that do not adequately reflect their interests.

Similarly, in the 1990s, the poorer developing countries complained that IMF and World Bank Structural Adjustment Policies (SAPs) and open market policies imposed on them felt like malevolent mercantilism. Many mercantilists charged that LDC growth rates actually *declined* over the same period when markets in many developing countries were supposedly opening up.[27] SAPs amounted to nothing more than a "mission creep" (at least for the working class and poor) and the imposition of economic liberal policies on many developing nations. As List might argue today, IMF and World Bank SAPs were merely another example of state power being used to increase U.S., European, and Japanese wealth and power—and not noble, let alone useful, development tools as so often claimed.

The problem of *intentions* behind trade and structural adjustment policies tends to generate conflicts in multilayer trade negotiations such as those in the Doha round. Many LDCs charge that a new agreement would make it difficult for developing countries to protect some of their "infant industries." They also suspect that industrialized countries trying to adopt measures to require high labor or environmental standards in all countries are masking protectionist support for their own inefficient industries. For many LDCs, despite the formal commitment to the international goals of opening up international trade and reducing trade barriers, members of the WTO remain quite protective of their own economic security and national independence.

NEOMERCANTILIST POLICIES TODAY

The kinds of contemporary neomercantilist policies that states frequently adopt depend on each state's level of development and its relative power in the international system. Poorer countries, as we have noted above, have a particular interest in "catching up" to the industrialized countries, but they must work within ideological and political constraints imposed on them by major powers and neoliberal institutions like the WTO, the World Bank, and the IMF. Advanced industrialized nations face the double challenge of competing with one another in high technology and knowledge-based industries while stemming the loss of blue-collar manufacturing industries to emerging economies with abundant, low-cost labor. As globalization and international agreements have wedded all countries to a complex set of broadly economic liberal principles, states have looked for new forms of benign mercantilist policies and carved out realms where they can still use tried-and-true mercantilist policies like quotas, tariffs, and plain old arm-twisting.

In this section, we survey two common types of neomercantilist policies found today: industrial and infrastructural policies and strategic resources policies. Although we focus on the developed countries' use of these policies, keep in mind that many developing countries resort to them as well. In fact, LDCs often point out that today's advanced industrialized nations used a variety of these policies throughout their *early history*, and thus it is somewhat hypocritical of them to try to stop LDCs from using some of the very same policies today. What many emerging economies want are weak protection of IPRs, a mix of protectionism with some free trade, and time to improve institutions without undue pressure by Western countries to quickly become democratic and get rid of corruption. But the developed countries seem to be saying to emerging economies: "Do as we say, not as we did (and sometimes still do)!"

Industrial and Infrastructural Policies

Many states limit foreign investments in their country in a variety of subtle and not so subtle ways—often in an attempt to reduce threats to independence or national sovereignty. They can limit the percentage of shares in a domestic company (like an oil company) that foreigners can own or they can ban foreign investments in strategic industries like natural resource extraction, power generation, banking, and media. It is also common to make it difficult for foreigners to buy land or real estate on which to build factories, set up services, or accumulate office space. The intent of these policies is often to give domestically-owned companies an advantage or to prevent foreigners from gaining too much control of a sector of the economy by forcing them to cooperate with local companies.

Chang points out that the United States and European countries had many such restrictions until well into the twentieth century. Similarly, countries like Japan, Korea, and Finland had many formal and informal restrictions on foreign direct investment until well into the 1980s, but they still managed to grow rapidly.[28] For example, post–World War II European countries regulated foreign companies by controlling their access to foreign exchange and requiring them to buy some supplies from local producers. Japan prohibited foreign direct investment (FDI) in vital industries and limited foreign ownership at 50 percent in many industries. Instead of favoring foreign takeovers of local companies, it pressured foreign companies to license technology to local companies so that they could learn to manufacture products themselves. The legacy of these restrictions is very clear today. In 2006, the stock of FDI as a percentage of GDP in Japan was a paltry 2.5 percent, compared to

13.5 percent in the United States, 25 percent in Germany, and 33 percent in France. And Finland had draconian restrictions on FDI until the 1980s: among other things, foreigners could not own more than 20 percent of a company and foreign banks were completely prohibited. Clearly, Japanese, Korean, and Finnish models of economic success owed almost nothing to FDI, a finding that conflicts with economic liberal insistence on unfettered capital inflows.

Robert Wade, in his influential book *Governing the Market*, argues that industrial policies had a decisive role in the East Asian development "miracles," especially Japan, South Korea, and Taiwan.[29] The political elites and heads of bureaucracies in these countries steered domestic investment into sectors of the economy like shipbuilding and hard disc drives that the government considered key to economic transformation. They encouraged high rates of saving and manipulated prices in the economy to support infant industries. They also used a lot of public investment to complement private investment. They allowed the formation of large conglomerates. Moreover, they nudged firms to improve the quality of products and to export a high percentage of their finished products. All of these neomercantilist policies—characteristic of what Wade calls a "developmental state"—have been imitated by countries like Brazil, Mexico, and Argentina, but without many of the same positive results.

Other significant government interventions in today's markets that many industrialized nations have adopted are designed to increase a country's competitiveness without being malevolently protectionist. Massive investments in public infrastructure and research are vital to business success, and they are effectively subsidies. When a state builds roads, power plants, and transportation systems, the benefits of its spending usually accrue to domestic workers and capitalists who become more efficient and productive as a result. One could argue that California has been a large, successful agricultural producer and exporter because of massive public investments for many decades in irrigation systems that bring water to the state from hundreds of miles away. Similarly, former investment banker Felix Rohatyn argues in a recent book that massive American *public* investments in infrastructure and education had a key role in making the United States a powerful, innovative (and capitalist) country. These programs, parallels to which can be seen today in other countries, included the following: the Erie Canal, the Transcontinental Railroad, land-grant colleges, the Panama Canal, the GI Bill, and Eisenhower's interstate highway system.[30]

Likewise, public education and investments in higher education give widespread economic benefits to many nations. India and China have invested heavily in education and especially in research and development in health sciences, engineering, and the natural sciences, all of which have huge spillovers for domestic companies. Developed countries have done the same to spur innovation and the development of a "knowledge-based economy" (see Chapter 10).

In addition, government procurement can be a powerful neomercantilist mechanism to spread benefits to local businesses that are denied to foreigners. Most governments want their huge spending on goods and services produced by the private sector to help local companies and labor. One of the best examples is U.S. defense spending that has helped aircraft producers like Boeing (see Chapter 18), who use the spillovers related to defense spending to become more competitive with Airbus in the commercial airliner industry. Australian political economists Linda Weiss and Elizabeth Thurbon emphasize how the U.S. government uses procurement policies to create "national champions"—big, globally-competitive companies like Lockheed, Motorola, IBM, and Microsoft—that relied on long-term government contracting. Even as the United States implements its own "buy national" procurement policies—most recently in the 2009 stimulus bill—it tries to get other countries to open up their public works projects to American companies. Weiss and Thurbon conclude that "although subject to multilateral discipline, government procurement offers a powerful tool for national economic promotion in an era of economic openness."[31]

Finally, Canadian political scientist Patricia Goff reminds us that the purpose of helping one's own companies and industries is not necessarily just to save jobs, boost exports, or hurt foreigners.[32] In fact, the purpose may be much more defensive and noneconomic. She has examined how Canada and the European Union have strongly protected their culture industries—music, television, radio, film, and magazine publishing—from an American onslaught over the last 60 years. They use public ownership of some culture industries (like public television), tax incentives for local private investment in movie production, public loans and grants for culture producers, minimum local content requirements (on TV and radio programming), and ownership rules to preserve and nurture domestic culture producers. They do so not so much to keep foreign cultural products out as to promote their own distinct national identity, cultural diversity, and social cohesion. Preserving "cultural sovereignty" in the face of globalization's homogenizing effects is an eminently political goal, vital for nurturing a democratic citizenry that is well informed about its *own* history and values.

Strategic Resources Policies

Neomercantilists also believe that interdependencies are not always symmetrical (felt equally) between states. The suppliers of oil and other strategic resources or commodities tend to view their capacity and the resulting dependency of others as something positive that improves their power and security. In many cases, the relatively high cost of oil, coupled with supplier threats to cut it off to client states, makes the issue of dependence on any resource or vulnerability to a supplier of that resource synonymous with a national security threat. Ideally, only complete self-sufficiency in raw materials would make a nation-state politically and economically secure. In the real world, however, states are constantly trying to minimize their dependence on others while fostering conditions that make others dependent on them.

Examples of this are common. France deliberately and massively expanded its nuclear power industry after the 1973 oil crisis. China has signed long-term oil supply agreements with countries in Africa and Latin America and invested in exploration as a way of getting "first dibs" on these global commodities instead of buying them in open markets in the future. The U.S. government has built costly strategic stockpiles of oil and tantalum (a key ingredient in cell phones and electronic equipment), along with dozens of other minerals and metals used in electronics and weaponry. Even the Centers for Disease Control and Prevention maintains a Strategic National Stockpile of medicines in case of a national emergency such as a terrorist attack or epidemic.

The motivation for these kinds of benign neomercantilism is in large part derived from the legitimate fear that other countries will use malevolent mercantilist polices to hurt another country. These fears today are not unfounded. Powerful countries and even the UN have imposed economic sanctions on countries such as Serbia, Iran, and Iraq, threatening their security and political stability. Industrial espionage is still widely practiced, whereby one country tries to steal the advanced technology of another. Theft of intellectual property, which can be thought of as strategic knowledge resource, is increasingly widespread in the world, manifested in counterfeiting and patent infringement, which can severely damage a country's companies (see Chapter 10).

Access to and control over strategic resources has always been a top concern of industrialized nations who fear that being "cutoff" from energy, minerals, and metals will cripple their economy and weaken their war-fighting ability. In the past, colonial powers took direct control of many territories with important resources, or they built powerful militaries to guard these sources or prevent rival empires from threatening them. Industrialized democracies today usually try to establish political and military alliances with governments of big resource-producers like Saudi Arabia (oil) and Morocco (phosphates)—despite those countries' undemocratic political regimes. At the same time, they may establish stockpiles of resources or encourage domestic exploration and extraction by offering subsides to national producers or by leasing public lands to them cheaply.

Industrialized nations and rapid industrializers like China also encourage their national companies to diversify suppliers overseas, buy foreign resource-extracting companies, and buy concessions (exploration and production rights) in other countries. Right now, foreign oil companies are scrambling to buy concessions to explore offshore West Africa, where many think vast oil deposits may exist. The United States has deliberately and successfully diversified its oil and gas supplies as a matter of national security. Its top five suppliers of imported oil, in order of significance, are Canada, Saudi Arabia, Mexico, Venezuela, and Nigeria—only one of which (Saudi Arabia) is in the conflict-prone Middle East. Japan has been much less successful in diversifying and reducing energy imports. Although it has increased energy efficiency and invested in nuclear power, 90 percent of all its oil imports are from the Middle East.

There is an ongoing tension in the global political economy as commercial development and national security are increasingly wedded in the minds of policy makers and corporations. As nations such as China and India develop major industrial production economies, the battle for control of scarce energy resources will no doubt become more intense. The United States' actions in responding to the attempt by a Chinese company to buy Unocal Corporation in 2005 (see box) may well have set a new paradigm for international trade that is far more guarded and complicated—and neomercantilist—than the economic liberal globalization of the past three decades.

CHINA VS. UNOCAL[a]

In April 2005, Chevron Corporation, the largest U.S.-based oil conglomerate, made a $16.5 billion bid comprised of cash and stock offerings to acquire a controlling stake in its smaller domestic rival, Unocal. While financial analysts and key players on all sides considered the offer, another multinational energy giant stepped into the game with an unsolicited counter bid. The Chinese National Offshore Oil Corporation (CNOOC), a firm in which the Chinese government holds a 70 percent stake, leveraged its strong fiscal reserves to make what was at first glance a significantly more compelling proposal: $18.5 billion for Unocal, paid entirely in cash.

For Unocal's shareholders, however, choosing the better option quickly became more complicated than a simple analysis of balance sheets. As word of the CNOOC bid spread, concern arose in the United States over the prospect of a foreign government taking control of critical resource production. The deal quickly became a national security issue. On June 27, 2005, key Republicans and Democrats on Congressional energy committees wrote a letter to President George W. Bush warning that China's "aggressive tactics to lock up energy supplies" threatened domestic interests.[b] More than 40 members of Congress signed a similar letter to the Treasury Department, urging a review of the deal for security reasons, and former CIA Director James Woolsey publicly referred to the CNOOC offer as part of a "conscious long-term effort" to take control of U.S. energy resources.[c] Days later, the House of Representatives overwhelmingly (398 to 15) passed a resolution urging the president to block the deal as a threat to national security.[d]

Shortly after the Congressional resolution passed the House, the Chinese Foreign Ministry issued a harsh statement condemning the United States for erecting barriers in the face of business. The statement demanded that Congress "correct its mistaken ways of politicizing economic and trade issues and stop interfering in normal commercial exchanges between enterprises of the two countries."[e] Despite this tough rhetoric, CNOOC ended up dropping its bid. The U.S. government never directly blocked the deal as the House resolution was nonbinding and never cleared the Senate. Ultimately, the political barriers created by the controversy discouraged hopes for the efficacy of a CNOOC-operated Unocal. Fiscal advisors from top Wall Street firms came to a consensus that the extra $2 billion in cash was not worth the hassle that CNOOC's bid incited.[f]

Both China and the United States operated under fundamental mercantilist principles in approaching the China/Unocal incident, but neither addressed these reasons directly in public discourse. The United States framed the issue under the guise of realism as a security concern, and China retaliated with classic economic liberal language about interfering in the market. Ultimately, these political factors became part of the economic equation that favored Chevron's offer.

Though Unocal was a small player in the global oil industry—producing less than 200,000 barrels daily worldwide—its most lucrative holdings were based largely in and around Asia, and it claimed to be the largest producer of geothermal energy on that continent. According to its last quarterly Securities and Exchange Commission (SEC) filing as an independent firm, 57 percent of its revenue came from its Asian operations in Thailand, Indonesia, Myanmar, and Bangladesh.[g] China's incentive to control these regional energy resources is clear: for the first time in its history, the budding industrial nation has come to rely on foreign energy imports to meet its growing demand for oil. Acting through its controlling interest in CNOOC, the Chinese government was attempting to secure an oil supply line for its rapidly growing economy—a perfect example of neomercantilism at work.

The United States acted with equally mercantilist motivation in moving to block the deal. As the debate unfolded in the United States, many energy experts remained skeptical of the national security concerns ostensibly behind the controversy. They criticized the logic that the Unocal bid was part of a larger Chinese military supply strategy antagonistic to the United States, pointing out instead that the industrial growth inciting China's oil demand in the first place is dependent largely on the United States as a primary importer of Chinese industrial goods. Indeed, it is this trade situation that provided a much more genuine cause for U.S. concern: By the time CNOOC submitted its bid, the United States already had a $160 billion trade deficit with China.[h] Moving to correct this rapidly expanding trade imbalance and block China from acquiring a strategic commercial asset, congressional leaders were clearly leveraging their political power in the name of national commercial interests.

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CONCLUSION

Of the three ideological perspectives most often used to explain IPE, mercantilism is the oldest and arguably the most powerful because it is so deeply entrenched in the psyches of state officials and their societies. For many neomercantilists, as it was for classical mercantilists and colonial powers in the nineteenth century, economic liberalism is simply another tool that state officials employ to protect their industries so as to achieve more wealth and power. All nations in the past have employed mercantilist policies and measures, as Great Britain did in the nineteenth century during the height of the popularity of economic liberal ideas about free trade. Likewise, the United States did the same throughout the twentieth century, even when it advocated free trade and globalization.

Mercantilist ideas have evolved over the years and adapted to changing conditions in the international political economy. The nature of mercantilism has changed as the types of security threats have changed, and the tools used to protect society have also changed. Classical mercantilism tended to view threats to a nation's security by foreign armies, foreign firms and their products, and even from foreign influence over international laws and institutions. Both mercantilists and their realist cousins would also note that by their very nature states *can* be expected to use the economy, either legally or illegally, as a means to generate more wealth and power.

Certainly, mercantilist motives and neomercantilist policies are still responsible for a good deal of international conflict. Efforts to maintain and increase state wealth and power have proliferated since World War II, as a result of the growing interdependence of nations and globalization of the international political economy. Managing the international economy remains a complicated task that befuddles politicians and academics alike. Many of these issues demonstrate that despite OELs' efforts to isolate economics and markets from politics and society, mercantilists and HILs do not believe it can be done.

With the onset of deep interdependence between states in the 1970s and the globalization campaign of the 1990s, many state officials and academic experts became increasingly aware of the tightening connection between domestic and foreign policy issues. The end of the Cold War in 1990 also helped blur the line between economic and broader national security concerns for most states. However, as discussed in Chapter 1, since the mid-1980s the popular ideas of economic liberalism and globalization envision a limited role for the state in the economy resulting in less conflict between nation-states. Curiously, some OELs envision the withering away of the nation-state as the global economy integrates into a single economic unit.

As long as states exist, they can be expected to give first priority to their own national security and independence followed by advancing their economic wealth. Today, all states continue to use a variety of protectionist measures to assist some of their manufacturing, agricultural, and service sectors. To a great extent, the *success* of globalization has also helped undermine the openness of the international political economy when it comes to state economic interests as well. As states and national industries have become more dependent on external sources of revenue and markets, public officials have also felt more *vulnerable* to developments in the international political economy, leading to arguments that market forces have weakened state power and authority significantly. Yet, protectionist trade, financial, and monetary policies have periodically proliferated as governments have attempted to reassert themselves and better manage their economies.

If Hamilton and List were still around, they would likely argue that as long as states are the final source of political (sovereign) authority, markets cannot be separated from politics and the role of the state in society. But they would inject more attention to the impact of the market on society and vice versa. Their views tied together the importance of linking a nation-state's interests and goals to a positive role for the state in the economy and sacrifice for future gain.

For mercantilists and realists today, despite the popularity of economic liberal ideas discussed in Chapter 2, the world has not been ready for the market to rule all for very long. Globalization and financial crises have exposed the inadequacy of the market alone to protect states and their societies. Markets are often not self-regulating or self-adjusting, and therefore states should not leave it to markets to make key decisions related to human issues and problems. But things are not that simple, either. State-guided policies often fail to accomplish their objectives and can sometimes cause great damage to a society. Nevertheless, states will probably always face the fact that politics forces them to re-embed society into the market. Voters and citizens want protection from the excesses of the market at the same time that they want competitive markets to work better. As suggested in Chapter 2, HILs would agree with mercantilists that there would be no market without the state, and the invisible hand must serve more than the interests of a select few.

KEY TERMS

mercantilism 57
classical mercantilism 57
realism 57
neomercantilism 57
nation 58
state 58
sovereignty 58
industrial policy 58
security dilemma 59
zero-sum 59
colonialism 59
comparative advantage 60
countermovement 61
economic nationalism 61
Alexander Hamilton 61
infant industries 62
Friedrich List 62
OPEC 65
interdependence 65
nontariff barriers 66
import quotas 66
malevolent mercantilism 67
benign mercantilism 67
Structural Adjustment Policies 71
developmental state 73
strategic resources 74

DISCUSSION QUESTIONS

1. Each of the IPE perspectives has at its center a fundamental value or idea. What is the central idea of mercantilism? Explain how that central idea is illustrated by the mercantilist period of history, mercantilist philosophy, and recent neomercantilist policies.
2. What is the difference between benign mercantilism and malevolent mercantilism in theory? How could you tell the difference between them in practice? Find a newspaper article that demonstrates the tensions between these ideas, and explain how the issue is dealt with by the actors in the article.
3. How much is economic globalization a threat to nation-states? Make a brief list of the positive and negative potential effects of a more integrated global economic system, and explain the basis for your opinion.
4. Compare and contrast some features of the Great Depression with those of the global financial crisis today. If Keynes were alive, what do you suppose he would propose the state do about the current crisis?

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NOTES

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2. The concepts of *nation* and *nationalism* are the focus of the classic work by Hans Kohn, *The Idea of Nationalism* (New York: Macmillan, 1944) and of Eric J. Hobsbawm's *Nations and Nationalism Since 1780,* 2nd ed. (Cambridge: Cambridge University Press, 1992).
3. The classic definition of the state is Max Weber's, which emphasizes its administrative and legal qualities. See Max Weber, *The Theory of Social and Economic Organization* (New York: The Free Press, 1947), p. 156.
4. See Mark A. Martinez, *The Myth of the Free Market: The Role of the State in a Capitalist Economy* (Sterling, VA: Kumarian Press, 2009), pp. 106–110.
5. The history discussed in this section draws on Ha-Joon Chang's *Bad Samaritans: The Myth of Free Trade and the Secret History of Capitalism* (New York: Bloomsbury Press, 2008), pp. 40–43.
6. Ibid.
7. Ibid., especially Chapter 2.
8. See Kenneth Pomeranz and Steven Topik, *The World That Trade Created: Society, Culture, and the World Economy*, 2nd ed. (Armonk, NY: M.E. Sharpe, 2006).
9. Ibid., p. 141.
10. Ibid., p. 149.
11. See Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston, MA: Beacon Press, 1944).
12. See Pietra Rivoli, *The Travels of a T-Shirt in the Global Economy: An Economist Examines the Markets, Power, and Politics of World Trade,* 2nd ed. (Hoboken, NJ: John Wiley, 2009), pp. 207–211.
13. For a detailed account of Hamilton's works, see Henry Cabot Lodge, ed., *The Works of Alexander Hamilton* (Honolulu, HI: University Press of the Pacific, 2005).
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15. Friedrich List, *The National System of Political Economy* (New York: Augustus M. Kelley, 1966), p. 144. Italics are ours.
16. Ibid., pp. 199–200.
17. The history in this paragraph is drawn from Martinez, *The Myth of the Free Market*, Chapter 6.
18. See for example, Chang, *Bad Samaritans*.
19. Martinez, *The Myth of the Free Market*, p. 150.
20. See, for example, Chalmers Johnson, "Introduction: The Idea of Industrial Policy," in his *The Industrial Policy Debate* (San Francisco, CA: ICS Press, 1984), pp. 3–26.
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23. See, for example, Tina Rosenberg, "Globalization: The Free Trade Fix," *The New York Times Magazine,* August 18, 2002.
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25. See Parag Khanna, *The Second World: How Emerging Powers Are Redefining Global Competition in the Twenty-first Century* (New York: Random House, 2008).
26. See, for example, Michael Shifter and Vinay Jawahar, "Latin America's Populist Turn," *Current History, 104* (February 2005), pp. 51–57.
27. See Chang and Robert Wade for analysis of LDC growth rates in the 1980s.
28. See Chang, *Bad Samaritans*, for many examples (especially his Chapter 4 "The Finn and the Elephant").
29. Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization,* 2nd paperback ed. (Princeton, NJ: Princeton University Press, 2004).
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32. See Patricia Goff, *Limits to Liberalization: Local Culture in a Global Marketplace* (Ithaca, NY: Cornell University Press, 2007).

CHAPTER 4

Economic Determinism and Exploitation: The Structuralist Perspective[1]

The sinews of the global economy.

Jacob Silberberg

On April 11, 2002, the president of Venezuela, Hugo Chávez, was ousted in a coup d'etat by a faction of the military and police. Chávez, a democratically-elected socialist, was replaced by Pedro Carmona, head of the Venezuelan Chamber of Commerce, a conservative business organization. *The Observer of London* reported that the "coup in Venezuela was tied closely to senior officials" in the United States, but the Bush administration, although admitting to meeting with several opposition leaders in the weeks before the coup, insisted it encouraged a change in leadership through constitutional means only.[2]

Whatever the degree of outside involvement, the overthrow of a leftist Latin-American president opposed by the United States and his replacement with a pro-U.S., pro-business dictator would have been no great surprise to many structuralists. Throughout the twentieth century, the United States was directly or indirectly involved in the overthrow of leftist governments in Nicaragua, Guatemala, Brazil, the Dominican Republic, and Chile by consistently using foreign aid to support right-wing military dictatorships.[3] The U.S. Army School of the Americas, now called the Western Hemisphere Institute for Security Cooperation, trained Latin American military officers and sent them back to their home countries where many were accused of torture and other human rights violations.[4]

But the Chávez coup did not follow the same twentieth-century script. The first Latin-American coup attempt of the twenty-first century failed. In a dramatic reversal, the pro-Chávez faction in the military restored Chávez to the presidency. Something, it seems, had changed in the world, and this change goes to the heart of the structuralist perspective. **Structuralism** has its roots in the ideas of Karl Marx but today encompasses a much broader group of scholars and activists. While most structuralists do not share the commitment to a socialist system as envisioned by some Marxists, they do believe that the current global capitalist system is unfair and exploitative and can be changed into something that distributes rewards in a more just manner. Indeed, the *structure* in "structuralism" is the global capitalist system. The global capitalist economy acts as an underlying system or order that is the driving force in society. It shapes society's economic, political, and social institutions and imposes constraints on what is possible.

Many claim that the sudden demise of socialist economies in the former Soviet Union and Eastern Europe and the more gradual transformation of Chinese communism into something closer to capitalism means that "Marx is dead." They believe we should stop using a structuralist analysis of these conditions and embrace free markets as the best political-economic system. But the presidency of Hugo Chávez in Venezuela and other democratically–elected leftist administrations in Bolivia, Ecuador, and Brazil remind us that some think there is an alternative to free market capitalism. Furthermore, the recent developments related to the global financial crisis highlight not only the failures of free market capitalism but also the political clout of the economic elite, who receive bailouts while ordinary taxpayers struggle. Outside the seats of official power, millions of citizens continue to protest against free-trade organizations or U.S. imperialism. Those who feel excluded from economic progress, who believe that their share of the economic pie is too small, or who reject the legitimacy of the global capitalist elite represent a force that cannot be overlooked.

The structuralist perspective has no single method of analysis or unified set of policy recommendations. Rather it is the site of an active, exciting debate that forces us to ask important questions. What are the historical events that created the capitalist structure? How does the global capitalist system operate? How are resources allocated? Is it fair? What comes next and how do we get there? Moreover, this perspective is, at its roots, a critical one that challenges the existing state of affairs.

The main theses of this chapter are as follows: First, many see in structuralism not only the tools to conduct a scientific analysis of existing capitalist arrangements but also the grounds for a moral critique of the inequality and exploitation that capitalism produces within and between countries. Second, this framework of analysis is the only one that allows us to view IPE "from below," that is, from the perspective of the oppressed classes, the poor, and the developing "Third World" nations. In contrast to mercantilism and liberalism, it gives a voice to the powerless. Third, this perspective raises issues about human freedom and the application of reason in shaping national and global institutions. Finally, structuralism focuses on what is dynamic in IPE. It views capitalism and other modes of production as driven by conflict and crisis and subject to change. What exists now is a system and set of structures that emerged at a particular time and may one day be replaced by a different system of political economy.

After outlining some of the major ideas, concepts, and policies associated with both Marx and Lenin, we explore some of the more recent theories of dependency, the modern world system, and neoimperialism. We also briefly discuss some structuralist arguments about the recent financial crisis and conclude with some structuralists' views about reform of the global political economy.

FEUDALISM, CAPITALISM, SOCIALISM—MARX'S THEORY OF HISTORY

The first great scholar to pioneer a structural approach to political economy was Karl Marx (1818–1883). Born in Trier, Germany, Marx did his most significant work while living in England, spending hours on research at the British Museum in London. Many of his views reflect the conditions he and his collaborator Friedrich Engels observed in English mills and factories at the height of the Industrial Revolution. Adults and children often labored under dreadful working conditions and lived in abject poverty and squalor. Marx's theory of history, his notion of class conflict, and his critique of capitalism must all be understood in the context of nineteenth-century Europe's cultural, political, and economic climate.

Marx understood history to be a great, dynamic, evolving creature, determined fundamentally by economic and technological forces. Marx believed that through a process called **historical materialism** these forces can be objectively explained and understood just like any other natural law.[5] Historical materialism takes as its starting point the notion that the *forces of production* of society, defined as the sum total of knowledge and technology contained in society, set the parameters for the whole political-economic system. As Marx put it, "The hand mill gives you society with the feudal lord, the steam mill society with the industrial capitalist."[6] At very low levels of technology (primitive forces of production), society would be organized into a hunting-gathering system. At a higher level, we would see an agricultural system using steel ploughs and horses, oxen, or other beasts of burden. This technological advancement (although still considered "primitive" by modern standards) causes a change in the social relations in society, specifically the emergence of feudalism. Instead of hunters and gatherers banding together in small-scale tribes with a relatively equal division of the economic output, feudalism is characterized by a large strata of peasant-farmers and a smaller aristocracy. The key Marxist claim is this: the change in technology *determines* the change in the social system. Thus Marx has been considered a *technological determinist*, at least within his theory of history.

Marx sees the course of history as steadily evolving from one system of political economy (or "mode of production," in Marx's words) to another due to the growing contradiction between the technical forces of production and the social class or property relations in which they develop. In each of these modes of production, there is a dialectical process whereby inherently unstable opposing economic forces and counterforces lead to crisis, revolution, and to the next stage of history. Over long periods of human history, the forces of production will continually improve because technology is simply an aspect of human knowledge. Once a discovery is made, whether the smelting of copper and tin into bronze or the development of a faster computer processor, the knowledge tends to be retained and can be used and improved upon by subsequent generations. Human knowledge and technology have a ratchet-like quality—they can go forward a bit at a time but will not go backward.

For Marx, the agents of change are human beings organized into conflicting social classes. Because class relations change more slowly than technological development, social change is impeded, fostering conflict between the classes that in a capitalist society gradually produces a face-off between the bourgeoisie and the proletariat. According to Marx, the **bourgeoisie** are wealthy elites who own the means of production—or what today would be bigger industries, banks, and financial institutions. In British society, the bourgeoisie also made up the members of Parliament and thus controlled the government—or state, as Marx would refer to it. In Marx's day, the **proletariat** were the exploited workers (including their families) in Britain's woolen mills, who received very low wages and often died on the job. Gradually, it was thought, workers would realize their common interests and would organize and press on the bourgeoisie for higher wages and better working conditions.

Marx identified three objective laws that would, at some point, destroy capitalism from within. First, *the law of the falling rate of profit:* Over time as investment causes machines to replace workers, profits must decline and ultimately disappear. Second, *the law of disproportionality* (also called the *problem of underconsumption*)[7] suggests that capitalism, because of its anarchic, unplanned nature, is prone to instability such that workers cannot afford to buy what they make. Like other classical economists, Marx believed in the *labor theory of value*, which argues that the value of a commodity is related to the amount of labor required for its production. Marx tried to demonstrate that workers were paid less than the full value of what they produced. Because workers were abundant (as poorer people moved from the countryside and into cities looking for work), the bourgeoisie were able to pay them less and make more profit for themselves from the sale of the goods the workers produced. And yet, poorer workers could not afford these goods, which turned into an oversupply of products, driving down their owners' profits. This disproportionality between supply and demand leads to wild fluctuations in the history of capitalism, with periodic booms and busts such as the one the world finds itself in now with regard to surplus credit, which we discuss later in the chapter (see also Chapter 8).

Third and finally, *the law of concentration* (or *accumulation of capital*) holds that capitalism tends to create increasing inequality in the distribution of income and wealth. As the bourgeoisie continue to exploit the proletariat and as weaker capitalists are swallowed by stronger, bigger ones, wealth and the ownership of capital become increasingly concentrated in fewer and fewer hands. Marx viewed these as objective, inescapable features of the capitalist mode of production, which he predicted will result in the ultimate collapse of the system.

For Marx, capitalism is more than an unhappy stop on the road to socialism. It is also a *necessary* stage, which builds wealth and raises material living standards. It is the dynamic nature of market capitalism that lies at the heart of political economy. According to Marx, capitalism plays two historic roles. First, it transforms the world and in so doing breaks down feudalism, its historical antecedent. Second, it creates the social and economic foundations for the eventual transition to a "higher" level of social development. Marx argued that when class conflict becomes so severe that it blocks the advance of human development, a social revolution will sweep away the existing legal and political arrangements and replace them with ones more compatible with continued social and technological progress. In this way, history has already evolved through distinct epochs or stages: primitive communism, slavery, feudalism, and capitalism. Marx's *Communist Manifesto,* published in 1848, was a call for a revolution that would usher in a new epoch of history—socialism—which would, after yet another revolution, finally produce pure communism.

As we will see below, neo-Marxists and structuralists still accept the notion of exploitation, although it has been separated from the labor theory of value. Also, most neo-Marxist scholars no longer accept the claim that capitalism will someday destroy itself. Rather, it is generally accepted that Marx's mathematical analysis that produced this prediction was simply erroneous.[8] When socialism was regarded as inevitable it made sense to plan for it, but now that capitalism is recognized as a viable economic system, the entire discussion about socialism has shifted. Socialism may be a possible future, but it would have to be a political choice, not something imposed on society by Marx's deterministic laws of historical epochs. Nonetheless, many other ideas from Marx or from the school of thought he established contribute to an explanation of phenomena we still observe today in the international political economy.

SOME SPECIFIC CONTRIBUTIONS OF MARX TO STRUCTURALISM

A word of caution is in order concerning the nature of Marxist thought and its relationship to contemporary structuralism. Marx wrote millions of words; in so vast a body of work, he necessarily treated the main themes repeatedly and not always consistently. What Marx "said" or "thought" about any interesting issue is therefore subject to dispute. At the same time, Marxist scholars have interpreted his writings in many ways. Here we explore four ideas that are found in varying degrees within Marx's work and that have been further developed by neo-Marxists, structuralists, and other varieties of radicals up to the present. Some ideas that Marx considered to be of great importance are no longer regarded as useful by most current scholars. And many ideas that he presented have been modified (and hopefully improved) by subsequent scholars, which can be seen as part of the normal development in any field of academic inquiry.

The following four Marxist ideas are central to contemporary structuralist analyses of the international political economy: the definition of class, class conflict and the exploitation of workers, capitalist control over the state, and ideological manipulation.

The Definition of Class

To understand the Marxist notion of class, we must first define capital. Capital, what Marx called the means of production, refers to the privately owned assets used to produce the commodities in an economy. Car factories are capital, as are all the machines and tools inside them. A computer, when owned by a company, is capital. So are the desks, filing cabinets, cranes, bulldozers, supertankers, and natural resources like land and oil. Almost all production requires both workers and physical assets, and in modern economies production processes can indeed be very capital-intensive.

When we speak of "capital goods" we mean more than simply the existence of such productive assets. Humans have used tools for much longer than capitalism has existed and socialist societies have machines and factories just like capitalist ones. To call an asset capital also means that it is privately owned, that somebody has legal ownership and effective control over that asset. In many cases today that ownership is merely a piece of paper or a computerized account representing stock in a corporation. The property rights in a capitalist society dictate that the owners of capital will receive the profits from the sale of commodities produced by the capital they own and the labor they hire.

Class is determined by the ownership, or lack of ownership, of capital. A minority of people will own a disproportionate share of the productive assets of the society; these constitute the capitalist class, also referred to as the bourgeoisie. In the United States, for example, the wealthiest 1 percent of the population owns 50 percent of all stocks and the top 10 percent owns 86 percent, leaving 14 percent of this financial asset for the remaining 90 percent of society.[9] Real estate, excluding a household's principal residence, has a similarly unequal distribution, while bonds are even more concentrated among the wealthy. The majority of the population will own very little capital and indeed many people will own no productive assets or any shares of stock; these constitute the working class, known as the proletariat. Note that workers may own assets—houses, cars, appliances, and so on—but these are not productive assets but simply possessions. They cannot be mixed with labor to form a commodity that could be profitably sold on a market. Implicitly, if not explicitly, Marxists regard the original distribution of assets as unjust, noting that historically a small number of people confiscated large amounts of land and other resources by means of violence and coercion. Thus, the contemporary consequences of this distribution are criticized for moral reasons.

Class Conflict and the Exploitation of Workers

For households in the capitalist class, profits are the leading source of income. For example, if the average return in the stock market is 5 percent per year and a capitalist household owned $50 million worth of stock in various corporations, then the income produced by that ownership would be \$2.5 million in one year (\$50 million times 0.05). This leaves the original \$50 million intact and it comes without any requirement that the capitalists actually perform any work.

Workers, on the other hand, have little or no capital and therefore must sell their ability to labor to capitalists if they are to receive an income. In other words, businesses hire workers and pay them a wage or salary. Workers must work to receive an income. For Marxists, this inevitably leads to the exploitation of workers because of their weak bargaining position. In a capitalist economy, there is always a certain level of unemployment; that is, some workers are denied access to capital and thus the ability to produce goods (remember that production requires the combination of physical assets and labor). By restricting access to their productive assets, capitalists, in effect, create an artificial scarcity of capital. At the same time that 5 percent or even 10 percent of the workforce might be unemployed, there is likely sufficient idle machinery that could put everybody to work if put into operation. But it is actually more profitable for businesses to keep some capital out of use in order to maintain a certain amount of unemployment. The presence of unemployed workers functions to keep down the wages of the employed—if one worker does not accept the going rate, then he or she can be easily replaced. Thus, unemployment allows capitalists to dominate workers and serves as the foundation for exploitation.

The exploitation of workers by capitalists is a specific instance of power relations more generally. To say that actor A has power over B (or can dominate B) is to say that A is able to get B to act in ways that promote the interests of A and are contrary to B's.[10] This does not necessarily mean that B has literally no choice but simply that the options are configured to benefit A. When the armed robber tells the hapless victim, "Your money or your life!" the victim could choose the latter. Nonetheless, it is the case that the robber, due to the presence of a gun, has power over the victim because in either scenario the robber will make off with the money. The victim is coerced into making the least bad choice.

Many workers are in a similar situation: Either accept low wages or starve! Capitalism depends on "the existence of workers who in the formal sense voluntarily, but actually under the whip of hunger, offer themselves."[11] Joan Robinson, the famous socialist-leaning post-Keynesian economist, captured the position of workers by remarking that the only thing worse than being exploited under capitalism is not being exploited. In other words, the worst outcome for those in the working class is to be unemployed, and it is the fear of unemployment that forces workers to accept low wages. Workers technically do have a choice, but the game is structured such that the best choice is still a bad choice for them but a good one for the capitalists. In sum, exploitation means that capitalists, because they have greater labor market power, are able to expropriate a share of the economic output that should belong to workers. Essentially, the capitalists force the workers to accept a bad deal because the alternative is even worse.

We should be clear that class conflict does not necessarily mean a state of warfare or even hostility of any sort. In fact, many individuals may not even recognize the conflicting nature of their relationship with the other class. Class conflict usually results in a gain for one side at the expense of the other. The degree to which individuals in different classes act upon this fact is hard to predict. Furthermore, even when the conflict is recognized, it is possible that a compromise between classes can be found. The welfare states of Western Europe may be considered instances of such compromise. In states such as France, Germany, and Sweden, organized labor renounces the goal of a socialist society and offers a relatively harmonious relationship with business in exchange for high wages, adequate unemployment compensation, universal health care, paid vacations, and generous pensions.

Because workers are exploited, they share an objective economic interest in changing the economic system, while capitalists will have an interest in maintaining the status quo. The presence of an "objective" interest does not necessarily mean that workers will actually form a socially and politically active group or movement. Workers (1) may not subjectively recognize their common objective interest, or (2) they may recognize their interest but be unable to organize. The first is an instance of false consciousness (discussed in section "Ideological Manipulation"). The second may be the result of class struggle in which an organized capitalist class prevents the successful organization of the working class, for example, into unions, or the result of collective action problems that impede the working class from organizing itself (and these two may be interrelated in complex ways). In Marxist language, workers are often a class *in itself* without becoming a class *for itself*.

The central idea, however, is that the relationship between capitalists and workers is built upon an objective division of the economic output of a society into wages and profits. The actions of individual workers and capitalists will depend on many concrete historical variables, leading to civil war or revolution, to class compromise, or to passivity due to subjective ignorance. But regardless of the way in which the conflict plays itself out, class conflict is a fundamental objective characteristic of capitalist societies.

Capitalist Control over the State

The state is defined as the organization in a society that governs, by force if necessary, a population within a particular territory. Despite globalization, the modern state is still usually the most powerful organization within any society, typically possessing the strongest tools of repression in the form of military and police forces. Based on its powers, the state also exercises tremendous influence in picking economic winners and losers through taxation, spending, and regulations. Some of its most important regulations involve workplace and labor issues such as setting the minimum wage, writing and enforcing child labor laws, and establishing the ease or difficulty in forming labor unions. While states and their leaders are not omnipotent, they do indeed have the ability to help their friends and punish their enemies. It is therefore reasonable that both capitalists and workers would seek to "capture" the state, to apply the capacities of the state to their particular interests.

In the struggle to control the state, capitalists and workers have very different resources. The capitalist class has greater financial resources, and this often translates easily into influence in the political system. Capitalists are typically able to donate more money to probusiness candidates. The "think-tanks" used by officials to craft policies, such as the Brookings Institution or the Heritage Foundation, are largely funded by corporations or individual members of the capitalist elite. Furthermore, the state depends upon the investments of businesses in order to provide tax revenue and employment for its citizens; a climate that is too antibusiness will cause capital to flee elsewhere or at least reduce investment. Thus, even without direct attempts by capitalists to influence the state, many policies will promote their interests regardless.

Workers, for their part, have greater numbers. To turn this into political power the state must have strong democratic institutions that give workers a substantial role in policy making, and workers must also be sufficiently organized. Capitalists therefore will not always prefer democratic institutions. They certainly want (capitalist) property rights defended along with a reasonably stable investment climate, but these can be found in undemocratic countries. In fact, in the most democratic systems, such as Western European countries that have proportional representation voting, workers' parties (Social Democratic or Socialist Parties) often win majorities or significant pluralities.

Workers may also attempt to influence the political system through strikes and protests. Capitalists may have the power to relocate or reduce investment, but workers are able to withhold their labor, that is, they can strike. Workers will be stronger to the extent that the strike involves many participants (including few who will cross the picket line) and when the workers can survive for a long time without the wages from the employer. Often a strike is the response of a single union to a particular grievance with a firm, but when a large segment of the population is involved in a general strike the entire economy can be halted and governments can be forced to respond to the demands of the working class. For this reason it is no surprise to Marxists that general strikes, or even the more limited secondary or sympathy strikes, have been made illegal in the United States. On the other hand, social action in the form of protests or riots cannot be as easily regulated by the state and may have class objectives. But again the efficacy of these actions depends heavily on the degree of solidarity among its members. If workers do not hang together, then the capitalists will find it easy to divide and conquer.

Structuralists believe that the superior financial resources of capitalists and the difficulties inherent in forming large worker or social movements give capitalists the advantage in most countries today. If this is true, we would expect that policies generally favor capitalists, at least as a class, even if many capitalist firms will be permitted to fail due to competition (although note the power of certain firms or sectors to receive government "bailouts").

Structuralists recognize that the influence of the state does not necessarily end at the border. Like mercantilists, structuralists agree that any state can be regarded as an actor in a global system made of other states. States can form treaties or trade agreements. States can also go to war with each other or be in colonial relationships whereby one state controls or even occupies another. As mercantilists emphasize, the relative military and economic strengths of the states involved will generally determine the winners and losers in any conflict. There is little disagreement between structuralists and mercantilists regarding the importance of the powers that states wield. The difference between the two concerns the motives behind the use of state power. Whereas mercantilists see the state as an actor with its own interests (or perhaps the interest of all its citizens), structuralists believe that a state will act to advance the narrower interests of the class that dominates it—typically the capitalists, as mentioned above. Thus, Marxists see **imperialism** as a natural feature in the global capitalist system, which we discuss later in the chapter.

Finally, in their search for profits, capitalists in the rich states not only exploit domestic workers but workers in other countries as well. The international situation, however, is complicated because capitalists in any country are not only in conflict with their own workers but also have a complex relationship with capitalists in other countries. Capitalist firms do compete with other firms both domestically and internationally, yet they also form alliances with those firms on issues that impact the functioning of the global capitalist system. Thus, depending on the issue, capitalists in New York or London often form alliances with the local capitalist elite in Mexico City or Riyadh in order to keep profits up, workers weak, and wages down.

Ideological Manipulation

Power derives from the control over hard resources, like capital or the military, and the ability to force others to act in certain ways by structuring the choices of the weaker to the benefit of the stronger (see Chapter 9). Yet, structuralists also accept that power has a softer side, the control over people's hearts and minds. The traditional Marxist term for this is *ideology*.

Idea is the root word of *ideology*. An idea is a belief or thought, and an *ideology* is simply a set of beliefs. But in the Marxist tradition, this term takes on particular importance when linked to the notion of class, generating the notions of a capitalist (or bourgeois) ideology and a working-class (or proletarian) ideology. The domain of ideology is another terrain upon which the class struggle is fought. An important goal of capitalist ideology is to give *legitimacy* to the capitalist economic system. To believe that a system is legitimate is to believe that it is appropriate and just. This is quite clear in the realm of state governance.

Most authoritarian regimes are regarded as illegitimate by their own citizens when the people do not believe that those who hold power have a fair and proper claim to it. Under such conditions, many individuals will be motivated to undermine or overthrow the government.[12] Thus, somewhat paradoxically, a dictatorship, which relies upon brute military and police strength, can be seen as the least stable system of government because it requires consistently high levels of surveillance and repression to maintain. A democracy, on the other hand, is generally seen as a legitimate form of governance. When citizens can participate in fair elections, the leaders typically earn the consent of the led, including even those who voted for a different candidate or party. Those with less power believe that it is appropriate that they lack certain powers (although they may not consent to being completely powerless) because those with more power are seen to possess a fair claim to it. While even democratic societies possess arsenals of surveillance and repression, they tend to be less intrusive than those found in authoritarian systems.

The concept of legitimacy applies not only to political institutions but to the economy as well. When capitalism is regarded as legitimate, individuals believe that the system is proper and just, meaning that those with fewer resources will believe that they *should* have fewer resources. Furthermore, a belief by workers in the legitimacy of the capitalism ensures that (1) they will not seek to replace it with something else (e.g., socialism) and (2) they will work harder within the present system, thus increasing the income of the capitalists. When capitalism is regarded as legitimate by the working class, then the capitalists generally do not have to use force in order to protect the wealth they have obtained through the exploitation of workers; workers consent to their own exploitation.

Given the importance of legitimacy, many Marxists argue that the capitalist class will actively seek to create an ideology in society that gives legitimacy to procapitalist institutions (see the box "Antonio Gramsci and Intellectual Hegemony" below). Elements of this ideology, like the belief in free trade (see Chapters 3 and 6), are actively promoted. This marketing of ideas requires resources and, although ideas cannot literally be bought and sold, their production in many ways is similar to the production of ordinary commodities. Noam Chomsky, a linguist at MIT and structuralist theorist, has analyzed the ways by which the consent of the proletariat is "manufactured" by powerful interests in society, including the state and the corporate media.[13] For example, the threat of foreign enemies has been used by those in power to draw attention away from internal, class-based, conflicts. For much of the twentieth century, the Soviet Union served that function but has been replaced more recently by Iraq, the "axis of evil," and (Islamic) terrorism in general. Writing on the Bush administration, Chomsky observed, "Manufactured fear provided enough of a popular base for the invasion of Iraq, instituting the norm of aggressive war at will, and afforded the administration enough of a hold on political power so that it could proceed with a harsh and unpopular domestic agenda."[14] Almost a century earlier, many socialists and communists were greatly disillusioned by World War I, because workers in different countries—who all had a common *objective* interest in fighting the capitalists—accepted the patriotic propaganda of their countries, resulting in the slaughter of workers by other workers.

Just like the competition between the classes for control of the state, Marxists see an unfair fight in the realm of ideology where capitalists use their resources to promote their ideology while workers, who have fewer resources, attempt to promote their own competing set of beliefs. The superior financial resources of the capitalists typically means that the procapitalist messages—the benefits of free trade, the need for low taxes on the rich, the problems with unions, and so on—will be stronger than those favored by workers. Workers, of course, are not powerless and at certain times on certain issues may succeed in persuading the public. But the game is biased in favor of capitalists. It is a great tragedy, according to Marxists, that capitalists not only exploit workers but also take part of this undeserved wealth and use it to manipulate the beliefs of workers so that they are ignorant of, or apathetic about, their own exploitation. The wealth produced at the hands of workers gets transformed into ideas that poison their minds.

From a Marxist perspective, the belief in the legitimacy of capitalism by workers is analogous to the belief in the legitimacy of a dictatorship by its citizens. Is it possible that people could ever be fooled like this? We should recall that the rule by monarchs in the Middle Ages in Europe was at least partially legitimized by an ideology promoted by the Catholic Church asserting a Divine Right to govern: to challenge the rule of the aristocracy was to offend God. Even today, in Thailand it is a serious crime to insult the king.[15]

According to Marxists, belief in the legitimacy of capitalism by workers is *false consciousness*. Workers are often fooled into believing that capitalism will benefit them, which makes it easier for them to continue to be exploited. We could say that Marxists regard capitalism as a dictatorship in which the people have been fooled, while economic liberals would see capitalism as a democracy that has earned its legitimacy because people view it as a fair system. The evaluation seems to depend on whether or not one believes that capitalists, in fact, exploit workers.

For many people, Marxism is equated with socialism or communism. Yet, we can now see that Marx envisioned those systems as epochs of history that would come after capitalism. Marx's four major contributions to IPE (discussed above) can be separated from his theory of history and its prediction regarding the inevitability of socialism and then communism.

ANTONIO GRAMSCI AND INTELLECTUAL HEGEMONY

One of the most influential structuralists of the twentieth century—and one whose ideas are particularly relevant to the global political economy of the twenty-first—is the Italian Marxist Antonio Gramsci (1891–1937). Gramsci provides a broader account of the nature of class relations.

Gramsci lived in a time of tremendous economic and political tension, where he witnessed the rise of fascism in the 1920s and 1930s and the intense conflicts among nations and between classes. He proposed a philosophy of *praxis*—that we should demonstrate our beliefs through our actions. He edited an intellectual journal, *Ordine Nuovo* (The New Order), and led worker protests in the Italian industrial center of Turin, especially against the manufacturing giant FIAT. His political and intellectual activities drew the attention of Italy's proindustry fascist government, which imprisoned him. In his *Prison Notebooks*, Gramsci attempted to revise Marxist theory to account for changing conditions in the advanced industrial world. He died in prison at the age of 46.

According to Gramsci, the dominant class in society maintains its position in two fundamentally different ways: through coercion and through consent. Coercion is an obvious mechanism, applying economic and political power directly to keep the subordinate class in line. In Gramsci's time, for example, government police and manufacturer-backed thugs employed violence against protesting workers. In contemporary times, one might substitute the images of police at antiglobalization protests such as the 1999 World Trade Organization meetings in Seattle, Washington.

Coercion is a powerful tool, Gramsci said, but ideas are even more powerful because they allow rule over the masses. The dominant class produces and promulgates an ideology or worldview that supports and legitimizes its interests. These popular ideas permeate society through education and the communications media. Once the subordinate class accepts this worldview, whether intentionally or by osmosis, its thoughts and actions are brought into line with the interests of the dominant class. Police are not necessary because the idea of taking actions that oppose the dominant class is not part of society's accepted values and norms. Many contemporary writings, such as Benjamin R. Barber's *Jihad vs. McWorld* (see Suggested Readings), which oppose the increasing control of global media by an elite group of private owners, express a Gramscian-type concern about **intellectual hegemony**.

In Gramsci's view, there are no truly independent intellectuals. Traditional intellectuals, such as professors, like to "put themselves forward as autonomous and independent of the dominant group,"[a] but this self-image is inaccurate, as all intellectuals are products of particular historical events and social relationships. What is needed is for workers to develop, from within their own class, **organic intellectuals** who remain connected to their class while providing organization, leadership, and a vocabulary that challenges the ideology of the dominant class and articulates a different vision of the future. If they can also win over many of the traditional intellectuals, the formulation of a counterhegemonic ideology becomes all the more likely and legitimate. Schools, colleges, newspaper cartoons and editorials, political slogans, songs, and coffee shops will then reverberate with debate and demands for change.

Reference

[a]Antonio Gramsci, *Selections from the Prison Notebooks*, Quintin Hoare and Geoffrey Nowell Smith, trans. and eds. (New York: International Publishers, 1971), p. 7.

LENIN AND INTERNATIONAL CAPITALISM

V. I. Lenin (1870–1924) is best known for his role in the Russian Revolution of 1917 and the founding of the Soviet Union. In many ways he turned Marx on his head, placing politics over economics when he argued that Russia had gone through its capitalist stage of history and was ready for a second, socialist revolution. Lenin is also known for his views on imperialism based on Marx's theories of class struggle, conflict, and exploitation. In his famous book *Imperialism: The Highest Stage of Capitalism* (1917),[16] Lenin explains how, through imperialism, advanced capitalist core states expanded control over and exploited what his contemporaries called "backward" colonial regions of the world, leaving them unevenly developed, with some classes to prosper and others mired in poverty. By the end of the nineteenth century, new colonies were established mainly in Central and Southern Africa, and they became the main sources of cheap labor, scarce resources, and an outlet for industrial investment of the advanced capitalist nations. These colonies produced coffee, tea, sugar, and other food commodities not found in mother countries.

The critical element fueling imperialism, in Lenin's view, was the centralization of market power into the hands of a few "cartels, syndicates and trusts, and merging with them, the capital of a dozen or so banks manipulating thousands of millions."[17] Because capitalism led to monopolies that concentrated capital, it gradually undermined the ability of capitalists to find sufficient markets and investment opportunities in industrial regions of the world. Of course profit-seeking capitalists were unwilling to use their surplus capital to improve the living standards of the proletariat so that they could purchase more goods and services. To prevent capitalism from imploding, Lenin and others argued that imperialism therefore was a necessary outlet for surplus finance and allowed capitalism to survive. Imperialism allowed rich capitalist nations to sustain their profit rates while keeping the poorer nations underdeveloped, deep in debt, and dependent on the rich nations for manufactured goods, jobs, and financial resources.

For Lenin, imperialism also signified the monopoly phase of capitalism or "the transition from capitalism to a higher system," by which he meant that the presence of monopolies and imperialism that followed was yet *another* epoch of history between capitalism and socialism, unaccounted for by Marx.[18] Finally, imperialism helped convert the poorer colonial regions into the new "proletariat" of the world or "international capitalist systems." According to Lenin, "Monopolist capitalist combines—cartels, syndicates, trusts—divide among themselves, first of all, the whole internal market of a country, and impose their control, more or less completely, upon the industry of that country," generating a world market.[19]

It is not surprising that Lenin's theory of imperialism has been very influential, especially among intellectuals in the less developed countries, where his views have shaped policies and attitudes toward international trade and finance generally. Before and especially after World War I, cutthroat competition among capitalist nations contributed to international tensions and conflict. Elites in poorer nations competed for capital and investment, which made them easy targets for production monopolies. In these regions and countries, communist revolutionaries and leaders, like Mao Zedong in China, Ho Chi Minh in Vietnam, and Fidel Castro in Cuba organized anticolonialism and anti-imperialism campaigns and fought "wars of national liberation" against capitalist imperial powers.

Today, most structuralists no longer believe that the falling rate of profit for capitalists will cause the collapse of the capitalist mode of production. However, Leninist arguments about imperialism still remain influential in China, Vietnam, Cuba, Venezuela, and even in some industrialized nations that have active socialist and communist parties. Leaders of these and other countries still view capitalists as profit-seeking imperialists who seek opportunities abroad where democratic political institutions and the working class are weak.

No attempt to consider the IPE of relations between developed and developing countries is complete without considering theories of imperialism. We include Lenin's theory of imperialism under the general heading of "structuralism," as we did Marx's theories, because its analysis is based on the assumption that it is in capitalism's nature for the finance and production structures among nations to be biased in favor of the owners of capital. In theory, the relationship between capital-abundant nations and capital-scarce nations *should be* one of *interdependence,* because each needs the other for maximum growth. But for many structuralists, the result in practice is *dependence,* exploitation, and uneven development.

IMPERIALISM AND GLOBAL WORLD ORDERS

In this section, we explore some of the more recent structuralist theories of dependency, the modern world system, and modern imperialism (or "neoimperialism") that trace their analytical approaches and policy prescriptions to both Marx and Lenin.

Dependency Theory

A structuralist perspective that highlights the relationships between what are referred to as core and peripheral countries, while calling attention to the constraints put on countries in the latter group, is called **dependency theory.** A wide range of views can be grouped together under this heading. Their differences, however, are less important to us here than what they have in common, which is the view that the structure of the global political economy essentially enslaves the less developed countries of the South by making them reliant to the point of being vulnerable to the nations of the capitalist core of the North. Theotonio Dos Santos sees three eras of dependence in modern history: colonial dependence (during the eighteenth and nineteenth centuries), financial-industrial dependence (during the nineteenth and early twentieth centuries), and a structure of dependence today based on the postwar multinational corporations.

Andre Gunder Frank has focused a good deal of attention on dependency in Latin America and is noted for his "development of underdevelopment" thesis.[20] He argues that developing nations were never "underdeveloped" in the sense that one might think of them as "backward" or traditional societies. Instead, once great civilizations in their own right, the developing regions of the world *became* underdeveloped as a result of their colonization by the Western industrialized nations. Along with exploitation, imperialism produced underdevelopment. In order to escape this underdevelopment trap, a number of researchers, including Frank, have called for peripheral nations to withdraw from the global political economy. In the 1950s and 1960s, the leadership of many socialist movements in the Third World favored revolutionary tactics and ideological mass movements to change the fundamental dynamics of not only the political and economic order of their society but also the world capitalist system.

Recently, some dependency theorists have recommended a variety of other strategies by which developing nations could industrialize and develop. Raul Prebisch, an Argentinean economist, was instrumental in founding the United Nations Committee on Trade and Development (UNCTAD). The developing nations that have joined this body have made it their goal to monitor and recommend policies that would, in effect, help redistribute power and income between Northern developed and Southern developing countries. Many dependency theorists, however, have been more aggressive about reforming the international economy and have supported the calls for a "new international economic order" (NIEO), which gained momentum shortly after the OPEC oil price hike in 1973. The important point to make here is that dependency theories have served as part of a critique of the relationship of the core to peripheral nations. Whether that relationship can—or even should—be equalized is a matter usually played out in the political arena.

Modern World System Theory

One fascinating contemporary variant of the structuralist perspective focuses on the way in which the global system has developed since the middle of the fifteenth century. This is the **modern world system (MWS)** theory originated by Immanuel Wallerstein and developed by a number of scholars, including Christopher Chase-Dunn. Capitalist in nature, the world system largely determines political and social relations, both within and between nations and other international entities.

For Immanuel Wallerstein, the world economy provides the sole means of organization in the international system. The modern world system exhibits the following characteristics: a single division of labor whereby nation-states are mutually dependent on economic exchange; the sale of products and goods for the sake of profit; and, finally, the division of the world into three functional areas or socioeconomic units which correspond to the roles that nations within these regions play in the international economy.[21] From the MWS perspective, the capitalist core states of northwest Europe in the sixteenth century moved beyond agricultural specialization to higher-skilled industries and modes of production by absorbing other regions into the capitalist world economy. Through this process, Eastern Europe became the agricultural **periphery** and exported grains, bullion, wood, cotton, and sugar to the core. Mediterranean Europe and its labor-intensive industries became the **semiperiphery** or intermediary between the core and periphery.

It would be easy to define the core, periphery, and semiperiphery in terms of the types of nations within each group (such as the United States, China, and South Korea, respectively), but the MWS is not based primarily on the nation-state. In this theory, the core represents a geographic region made up of nation-states that play a partial role in the MWS. The force of bourgeois interests actually exists, in varying degrees, in every country. Every nation has elements of core, periphery, and semiperiphery, although not equally. In common with Marx, then, the MWS theory looks at IPE in terms of class relations and patterns of exploitation.

According to Wallerstein, the core states dominate the peripheral states through unequal exchange for the purpose of extracting cheap raw materials instead of, as Lenin argued, merely using the periphery as a market for dumping surplus production. The core interacts with the semiperiphery and periphery through the global structure of capitalism, exploiting these regions and also transforming them. The semiperiphery serves more of a political than an economic role; it is both exploited and exploiter, diffusing opposition of the periphery to the core region.

Interestingly, on some issues Wallerstein attempts to bridge mercantilism (and political realism) with Marxist views about the relationship of politics to economics. For instance, as a mercantilist would, he accepts the notion that the world is politically arranged in an anarchical manner—that is, there is no *single* sovereign political authority to govern interstate relations. However, much like a Marxist-Leninist, he proposes that power politics and social differences are also conditioned by the capitalist structure of the world economy. According to Wallerstein, capitalists within core nation-states use state authority as an instrument to maximize individual profit. Historically, the state served economic interests to the extent that "state machineries of the core states were strengthened to meet the needs of capitalist landowners and their merchant allies."[22] Wallerstein also argues that, once created, state machineries have a certain amount of autonomy.[23] On the other hand, politics is constrained by the economic structure. He asserts, for instance, that strong (core) states dominate weak (peripheral) ones because placement of the nation-state in the world capitalist system affects its ability to influence its global role. As Wallerstein puts it, "The functioning then of a capitalist world economy requires that groups pursue their economic interests within a single world market while seeking to distort this market for their benefit by organizing to exert influence on states, some of which are far more powerful than others but none of which controls the world-market in its entirety."[24]

One problem with Wallerstein's theory is precisely what makes it so attractive: his comprehensive yet almost simple way of characterizing IPE. Many criticize his theory for being too deterministic, both economically and in terms of the constraining effects of the *global* capitalist system. Nation-states, according to Wallerstein, are not free to choose courses of action or policies. Instead, they are relegated to playing economically-determined roles. Finally, Wallerstein is often faulted for viewing capitalism as the end product of current history. In this sense he differs from many structuralists who feel that political-economic systems are still a choice people have and not something structurally determined.

Neoimperialism, Neocolonialism, and Empire-Building Redux

As we suggest in several chapters throughout this text, the term **neoimperialism** describes a newer, more subtle version of imperialism that structuralists claim the United States and other industrialized nations have been practicing since the end of the Vietnam War in 1975. Neoimperialism differs from classic imperialism in that states no longer need to occupy other countries in order to exploit or control them.

Harry Magdoff (1913–2006), who edited the socialist journal *Monthly Review*, provides a good example of the older, *orthodox* version of Marxist-Leninist ideas related to U.S. imperialism. In his 1969 book *The Age of Imperialism: The Economics of U.S. Foreign Policy*, Magdoff established some of the same themes adopted by dependency and MWS theorists—especially those that focused on capitalism's expansive nature. He argued that the motives behind U.S. efforts to promote the economic liberal policies of the GATT, the IMF, and the World Bank could not be separated from U.S. security interests. During the Cold War, U.S. intervention abroad was not the result of one leader's decision, but the result of underlying structural economic, political, and military forces governing U.S. foreign policy.

Contrary to realists who argued that the United States intervened in Vietnam and other developing nations to "contain communism," the United States was motivated by a breakdown of British hegemony, coupled with the growth of monopoly capitalism—domination of the international economy by large firms that concentrate and centralize production.[25] President Eisenhower had earlier linked maintaining access to the natural resources of Indochina (Vietnam, Laos, Cambodia, and Thailand) to U.S. security interests. But in his farewell address, Ike warned of the growing influence of the military–industrial complex and its tendency to exaggerate the strength of enemies in order to justify military spending.

When the Vietnam War ended in 1975, many believed that the "naked" version of classical imperialism was over. U.S. hegemony declined as U.S. economic growth slowed and the U.S. dollar weakened when the Bretton Woods system formally collapsed in 1971 (see Chapters 7 and 9). The 1973 OPEC oil crisis exposed the United States' and other core countries' dependence on foreign oil. The U.S. public opposed military intervention in developing nations outside the U.S. "sphere of influence" in Europe, Japan, and Latin America.

However, by the late 1970s, a more classic type of imperialism resurfaced in the combined economic and military objectives President Carter established in his Carter Doctrine, proclaiming the United States' willingness to intervene in the Persian Gulf to protect U.S. oil interests. In 1979, the Iranian Revolution overthrew the U.S.-backed Shah of Iran, threatening U.S. control over oil and U.S. influence in the Middle East. Soon after, the U.S. CIA supported efforts of the Mujahedeen in Afghanistan against the Soviet occupation.

In the 1980s, as part of the Reagan Doctrine, the United States renewed its efforts to intervene in developing nations that threatened U.S. economic and security interests. Reagan assisted Saddam Hussein in the Iran–Iraq war and unsuccessfully intervened in Lebanon in 1983 and 1984. To contain communism in the western hemisphere, Reagan backed the *Contras* in Nicaragua. The United States also supported pro-Western authoritarian regimes in Guatemala, El Salvador, and other South American countries. All this time, he (and the presidents that followed him) never let up from seeking to control oil and assist Western oil corporations in the Middle East. One method of maintaining that influence was by giving military and other forms of aid to states like Saudi Arabia.

After the fall of the Soviet Union in 1990 and the Persian Gulf War in 1991, President Bush I ushered in what many structuralists view as a "new age of imperialism." From the perspective of U.S. policy makers, because the Soviet threat was gone, the globalization campaign provided the United States with an opportunity not to intervene as much as it did during the Cold War. Core nations could penetrate peripheral states via trade, investment, and other policies that rendered them dependent on core states. The United States and other industrialized nations promoted globalization as a beneficial package of policies that would help all developing countries grow. The "Washington Consensus" that economic liberal trade and investment best served this purpose became the rationale for policies for the IMF, the World Bank, and the WTO.

Many structuralists viewed these financial institutions as mere "fronts" for a U.S. goal to exploit the periphery, especially in Southeast Asia and Central and Latin America. Throughout the 1990s, President Clinton promoted economic liberal policy objectives with *selective* military intervention abroad. His campaign of "engagement and enlargement" mixed hard and soft power to explicitly draw other countries into the global capitalist economy while expanding the scope of democracy. Based on some of the lessons learned in Vietnam, Clinton was not as overtly interventionist as Reagan. However, U.S. troops continued to be staged in many regions—for short periods of time. The U.S. military hit terrorist targets in Sudan and Afghanistan with cruise missiles launched from U.S. warships. In cases where U.S. interests were not as clear, such as Rwanda, the United States failed to intervene to save hundreds of thousands who died in a campaign of genocide. Clinton's preference for multilateral (relatively equal) relations with the United States's main allies set the tone for joint NATO operations in the Balkans and for intervention in Kosovo in 1998.

As we discussed in Chapter 1, it was during the 1990s that many structuralists became quite critical of the latest phase of global capitalism—often referred to as hypercapitalism—that drives TNCs to produce new products in a supercompetitive global atmosphere in which individuals are made to feel better off but really are not. For many antiglobalization protestors, capitalism and globalization weaken local environmental laws, exploit labor, and are a major cause of poverty. And in many developing nations, they exacerbate class struggle between the world's richest fifth and nearly everyone else.

In the 1990s, the idea of "imperialism" once again appeared in U.S. policy-making circles but not in the *negative* context of military intervention abroad to protect economic interests. A growing number of neoconservatives (aka "neocons") such as Charles Krauthammar and Max Boot deplored the fact that when the Soviet Union fell, the United States missed an opportunity to capitalize on a "unipolar moment" by imposing its (benevolent) will on the rest of the world.[26] After 9/11, many policy officials and academics encouraged the new Bush administration to seize the moment and make maintaining U.S. hegemony—especially against "Islamo-fascism"—a central premise of U.S. foreign policy. Issuing a new Bush Doctrine that brazenly proclaimed that the United States "will not hesitate to act alone" or be restrained by conventions of international law, the Bush II administration invaded Afghanistan and Iraq.[27] In essence, when it came to security, the United States could do what it wanted, whenever it wanted, and with whatever instruments it chose.

Increasingly, a number of experts and academics also encouraged the administration to embrace the idea of *promoting* an American empire.[28] Although the administration never officially adopted the policy of empire-building, many argued that, in effect, many U.S. policies constituted behavior similar to that of the Roman and British empires. These policies included maintaining U.S. military installations and troops around the world and promoting the moralistic idea that the U.S. principles of liberty, equality, and individualism could not be questioned.[29]

Today, many structuralists argue that the Bush II administration's case for U.S. hegemony (and an empire) appeared to be more of the "naked" type of imperialism evident in earlier administrations. Professor of Geography and Anthropology Neil Smith argues that recent efforts to pacify Iraq and the Middle East have been part of a larger war and endgame to control not only oil but the global economic structure.[30] For some Bush administration neocons, the war in Iraq has indeed been a conscious quest for empire, albeit not labeled as such. Once again, globalization and U.S. interests complemented one another.

Contrary to the assurances of economic liberals, these efforts have failed to produce an equitable distribution of wealth; instead, they have led to violence and more inequality. Hegemony is yet another tool of the global bourgeoisie in the capitalist struggle against the proletariat who are confined to the sweatshops of the TNCs. Moreover, many structuralists maintain that Thomas Friedman's golden straitjacket of neoliberal policies do not empower and free people. Instead, these policies are totalitarian in nature, as communist dogma was in the Soviet Union. Globalization is merely part of a new religious-like canon pretending to explain the natural order of society.[31]

A STRUCTURALIST ANALYSIS OF THE FINANCIAL CRISIS OF 2007

Today, many structuralists focus on a variety of international and domestic factors that resulted in the financial crisis of 2007 (see Chapter 8 for more details of the crisis itself). They would start by pointing to the contradiction between the global *glut* of capital and the growing *debt* in most countries. Much of this capital was earned from export sales by the emerging economies in the 1990s and early 2000s and *not* invested back in the United States, which left it with a major debt problem that, in part, contributed to the global financial crisis. Walden Bello and others argue that the global glut of capital problem is endemic to capitalism in that, as Marx suggested, heavy investment in production leads to overproduction that outruns the capacity of consumers to buy enough goods to keep prices from falling.[32] In other words, the United States should *not* have to rely on investments by other countries to sustain its economic growth. The real issue is the unequal distribution of income within nations that prevents their consumers from purchasing more goods and services.

Thus, many structuralists point to the massive increase in the inequality of income and wealth in the United States that began around 1970.[33] In 1970s, the mean income of the richest 20 percent of Americans was around $103,000.[34] Adjusted for increases due to inflation, this had grown to $168,000 by 2007, a 63 percent increase. Over the same time, the mean income of the poorest 20 percent increased by only $2,000 from $9,500 to $11,500, an increase of only 21 percent. The share of total national income going to the richest 20 percent of Americans grew from 43 percent in 1970 to 50 percent by 2001, while the share going to the poorest 20 percent fell from 4.1 percent to 3.4 percent. Thus, the richest fifth of the population received half the nation's income while an equal number of people, the poorest fifth, share about one-thirtieth. Again adjusting for inflation, the median earnings of a full-time year-round male worker were actually higher in 1972 than in 2007.[35] Over this 35-year period, the richest Americans claimed virtually all of the increase in new income produced by the economy, increasing the power of capitalists over workers and resulting in a higher degree of exploitation of the working class.

As discussed in Chapters 1 and 8, from the 1990s to 2008, large numbers of middle class and poor people could more easily get credit cards and home mortages. From 1989 to 2007, the mean level of mortgage debt for the middle class, defined as those between the 40th and 60th income percentiles, increased from $45,000 to $104,000.[36] This form of debt would not have been as troubling if housing prices kept increasing. But when prices started coming down in 2006, many homeowners owed more on their mortgages than they could get by selling their houses. Credit card debt, on the other hand, is not backed up by any assets and is simply a promise to pay out of future income. Although the amounts are smaller, the mean credit card balances more than doubled, from $2,600 in 1989 to $5,600 in 2007, for those in the middle 20 percent of the income distribution. Overall, the degree of indebtedness grew for the middle class, leading the ratio of total debt to total assets to increase from 20.6 to 24.3 percent between 1998 and 2007.[37]

Initially, debt provides a boost to the economy because those who borrow the money are very likely to spend it on a car, consumer goods, improvement to a house, or a vacation. Of course, the loan plus interest must be repaid. Now borrowers have less income to spend on consumer goods because they have to pay back the (wealthier) lenders. However, economic growth is usually anemic whenever households in the middle class must spend a large portion of their income to service their debt, which transfers a good deal of income to the wealthy instead of purchasing goods and services. This leads to less production and lower employment in other firms, which generates ripple effects that decrease spending and production and increase unemployment in other parts of the economy. Structuralists also argue that when lenders are repaid, they tend to consume a *smaller* share of their higher income. From a structuralist viewpoint then, the U.S. economy has been operating on an unstable foundation of debt and inequality. Any trouble, such as an unexpected drop in housing prices or a setback in some other sector of the economy, could easily trigger a serious recession. While the bailout policies of many governments attempt to improve the balance sheets of banks and other financial institutions, the amount of debt held by the average household will remain at a very high level, generating still more bankruptcies. Many households will find themselves unable to borrow money for a renovation or car purchase that they would have funded through debt in the past. The economy will probably continue to grow but at a relatively slow pace.

On a global level, structuralists connect the current financial crisis to a variety of their concepts and ideas. Since World War II, core nations of the industrial North have promoted the spread of neoliberal policies throughout developing regions of the world through the IMF, the World Bank, the WTO, and TNCs. The whole world has become the frontier for the neoimperial policies whose goals are the search for labor and natural resources, rendering most developing nations more dependent on the North and worse off. This reality frames many of the recent developments associated with the financial crisis in that many TNCs looked to LDCs as export markets and investment opportunities, adding to the glut of dollars in circulation around the world. Interestingly, it has been many of the semiperipheral nations that have employed protectionist measures that helped insulate them from many of the effects of the crisis. And now many of these states have shown signs of leading the recovery from the financial crisis before the core states.

According to most structuralists, the fundamental fix for the economy is no longer violent revolution but fairly substantial government regulation of both the global and national economies in order to transfer wealth from the upper class to those in the middle and working classes. Domestically, many structuralists focus on *strengthening* the capacity and willingness of the state to regulate the shadow banking and financial system. Of the suggestions mentioned in Chapter 8, some have supported the idea of temporarily nationalizing banks and establishing more state institutions to compete with those in the private sector. Many would like to see stricter measures to regulate derivates, executive salaries, and insider trading. If the masses are to regain confidence and trust in the financial system, states must do more to assure their taxpayers that they are *not* bailing out banks with their money while at the same time *rewarding* greedy officials with high salaries and bonuses. Many structuralists are also disappointed that policy makers themselves who espouse economic liberal values have not been more upset by the desire of financial institutions and officials to continue risky lending and investment practices.

Finally, many point to an assortment of "bad behaviors" by bankers, elected officials, and even individual voters as causes of the financial crisis. When it comes to state officials finally discovering people like Bernie Madoff who run Ponzi schemes that bilk their investors out of millions of dollars, Marx would be quick to say, "I told you so." Likewise, he and Gramsci would also not be surprised that state regulators failed to act on tips that Madoff's investment company was a scam because many of them were smitten by the laissez-faire outlook that discourages proactive state regulation of the economy. Nor would they be surprised that serious reform that reflects the interests of the working class has been difficult to pass in many national legislatures because most public officials reflect the interests of the financial elite.

More so than anything else, many structuralists blame the financial crisis on the shortcomings of laissez-faire economic ideas and policies. They would prefer a new ideology that accounts for the negative effects of the winner-take-all, individualist style of hypercapitalism, while justifying a more equitable distribution of income and the preservation of community values. These ideas are reflected in some of the social democracies of Europe.

On the global level, most structuralists support a variety of efforts to eradicate poverty, hunger, debt, and sickness in developing nations. Although IOs do not play a major role in Marxist theory, they have become increasingly important for any number of structuralist-oriented NGOs and activist groups. Many UN agencies have promoted programs that target women's issues, relief efforts for refugees, human rights, and the preservation of indigenous societies. Many structuralists are also behind proposals to increase regulation of TNCs (see Chapter 18).

CONCLUSION

Structuralism in Perspective

Some people ask whether studying Marxism or structuralism in the post-communist era is worthwhile. But one does not need to support Soviet-style socialism in order to see the value in Marx's analysis of capitalism as a political economic system. In this chapter, we separated Marx's four main contributions to IPE—the definition of class, class conflict and the exploitation of workers, control of the state, and ideological manipulation—from his theory of history, which predicted the inevitable collapse of capitalism and its replacement with socialism (and ultimately communism). Structuralists, drawing upon core ideas from Marxism, emphasize the class-based nature of the contemporary international political economy. One cannot understand domestic economic policies nor the international political economy without recognizing the conflict over the income derived from the division of the economic output into profits and wages.

Structuralists reject the optimistic liberal interpretation of free trade and deregulated markets, asserting instead that the inequalities in power between capitalists and workers, and the rich and poor countries, produces exploitation, inequality, unemployment, and poverty. The capitalist system tends to reproduce itself such that those who begin with more power and wealth are able to maintain that position at the expense of labor and the poor. Dependency, modern world systems, and theories about imperialism demonstrate that, given states' vastly unequal starting places, it is naïve to believe that free markets operate on a level playing field that will somehow lead to the end of poverty. This is because the state itself is seen as largely responding to the pressure of the capitalist-elite class, a group that is increasingly global in their orientation, seeking profits wherever they can be found, and having almost no loyalty to the citizens of their home countries.

The structuralist version of globalization calls for greater unity among workers from all countries and international trade and investment arrangements that no longer expose vulnerable developing countries to conditions that favor the core. This will require coordinated political action by those with fewer economic resources. Even Marx implied that not all decisions must be seen as beyond our collective control when he stated that "men make their own history, but .... they do not make it under circumstances chosen by themselves, but under circumstances directly encountered, given and transmitted from the past."[38] Thus, for many structuralists today, a deep understanding of the economic structure *permits* the exercise of human freedom, understood as the application of human reason to the shaping of our world. Of course, not every change is possible; but some very substantial improvements almost certainly are. The precondition for such action will be the development of a new consciousness—one that sees the free market version of globalization as simply ideological manipulation by those in power with an economic interest in perpetuating the status quo.

Despite the current economic crises and international conflicts, or perhaps because of them, there are many who agree with the structuralist agenda. One interpretation of the election of Hugo Chávez and other leftist leaders, or the massive protests against meetings of the global financial elite, is the claim that many people reject TINA (there is no alternative), the slogan of the neoliberals, and instead prefer the slogan of the World Social Forum: Another World Is Possible!

KEY TERMS

structuralism 82
historical materialism 83
dialectical process 84
bourgeoisie 84
proletariat 84
false consciousness 88
imperialism 89
intellectual hegemony 92
organic intellectuals 92
dependency theory 94
modern world system (MWS) 95
core 95
periphery 95
semiperiphery 95
neoimperialism 97

DISCUSSION QUESTIONS

1. Summarize the four main contributions of Marxism to contemporary structuralism.
2. Compare and contrast Marx's and Lenin's views of capitalism. How and why did their views differ? Be specific and give examples from the chapter.
3. Outline the essential characteristics or features of dependency theory, the modern world system approach, and neoimperialism.
4. Outline the key elements of the structuralist explanation of the current financial crisis.
5. If you were to come up with a new ideology to replace the wildcat version of U.S. capitalism, what, if any, structuralist elements would it include? Discuss.

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3. Many scholars have documented the history of U.S. involvement in Latin America. See, for example, Michael Grow, *U.S. Presidents and Latin American Interventions: Pursuing Regime Change in the Cold War* (Lawrence, KS: University of Kansas Press, 2008); Alan McPherson, *Intimate Ties, Bitter Struggles: The United States and Latin America Since 1945* (Washington, D.C.: Potomac Books, 2006); and Fred Rosen, ed., *Empire and Dissent: The United States and Latin America* (Durham, NC: Duke University Press, 2008).
4. Visit *School of the Americas Watch* at http://www.soaw.org/article.php?id=230&cat=63.
5. For a discussion of Marx's methodology see Todd G. Buchholz, *New Ideas from Dead Economists* (New York: New American Library, 1989), pp. 113–120.
6. Karl Marx, *The Poverty of Philosophy* (New York: International Publishers, 1963), p. 122.
7. A more analytical definition of disproportionality and its place in Marx's theory can be found in Paul M. Sweezy, *The Theory of Capitalist Development* (New York: Monthly Review Press, 1970), chap. 5.
8. Ian Steedman, *Marx after Sraffa* (New York: Verso, 1977), pp. 170–175.
9. Edward N. Wolff, *Top Heavy: The Increasing Inequality of Wealth in America and What Can Be Done about It* (New York: The New Press, 1996), p. 64.
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17. Ibid., p. 88.
18. Ibid., p. 68.
19. Ibid.
20. See Andre Gunder Frank, "The Development of Underdevelopment," *Monthly Review* 18 (1966).
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22. Ibid., p. 402.
23. Ibid.
24. Ibid., p. 406.
25. See John Foster Bellamy, *Naked Imperialism: The U.S. Pursuit of Global Dominance* (New York: Monthly Review Press, 2006), especially pp. 107–120.
26. See Charles Krauthhammar, "The Unipolar Era," in Andrew Bacevich, ed., *The Imperial Tense* (Chicago, IL: Ivan R. Dee, 2003).
27. See The National Security Strategy of the United States, The White House, September 17, 2002, www.hytimes.com/2002/09/20/politics/20STEXT_FULL.html
28. See, for example, Deepak Lal, "In Defense of Empires," in Andrew Bacevich, ed., *The Imperial Tense* (Chicago, IL: Ivan R. Dee, 2003).
29. See Chalmers Johnson, *The Sorrows of Empire: Militarism, Secrecy, and the End of the Republic* (New York: Metropolitan Books, 2004).
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33. See John Bellamy Foster and Fred Magdoff, "Financial Implosion and Stagnation: Back to the Real Economy," *Monthly Review*, December 2008, pp. 1–29.
34. Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, *U.S. Census Bureau, Current Population Reports, P60–235, Income, Poverty, and Health Insurance Coverage in the United States: 2007* (Washington D.C.: U.S. Government Printing Office, 2008), Table A3, Selected Measures of Household Income Dispersion: 1967–2007. This report is updated annually and can be downloaded from www.census.gov/prod/www/abs/income.html.
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CHAPTER 5

Alternative Perspectives on International Political Economy

Darfur—refugee women enduring.

Jacob Silberberg

The international political economy manifests many boundaries and tensions due to conflicting interests, points of view, or value systems that increasingly come into contact with one another. The mainstream IPE theories of economic nationalism, liberalism, and structuralism frame IPE issues in ways that capture some, but not all, of the most important elements of IPE today. One of the main intellectual projects of contemporary IPE is to expand its domain to include actors, frameworks, and ways of thinking that cannot easily be classified under the three main perspectives. One of the goals of this chapter is to highlight some of the ways in which IPE can be more inclusive—"without fences," as Susan Strange would say—when it comes to honestly confronting a broader range of important issues and theories in today's world without necessarily abandoning IPE's intellectual roots.

This chapter presents two alternatives or complements to the mainstream IPE theories: constructivism and feminist theory. Each of these critiques asks us to think of IPE in a different and generally broader way. IPE in the next few decades, however it develops, will necessarily reflect and condition each of these views.

We begin with constructivism, a new, vibrant theory that focuses on the beliefs, ideas, and norms that shape the views of officials, states, and international organizations in the global system. More than other alternative theories, constructivism focuses on society and culture and posits that policies change when people's values and fundamental beliefs change. It identifies an important role for global civil society in shaping the identity and interests of actors that wield enormous economic, military, and political power.

Feminist theory is concerned with the status of women and the role they play in relation to a variety of IPE issues, especially human rights and development. Along with constructivism, feminist theory focuses on the connections between gender and wealth, power, and authority. It identifies issues that are often ignored, such as the importance of family security, reproduction, and gendered beliefs in today's world. In the last twenty years in particular, a host of international organizations (IOs) and nongovernmental organizations (NGOs) have taken up the cause of promoting women's rights and improving conditions for women in all countries, but especially in developing nations. In many cases, IOs and NGOs have made end runs around states to accomplish these objectives.

Note that a discussion of the rational choice approach that appeared in this chapter in the previous edition has been moved to the Instructor's Manual. It applies what was originally an economic methodology to a variety of issues and problems in the social sciences. Students are encouraged to review the"rat choice" approach to understand the way individuals and the aggregate units that represent them, such as states and other actors, make decisions.

Before we begin, a word of caution is in order. Both of the IPE critiques described here are complex and controversial. As in the case of the three dominant IPE perspectives, many different viewpoints or variations exist within each critique. Thus, it is either bold or foolhardy to try to concisely and simply sum up either of these schools of thought. The analysis presented here, however, *is* concise and therefore intentionally incomplete, and also therefore necessarily superficial. This chapter was not written for experts of these theories as much as it was written for IPE students. Our aim is to acquaint students with a variety of other analytical tools and perspectives that may lead them to a deeper understanding of some of the issues surrounding IPE.

CONSTRUCTIVISM

Many students find the constructivist perspective exciting because it focuses on issues and actors that are often overlooked in typical studies that are labeled "the IPE" of something or other. **Constructivism** is a relatively new perspective in IPE and international relations, and it focuses on the role of ideas, norms, and discourse in shaping outcomes. Constructivists reject the realist assertion that by simply observing the distribution of military forces and economic capabilities in the material world we can explain how states will interact. Institutions like the state, the market, or IOs are constructed in a social context that gives them meaning, purpose, and patterns of behavior. How power is used, what goals states have, and how countries interact depend on the ideas that actors have about those things. As actors interact with each other, they create meanings about their own identity and purpose, and those meanings can change. In this section, we explore the ideas of constructivists and provide many examples of the tools they use to interpret important global issues. We look at constructivists' understanding of war and peace issues, the actors they assert are important shapers of the world, and some of the analytical tools they use.

Views of Conflict and Cooperation

Constructivism makes different fundamental assumptions than realism and economic liberalism about the structure of the IPE and its ability to condition state or individual behavior. Whereas realists (see Chapters 3 and 9) argue that the balance of power conditions states' behavior, constructivists suggest that conflict or cooperation between two or more actors is a product of those actors' different values, beliefs, and interests. One of realism's central assumptions is that a potentially anarchic "self-help" world forces all actors to make security their first priority, lest they be killed or overtaken by other states. Questions of identity and interest formation are considered to be analytically irrelevant. Social factors such as beliefs and values do not have causal power because they will always be overwhelmed by the structural realities of a self-help world.[1]

Likewise, economic liberals share the realist assumption of an anarchic world but hold that well-designed institutions can create the possibility for countries to share positive-sum gains. Like the realists, economic liberals have a rational view of the world, in which institutions such as capitalism or conditions such as interdependence order the international political economy. Social factors have little direct effect on these institutional structures or processes.

On the other hand, constructivist Alexander Wendt argues that "structure has no existence or causal power apart from processes. Self-help and power politics are institutions, not essential features of anarchy. Anarchy is what states make of it."[2] In other words, the existence of potential anarchy alone is not sufficient to produce a self-help world. A combination of social processes associated with different actors' assorted identities and subjective interests causes them to view anarchy in terms of a world of potential chaos and disorder. For Wendt, we do live in a self-help world, only because over time we have come to "believe" that self-help is a consequence of anarchy. The international system is quite orderly; most of the time, states act in accordance with formal and informal rules and norms.[3] The fact that some states are now regarded as "rogue states" is testimony to the idea that they are "deviant" in some fashion (see Chapter 9) because they have not behaved in a way acceptable to the community of nations.

Drawing more on the individual and state/societal levels of analysis (see Chapter 1), constructivists contend that states are not only political actors, they are also social actors to the extent that they adhere to norms (rules of behavior) and institutional constructs that reflect society's values and beliefs. Why do some people or states cooperate more than others? Is it because they are threatened by a more powerful state? Perhaps! More often than not, though, states cooperate because they are predisposed to work with other states. Their societies value cooperation and prefer cooperative tactics to more violent means of solving common problems. A good example of this is the states in the United Nations that tend to have reputations for "neutrality," or that act assertively to promote diplomatic or peaceful settlements of disputes, or that volunteer troops for UN peacekeeping missions—Canada, Norway, Sweden, Denmark, Belgium, and the Netherlands, to name only a few. Many of these states are also the first to sign on to arms control treaties or human rights conventions because of strong personal and public views in their nations about the nature of international relations and foreign policy.

Constructivists have found that sometimes seemingly implacable rivals cooperate with one another because they come to have a shared understanding that they are part of a "**security community**"—a group of people that is integrated with a sense of a shared moral purpose and a certain level of mutual trust. Israeli political scientist Emanuel Adler has looked at how the Organization for Security and Co-operation in Europe (OSCE), set up in the mid-1970s as a process by which the Cold War sides could cooperate on security matters in Europe, eventually became a transmission belt for liberal ideas about the importance of freedom of the press, arms control, and protection of human rights.[4] The process of interaction the OSCE has set up between states, NGOs, and experts inexorably spread a new, shared idea among participants that how a country treats its citizens within its own borders is a legitimate concern of other states and that that treatment would be governed by shared principles emerging through diplomacy and discussion.

This idea conflicted with traditional notions of state sovereignty and opened up the way for cooperation on security issues and resulted in constraining states in the Warsaw Pact, perhaps even supporting their prodemocracy movements. Since the collapse of the Berlin Wall, the OSCE has played a vital role in convincing European states—especially in Eastern Europe—to adopt new commitments to government transparency, free elections, and protection of minority rights. Constructivists argue that the OSCE shapes state behavior by defining what a "normal" European country comes to believe are its obligations to other states and its own citizens, irrespective of the country's particular foreign policy goals, historical rivalries, or military and economic power. As more states formally commit themselves to these obligations and discuss them, it becomes harder to accept the alternative of violating them—not so much because of the "costs" of doing so but because of the shock it would pose to a country's own identity.

In addition to explaining international conditions that do not simply reflect the material distribution of power, constructivists also observe how states behave in ways that do not seem to reflect a cost–benefit calculation or some other kind of rational self-interest. States sometimes constrain themselves even when they might gain more by shirking international rules and using military force. For example, powerful states often respect the sovereignty of other weaker states even when it would be much more expedient to "teach them a lesson." In the face of egregious piracy by Somalis in the Indian Ocean and the Gulf of Aden, no major military has launched raids on well-known pirate lairs along Somalia's coast. Even on the high seas, the navies of powerful countries have respected international rules about search and seizure of suspected Somali pirate boats, even when it would be easier to just "shoot and ask questions later."

Also, militarily powerful states have been extremely reluctant to accept or enforce changes in the borders of existing states, even when it would be in their interest to do so. Only grudgingly and after many years did NATO members who were policing Kosovo since 1999 accept its independence from Serbia. In places like Somalia and Iraq, where it is obvious that the borders are probably never going back to what they were before civil war started, the United States and the EU refuse to recognize the independence of pro-Western autonomous regions like Somaliland and Iraqi Kurdistan. The norms of sovereignty and border fixedness are so strong that powerful states will forego the opportunity to "solve" major headaches by violating those norms.

When it comes to WMD like nuclear and chemical weapons, constructivists help us understand why powerful states have not used them since World War II, even though these states possess them and could trounce many adversaries by using them. International relations scholar Nina Tannenwald has analyzed the "nuclear taboo"—the strongly held norm among the permanent members of the Security Council that first use of nuclear weapons is unthinkable.[5] Even nondemocracies or states like Israel and Pakistan, which face implacable enemies in their regions, have apparently internalized the norm that the use of nuclear weapons would be morally unacceptable. Tannenwald argues that the acceptance of the taboo—generated by a grassroots antinuclear weapons movement around the world—is what constrains states more than the fact of deterrence or an enemy's ability to retaliate. Similarly, international relations theorist Richard Price looks at how use of chemical weapons has become almost unthinkable. The stigmatization of their use is at odds with their obvious utility. Price explains how nonuse springs from a country's understanding of itself: "Abiding by or violating social norms is an important way by which we gauge 'who we are'—to be a certain kind of people means we just do not do certain things."[6]

Actors That Spread New Norms and "Socialize" States

Constructivists have made an important contribution to IPE by explaining how a variety of non-state actors influence the behavior of states and markets. These scholars assert that economic liberals and realists have overlooked and underestimated social forces that generate and spread values, norms, and ideas that change the way the world works. We will focus on three "actors" that feature prominently in constructivist literature: transnational advocacy networks, epistemic communities, and IOs. As they interact with these actors, states learn ideas and are socialized to behave in new ways.

Constructivists often focus on transformation of an idea or set of beliefs about something. Examples abound, such as the increasing importance of human rights, a variety of environmental issues (see Chapter 20), and the importance of debt relief (see Chapters 8 and 11). In these and other instances, constructivists see an important role for non-state actors like NGOs and social movements in shaping and propagating new norms that states eventually accept, internalize, and craft their policies upon.

Political scientists Margaret Keck and Kathryn Sikkink, for example, have written about **transnational advocacy networks** (TANs), defined as "those actors working internationally on an issue, who are bound together by shared values, a common discourse, and dense exchanges of information and services."[7] These interconnected groups include NGOs, trade unions, the media, religious organizations, and social movements that spread information and ideas internationally, frame new issues, and try to get states to accept new norms and interests, often about "rights" claims. TANs' influence comes more from their ideas than their often meager economic resources. They act as "norm entrepreneurs," using testimonies, symbolism, and name-and-shame campaigns to create a shared belief among political elites and social actors that, for example, human rights protection is an obligation, that torture is never acceptable, that debt relief for poor countries is "the right thing," or that human trafficking is a new form of slavery. According to Keck and Sikkink, TANs spread their ideas by rapidly communicating information, telling stories that make "sense" to audiences far away from a problem, and holding states accountable for the principles that they have already endorsed in their own laws and international treaties.

The International Campaign to Ban Landmines is an example of the role of TANs in using issue framing and information politics to initiate global change. As discussed in the box "Landmines," the Treaty to Ban Landmines was signed and ratified faster than almost any other treaty in history. Among the factors that led to its quick ratification were the efforts of treaty supporters to change the beliefs of people everywhere, along with the views of the security establishments of different states, regarding the need for landmines. World public opinion was swayed dramatically by information and photos about the effects of landmines, which often meant the loss of a leg or arm by civilian noncombatants, especially in developing nations. People's values and beliefs were also challenged by the background studies of many NGOs that were easily communicated via the Internet and by rock stars and famous dignitaries such as Princess Diana of England.

You can probably find many other examples of TANs—and you may even be a member of a TAN without knowing it. For example, Greenpeace, the Natural Resources Defense Council, university students, and a number of affiliated groups led a grassroots campaign beginning in 2004 to convince Kimberley-Clark, the world's largest tissue manufacturer, to stop using pulp from old-growth forests in its Kleenex, Scott paper towels, and Cottonelle toilet paper. In 2009, the company finally agreed with this TAN to switch to a new sourcing policy based on recycled fibers and to support sustainable forest management. In another recent case, an international coalition has been leading a campaign to stop torture—and particularly the repeated playing of ear-splittingly loud music—to break down suspected terrorists detained in places like Guantanamo Bay and other U.S. detention centers around the world. The unlikely TANish coalition against "music torture" includes musical groups like R.E.M. and Pearl Jam, major British music industry organizations, and Reprieve (an international human rights NGO that fights the death penalty).

Another group of non-state actors who diffuse ideas in the global political economy are "**epistemic communities**," defined as "professionals with recognized expertise and competence in a particular domain and authoritative claim to policy-relevant knowledge within that domain or issue area."[8] These are global networks of experts—often scientists—who have detailed knowledge about complex issues and who share common understandings of the truth about these issues, based on the standards of their profession. Although these epistemic communities are not politically motivated actors, political elites rely upon them for advice, technical explanations, and policy options. Thus, these experts can have a very profound role in "educating" power holders about what problems exist, how important they are, and even what can be done about them. The epistemic communities have "power" through the ideas and values they collectively transmit to policy makers and IOs.

Constructivists have studied many examples of how epistemic communities' knowledge and ideas matter. Peter Haas has shown how atmospheric scientists around the world studying the ozone layer gathered and disseminated the consensus scientific evidence about the effects of chlorofluorocarbons (CFCs) on ozone depletion. In coordination with colleagues in the UN Environmental Programme and the U.S. Environmental Protection Agency, they generated knowledge that provided an impetus to international negotiations on the Montreal Protocol to ban CFCs. Similarly, Haas points out that many international regimes to regulate global environmental problems such as climate change and acid rain have come about through a process of "**social learning**," in which epistemic communities taught policy elites and international institutions the expert scientific consensus on environmental issues. In other words, epistemic communities provided political negotiators "usable knowledge"—defined as knowledge having credibility, legitimacy, and saliency—that persuaded them to adopt sustainability treaties even though the negotiators may have been politically reluctant to do so initially.[9]

There are many other epistemic communities in the world, ranging from arms-control experts to development experts. Economists are also a community that disseminates fundamental ideas about economics to policy makers. Networks of economists spread the ideas of John Maynard Keynes in the 1930s and 1940s, laying the foundation for trade and financial policies adopted at Bretton Woods after World War II (see the next section). Similarly, Latin American economists (sometimes called the "Chicago Boys") trained in the United States had an important role in shaping the policies of neoliberalism in their home countries in the 1980s. By understanding the ideas these economists were socialized to believe in during graduate school in the United States, political scientist Anil Hira shows how these economists formed "knowledge networks" that enabled and rationalized the adoption of structural adjustment policies in Chile and other Latin American countries.[10]

In addition to TANs and epistemic communities, international organizations are also norm entrepreneurs: They "teach" states the interests they should have, the norms they should adhere to, and the policies they should adopt. In other words, IOs have a role in shaping what a state *is* (its identity), *wants* (its interests), and *does* (its policies). Constructivists stress that IOs often perform these things through discourse and social interactions with political elites and civil society in a country, not necessarily through military force, sanctions, conditionality, or material rewards.

Several examples of IOs that have been studied carefully by constructivists include the International Committee of the Red Cross (ICRC), the World Bank, and the United Nations. Martha Finnemore finds that individuals in the ICRC over many years convinced states that they should abide by humanitarian limits during war.[11] These norms about how to behave during war have become internalized in a number of states that observe these norms even though they would gain some by flouting them. The World Bank and the UN have tried to spread norms of poverty alleviation and the Millennium Development Goals that most developed countries have accepted as obligations (see Chapter 11).

Although the general public often perceives the UN as weak and ineffectual, it has had a very important role in spreading norms of gender equality and women's empowerment throughout the world. Its panoply of conferences, commissions, and protocols have not changed gender policies overnight, but they have set the stage for states to engage in a dialogue about women's rights when they otherwise might not. And they have convinced states to write periodic reports about gender policies and to subject themselves to periodic supervision of their policies toward women. As the belief has spread that a respectable, "modern" member of the international community must accept the goal of greater gender equality and women's empowerment, recalcitrant states find it ever more costly and isolating to resist the gender mainstreaming discourse.

While constructivists agree with realists and economic liberals that states, in pursuit of their own self-interests, create some of the norms and values enshrined in the charters of IOs, they point out that these same states often find themselves constrained by these same norms and values. Martha Finnemore points out that a "unipole" like the United States spreads and institutionalizes liberal values in an effort to legitimize its own behavior and goals and to reinforce its soft power.[12] It was very successful in doing so through the Bretton Woods institutions. However, the United States weakens its soft power when it violates the very principles it has convinced its own people and other countries it stands for. For example, the United States was viewed as hypocritical for proclaiming its values of humanitarianism but breaking them by enforcing sanctions on Iraq from 1991 to 2003 that caused enormous suffering and death of civilians. While proclaiming the importance of international law, the Clinton administration launched military action against Serbia in 1999 without the formal sanction of the UN Security Council (repeated again in 2003 against Iraq). And while professing to promote democracy throughout the world, the Bush administration tried to undermine Hamas after it won a majority of Palestinian legislative seats in free elections in 2005. States are haunted by their own principles and are usually less likely to violate them when they lose legitimacy from doing so. Constructivists believe that states often hold other states accountable by withholding legitimacy or crying "hypocrisy" when those states ignore what they say they stand for.

Tools and Concepts of Analysis

The four basic assumptions of constructivism applied to IPE are that:

1. Ideas, values, norms, and identities of individuals, groups, and states are socially constructed.
2. Ideas and values are social forces that are as important as military or economic factors.

3. Conflict and cooperation are products of values and beliefs.
4. Change can be explained by examining changes in the values and beliefs of actors over time.

Constructivists have developed a number of concepts to describe processes that involve the power of ideas. They also have a number of analytical tools to trace how ideas and norms are important to explaining outcomes in the global political economy. In this section, we look at several of these concepts and tools: framing, problematization, discourse analysis, and the life cycle of ideas.

Framing is the ability to define what the essence of a global problem is: What is causing it, who is involved, what are its consequences, and therefore the approach to mitigating or resolving it. All actors try to frame through language, reports, propaganda, and storytelling. Frames are always political constructs or lenses that focus on a particular story that may or may not be the "right way" to analyze a complex problem. Frames make us see a problem in a certain way as opposed to another, and therefore greatly influence how we understand how we should behave toward the problem. By exploring framing and framers, constructivists help explain who influences the global agenda and how our approach to problems changes over time.

For example, by framing deforestation and the loss of biodiversity as tied to the historic disempowerment of indigenous peoples and corruption in poor countries, we overlook an alternative understanding that global environmental destruction is rooted in consumption patterns in rich industrialized countries. The frame that we adopt will radically change the way we interpret our own behavior and what we must do to deal with the problem. Similarly, by framing the mounting U.S. military failure in Afghanistan as rooted in the inability to control warlords' profits from heroin trade that fund the Taliban, the U.S. government downgrades an alternative story that failure is the inevitable result of widespread resistance to foreign occupation and NATO forces' "crimes" against innocent civilians.

"Blood diamonds" has been pitched as a new frame to understand conflicts in Africa. TANs convinced some states that civil wars in places like Sierra Leone and Congo are tied to struggles over access to natural resources like diamonds and other minerals. Combatants fight not only to control the sources of these resources but also to gain money from them to buy weapons, destabilize governments, and terrorize civilians. We are led to believe that conflict can be reduced by cutting off combatants' ability to profit from diamonds by denying them access to international markets. The Kimberley Process is one such approach to conflict reduction arising from this framing (see Chapter 16). Critics argue that although this framing may have gotten countries and companies to "do something" about Africa, it obscured the more important reasons for conflict rooted in colonial history, ethnic rivalries, and bad governance.

Problematization is an important domestic and international process by which states and TANs construct a problem that requires some kind of coordinated, international response. Constructivists argue that problems exist because we talk them into existence. Of all the problems in the world, ask yourself, what are the ones on your radar screen? How do you know what you should care about in the world or be worried about in the world? Which are the problems your country cares about and which it does not? What we care about as people or states is a reflection of our social environment, our culture, and the beliefs we share with others in our society. The problems we care about are also "constructed" by political elites, powerful lobbying organizations, and social groups. The problems form lenses or filtering devices for you; rarely do you choose them yourself.

Constructivists trace the process by which "problems" become defined as problems. It is our perception of the problem that determines what countermeasures we will adopt. Today, much of the international community defines the following as problems: global warming, drug trafficking, Islamic terrorism, offshore tax havens, and North Korean missiles. These "problems" are not just "out there"; they become what we make them to be. For example, German political scientist Rainer Hülsse finds that the OECD countries talked the money-laundering problem into existence in recent years, even though it was never a big issue before and had always existed.[13] Similarly, Peter Andreas and Ethan Nadelmann note that until the twentieth century, drug trafficking and drug use were not considered crimes that required a global prohibition regime.

Similarly, constructivists suggest that states have choices in terms of who they identify with and against. Enemies have to be defined into existence as problems. There are no laws that will tell us who our enemies and friends are: We make them through a discursive, deliberative process informed by our culture, history, prejudices, and beliefs. Why has Iran been problematized as a pariah in the world in the last three decades? Haggai Ram argues, for example, that Israel has constructed an anti-Iran phobia, viewing Iran as posing an existential threat, in part because of completely unrelated anxieties in Israel over ethnic and religious changes within its own society.[14] In a similar way, countries create enemies by projecting their own fears on others like Iran and by attributing the characteristics of monsters, devils, madmen, and new Hitlers to leaders of some countries.

Discourse analysis is a particularly powerful tool for understanding where important concepts and terms come from and how they shape state policies, sometimes in very undesirable ways. Some constructivists trace changes in language and rhetoric in the speeches and works of important officials or actors on the state or international level. This is part of understanding the role of ideas in foreign policy. Officials talk their state's interests into existence, sometimes by adopting a discourse that resonates with an important lobbying group or sector of public opinion. Foreign policy can be seen as a social construct springing from a country's culture. We look at three examples of foreign policy issues that constructivists have interpreted through discourse analysis: Islamic terrorism, torture, and the clash of civilizations.

International politics professor Richard Jackson shows us that the way in which academics and states talk about problems creates meaning and limits the range of possibilities for actions. Through discourse analysis, he claims, we can understand the "ways in which the discourse functions as a 'symbolic technology,' wielded by particular elites and institutions, to: structure... the accepted knowledge, commonsense and legitimate policy responses to the events and actors being described; exclude and de-legitimize alternative knowledge and practice; naturalize a particular political and social order; and construct and maintain a hegemonic regime of truth."[15] He finds that an academic and political discourse has developed about "Islamic terrorism" that draws upon and reinforces historical stereotypes about Muslims, obscures understanding of the workings of Islamist movements, and paints a threat to Western civilization as so great that only counterterrorism or eradication are seen as appropriate responses to the Enemy.

Richard Jackson has also used discourse analysis to explain how political elites in the United States repeatedly used a "highly-charged set of labels, narratives and representations" in such a way that "the torture of terrorist suspects became thinkable to military personnel and the wider public."[16] In other words, official public discourse created the conditions for a "torture-sustaining reality" in the United States by using language that dehumanized suspected terrorists and made the public—despite minority opposition—willing to accept the necessity to abuse them. Without assessing the power of this discourse, it is hard to explain how the United States could adopt a set of practices so at odds with its moral values.

Similarly, constructivists have analyzed how political scientist Samuel Huntington's concept of the *clash of civilizations* became a popular way in the 1990s to explain the roots of global conflicts. The more this clash of civilizations rhetoric was used to describe relations between countries, the more it became a sort of self-fulfilling prophecy that constructed conflict itself. In effect, the clash exists because we believe it exists and we act on that belief. The clash discourse has become accepted as the truth—a causal explanation—even in the face of overwhelming social scientific studies that find no significant link between religious beliefs and terrorism and that point out the difficulty in even ascribing a common set of values to huge groups of people like the "Islamic world" or the "West."

The final constructivist method we describe is tracing the life cycle of ideas. The aim is to determine where ideas and norms originate, how they spread, the other ideas they come in conflict with, and how they become "naturalized," that is, accepted by states and IOs as the self-evident justification of policies. This may require going back in history to look at individuals or movements that promoted what at the time seemed like radical or even naïve ideas. Or it may mean studying the spread of ideas through negotiations over an international treaty or internal deliberations of a big organization like the World Bank. Of the many ideas floating out there in the world about what the nature of problems are and what states should do about them, only a few come to shape state interests and identities. Constructivists show us how those ideas become institutionalized and very resistant to change, especially when widely accepted in IOs, treaties, and the discourse of states. Sometimes it takes a traumatic event or crisis—a war, a depression, the collapse of the Berlin Wall, or massive, sustained street demonstrations—to shake organizations out of their routine thinking and accept alternative ways of viewing the world and defining their role within it.

For example, international relations theorist Charlotte Epstein has traced the life cycle of ideas about preservation of the environment and natural resources. These ideas originated with American Romantic authors and environmental organizations like the Sierra Club in nineteenth-century America.[17] As these ideas were transmitted to the global level they became focused on protection of endangered species, and industrialized states cooperated to preserve highly symbolic individual species like whales. Northern states and NGOs like Greenpeace "socialized" biodiverse Southern states and ex-colonies to believe that taking a "green turn" toward species preservation was what a "good" member of the international community should do. This way of looking at protection of individual organisms has, to some extent, crowded out a different—and more sustainable—way of thinking about environmentalism that is focused on preservation of *entire ecosystems*.

Others have traced how dominant economic ideas have changed over time within academic communities, states, and IOs. John Maynard Keynes's ideas spread rapidly after World War II and became the underpinning of the Bretton Woods institutions (see Chapter 2). But a new neoliberal discourse rose to challenge these ideas in the 1970s and 1980s, spread by American economists who constructed a different worldview about development, protectionism, and the role of the state in an economy. Individuals within the IMF in particular spread the notion that capital account liberalization, that is, unrestricted flows of capital across borders, was an inevitable force in the global economy and a necessary policy for every state that wanted to develop rapidly. As with many of the ideas of the Washington Consensus, the liberalization ideas lost some of their intellectual hold on governments only in the face of shocks such as the Asian financial crisis and development failures in Africa and Latin America.

Similarly, in the 1990s the World Bank began to change some of its neoliberal views (and thus policies) of development in the face of sustained efforts by TANs, which slowly convinced it through shaming and lobbying to believe that promoting environmental and social norms like sustainable development, poverty alleviation, and gender equality were part of its mission—indeed even critical to its own identity and purpose as an organization.[18] Even the first four chapters of this textbook have looked at the life cycle of many academic ideas—and particularly how the 2007 global financial crisis has given birth to new ideas about global financial markets.

Depending on the topics students study and the questions they ask, constructivism can provide enlightenment about some dimensions of an issue that are not captured in other perspectives. That alone makes it worth knowing something about.

LANDMINES[a]

The case of antipersonnel landmines (APLs) directly connects the issue of personal security to the growing role of NGOs in the new global security structure. Landmines have a long history of use in conventional wars and low-intensity conflict settings. APLs were particularly popular during the 1970s and 1980s, when insurgent groups took advantage of their low price and simple use. They are hockey-puck-size containers buried in the ground that explode when someone steps on them or drives over them, and they cost approximately $3 each to make.

After the Cold War, APLs were considered by many to be unreasonable weapons because they "do not distinguish between civilians and combatants; indeed, they probably kill more children than soldiers."[b] This new realization of the detriment of APLs motivated a worldwide effort in the early 1990s to eliminate them completely. With worldwide support of the issue, including publicity from such celebrities as Princess Diana and Linda McCartney, the International Campaign to Ban Landmines (ICBL) gained rapid popularity after its founding in 1992. Current estimates put the number of remaining APLs at around seventy million,[c] most of them in developing countries such as Angola, Afghanistan, Cambodia, and Mozambique, which injure an estimated 25,000 people (a third of them children) every year.

The ICBL is an umbrella organization pulling together a number of NGOs into an antilandmine advocacy campaign cosponsored by the Vietnam Veterans of America Foundation and Medico International.[d] Beginning with six core organizations, the ICBL has since expanded to include about 1,400 groups. In a very short time, the ICBL produced a comprehensive treaty that completely bans the use of landmines. Created under the auspices of the UN, the treaty calls on signatories to "never under any circumstances" "use," "develop, produce, otherwise acquire, stockpile, retain or transfer to anyone" antipersonnel mines. Each party also undertakes the duty "to destroy or ensure destruction of all anti-personnel mines." In Canada in December 1997, some 122 nations signed the treaty, officially named the Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and on Their Destruction, but known more commonly as the Ottawa Treaty. As of September 1998, some 40 nations had ratified the treaty, bringing it into international law in March 1999.

An interesting feature of the campaign itself was the method the NGOs used to further their cause. The ICRC commissioned an analysis of the military utility of APLs by a retired British combat engineer, who found them to be unnecessary and not as useful as has often been assumed. A number of NGOs also conducted extensive education campaigns to inform the public and state officials of the horrible effects of APLs, all the while lobbying, and also, in some cases, shaming state and military officials who resisted their discontinuation.

The Clinton administration claimed to support the treaty, but the United States did not sign it, for reasons related to the use of APLs as a defense mechanism in South Korea near the Demilitarized Zone (DMZ). As of the end of 2008, Russia, China, India, and the United States had not become signatories to the treaty. China has been a major supplier of cheap landmines, especially to African nations.[e] Thus far the ICBL is credited with the destruction of over two million antipersonnel mines and has been awarded the Nobel Peace Prize for its efforts. Its work is done primarily through advocacy networking and NGOs. The Hazardous-Life Support Organization (HALO Trust), a British de-mining organization, has been at the forefront of this effort since the beginning.

Most urgent for the international community to address in the war against APLs is increased cooperation of states and other IOs to help move the process along, particularly their willingness to share information and allow de-mining forces into their countries. In Afghanistan alone, HALO estimates there are still about 640,000 landmines, and although progress is slow, there is a foreseeable end to the blind violence.

References

[a] Many thanks to our students Meredith Ginn and Lauren Whaley, who helped research this issue.

[b] Warren Christopher, "Hidden Killers: U.S. Policy on Anti-Personnel Landmines," *U.S. Department of State Dispatch* 6 (February 6, 1995), p. 71.

[c] www.minesawareness.org.

[d] For an excellent discussion of the politics of the ICBL see Richard Price, "Reversing the Gun Sights: Transnational Civil Society Targets Land Mines," *International Organization* 52 (Summer 1998), pp. 613–644.

[e] www.minesawareness.org.

FEMINIST CONTRIBUTIONS TO IPE

Feminism has contributed to IPE scholarship in a variety of ways, and its influence can be seen throughout the discipline. Feminists began to make significant inroads in the social sciences during the 1970s, when IPE first developed as a discipline and the need for more interdisciplinary approaches became apparent. Feminists argue that every area of IPE—from the structure of state power to the allocation of political and economic resources--is impacted by gendered processes. Feminist theories and constructivist theories are often complementary because both perspectives challenge the positivist idea that concepts in IPE are unbiased or "value-free." This section explains what feminism is, why it is important, and what are some areas of consensus and debate. Although almost all feminists agree that women and men are equally valuable and that gender "matters," they disagree on many other issues. Not surprisingly, feminists who subscribe to economic liberal, mercantilist, or structuralist perspectives often advocate different policies and approach research in different ways.

Women Matter; Gender Matters

Gendered analysis takes into account not just sex (biological males and females) but *gender* as the *socially constructed norms* that determine what is masculine or feminine. *Women* matter simply because women are intrinsically valuable as human beings. *Gender* matters to IPE scholars because to understand many issues in IPE we need to understand the way our values and assumptions about gender affect institutions. Seems pretty simple, right? But it took a long time to convince mainstream scholars and policy makers of those two points. In the examples below, we will look at how some policies have ignored women, with unfortunate consequences. Furthermore, feminists argue that efforts to "add women" to existing frameworks have often failed to adequately explain the role of gendered social norms and to produce gender-equitable outcomes.

Believing that men and women are *equally* valuable is the defining feature of feminism. This means that if a policy hurts women, feminists would argue that the policy is bad—even if it does not hurt men or children. For example, overexploitation of forest resources is a problem that concerns many governments and international aid donors like the World Bank. One effective policy response is for international actors (like donors and environmental NGOs) to work with governments and include local communities in Joint Forestry Management (JFM). Communities promise to protect the forest from illegal timber harvesting, grazing, and even fire, in exchange for non-timber resources. This is a sustainable, participatory policy, so it should be great for everybody, right? The problem in some cases such as India, Andrea Cornwall points out, is that women, who are not well represented on village committees that take up JFM, are still responsible for cooking, which means they still need wood.[19] In this case, criminalizing deforestation without providing women an alternative fuel for cooking food just means that women have to break the law and sneak into the forest at night to gather wood in order to fulfill their *gendered obligations as women* (providing food). Good for the community, but not so good for women.

Policies like JFM have different impacts on men and women. In fact, gender is so important that we might say *most* major policies—from food stamps to timber tariffs—affect men and women differently. During the first debates in 2009 over President Obama's stimulus package, feminists pointed out that promoting jobs in construction (as was advocated by many) meant job creation primarily for men. If women matter as much as men, some said, then stimulus money should also be directed toward sectors where there is greater representation of women in the labor force, such as health and education. The same question applies to international trade policy. Bilateral trade agreements may benefit men in the most powerful industries more than women in less important sectors of the economy. For example, NGOs like Action Aid and Women in Development Europe (WIDE) have criticized Europe's negotiations with India over a free-trade agreement because it privileges large corporations and ignores potential effects on women and other vulnerable groups.[20] How will this kind of agreement affect small farmers and informal sector traders who cannot compete with large producers? Does it matter that women tend more to be in the former groups than the latter?

A nonfeminist might argue that large industry and infrastructure investments are important types of spending, and women will benefit from more jobs and an improved economy even if most new jobs go to men. Historically, when gender experts have not been included in policy design, gender has been ignored. Often, this has a negative impact on women, but it also frequently works to the detriment of the policy's overall objectives as well. In the case of JFM, failure to consider gender-differentiated outcomes failed to protect women, but in doing so, it also failed to find a solution to women's overexploitation of forest resources. That is one reason why gender matters.

So, feminists have convinced IPE scholars as well as policy makers that women matter and therefore, gender-differentiated policy impacts matter. But gender matters for another reason. The roles assigned to men and women, our gendered resources and obligations, the things we buy, where we work, how much money we make, and our room for maneuver in making decisions—these gender-influenced things shape markets and affect the distribution of power and resources in society. To understand how gender affects policies and other issues in IPE, we contrast some feminist ideas regarding economic liberal, mercantilist, and structuralist perspectives. Keep in mind that most people do not fit neatly into one IPE perspective, but support policies or viewpoints that are influenced by multiple schools of thought.

Liberal Feminisms

Even within liberal traditions, there are many debates among feminists. Classical liberal feminists (sometimes called libertarian feminists) are most concerned with individual freedoms, freedom from coercion, and "self-ownership" for men and women. Politically, they are concerned primarily with *de jure* inequality, meaning laws that proactively discriminate against women by barring their right to vote, to enter contracts, to transfer property in a free market, to use contraception, and to be protected by the state when their inalienable rights are threatened. Laws that condone marital rape, domestic violence, or men's control over women's property are all examples of discriminatory practices.

In defining freedom in terms of individual rights and seeking to limit the coercive power of the state, liberal feminists often do not support laws that promote women specifically, including those that would regulate equal pay with men or guarantee access to public office. Some liberal feminists argue that "just" laws will not necessarily lead to actual equality. This means they support only laws that protect individuals from direct coercion (e.g., threats against one's body or property). Justice, from this perspective, requires only that the state apply just means, not that the resulting society be equitable.

Other liberal feminists tend to support individual rights and free markets, but argue that men hold a disproportionate share of power in society. Because this *institutionalized patriarchy* is not confined to the state, liberal feminists advocate for both legal and social change. For example, they advocated that state universities in the United States be required to provide equal athletic opportunities to both men and women (known as Title IX rules). They also lobbied for the Violence against Women Act (VAWA), in response to the systematic difficulty in effectively prosecuting perpetrators of rape, domestic violence, and other gender-based crimes. These laws attempted to compensate for existing social discrimination rather than to curb inherently discriminatory laws. Until the 1980s, liberal feminist advocacy and research tended to pay only limited attention to the gendered implications of macroeconomic policies that IOs like the World Bank and the IMF began to impose on poor countries.[21]

Since then, liberal (and other) feminists have studied the many effects of global markets and development projects on women. Structural Adjustment Programs (SAPs), instituted in many developing countries during the 1980s and 1990s, have been criticized for (among other things) reducing governments' investment in health, education, and other social services so as to disproportionately hurt women and children. Similarly, development programs and government aid have been found to disproportionately benefit men, who have greater access to capital, land, salaried jobs, pensions, and political networks. Many women spend a disproportionate amount of time doing unremunerated labor such as housework, subsistence farming, fuel gathering, and caring for children, the sick, and the elderly. In the case of the JFM example, liberal feminists criticized the original projects because they were not designed to have gender equitable impacts by taking these particular roles of women into account.

In addition, Pietra Rivoli argues that the advent of free trade and globalization has been a great benefit to women in many poorer countries.[22] As textile and apparel production has moved to countries like China, it has created relatively high-paying jobs in urban areas for hundreds of thousands of young women who otherwise would be stuck in rural poverty. Despite the sweatshop-type conditions and poor labor practices in many of these clothing factories, women employed in them have gained higher incomes, economic autonomy, and even social liberation. Women's economic empowerment comes from China's industrialization and openness to global markets and investment. Over time, as the "bottom" of society rises, women may even gain more employee, union, and political rights.

Finally, liberal feminists (like many other feminists mentioned below) stress that the level of political rights that women enjoy in a country, along with their overall treatment, have important impacts on a country's overall economic health. Countries with stronger women's rights, lower fertility rates, better education for girls, and more women in government tend to have higher economic growth rates and more prosperous societies.

Feminist Critiques of Mercantilist Perspectives

Feminist scholars have played an influential role in questioning the assumptions and approaches of IPE scholars in the mercantilist and realist traditions. They have sought to redefine our understanding of international power and national security. Traditionally, the study of IPE has privileged macrolevel structures: the actions of nation-states, peace and war, international diplomacy, and global security, to name a few. By focusing research questions on states rather than cities, TNCs rather than small producers or grassroots organizations, and countries rather than households, IPE scholars make implicit assumptions that macrolevel institutions are masculine. Certainly, women's influence in society has been most visible in smaller arenas. In this way, by privileging the state, IPE scholars have (perhaps unwittingly) rendered women's contributions all but invisible.

Some feminist scholars have had considerable influence simply by approaching research from different levels of analysis, often by beginning at the household or community level. They learned that because men and women have different gendered obligations, they also play very different roles in global processes and are impacted differently by them. More importantly, ignoring certain levels of analysis can lead to false assumptions. For example, feminists point out that economists previously assumed that households pool resources: Whatever money (or asset) comes in is shared by the family members. In fact, there is often conflict or negotiation between individuals about access to household resources, and that conflict is very often gendered.

Similarly, feminist scholars point out that state-centric IPE scholars have overlooked the informal and non-wage-based economy in which many women work. This sector is a critical underpinning of the market system as a whole and of the ability of a state to compete in the global economy. Many sectors of national economies have become "feminized," including caregiving, domestic services, education, and sexual services, where women face low wages, marginalization, and exploitation. Other service industries including telephone customer service, administration, and health care are dominated by women. Some of these services can be provided to Europe or the United States electronically from India at much lower labor costs.

Feminist scholars have redefined the concept of security, showing the ways in which international relations are gendered and making women's often invisible roles more apparent. At the same time, feminist activists have promoted women's ability to participate in spheres of international diplomacy and military security. Traditional theories of international relations and national security have tended to ignore gender as an analytical tool. Many feminists argue that this is not just because women are excluded from positions of power, but because women's roles are considered unimportant.

For example, in an intriguing recent study, a team of political scientists, a psychologist, and a geographer have found a significant correlation between the security of women and the security of states.[23] States that have high levels of physical security for women (measured by the prevalence of various forms of violence against women) tend to be more peaceful and have better relations with their neighbors. Conversely, states with high level of violence against women tend to be involved in more civil wars and violent conflicts with other states. Similar studies have found that states with higher levels of gender equality tend to be involved in fewer violent interstate disputes and conflicts. All of this research suggests that the status of women in societies has an important impact on interstate relations.

In her influential book *Bananas, Beaches and Bases*, Cynthia Enloe shows how diplomats and soldiers depend on the often unpaid and devalued work that women do. By studying the role of diplomats' wives or the way military bases depend on cooks, laundresses, nurses, and sex workers, she shows how private and personal relationships influence the international political arena. International policy makers, she argues, "have tried to hide and deny their reliance on women as feminized workers, as respectable and loyal wives, as 'civilizing influences,' as sex objects, as obedient daughters, as unpaid farmers, as coffee-serving campaigners, as consumers and tourists."[24] It would be easy to argue that these practical functions of everyday military operations or lawmaking do not directly influence larger processes like the laws or military campaigns themselves. But the practical dynamics of political negotiations and military engagements can have a tremendous influence on their outcomes.

Feminist security theory shows how the invisibility of gender in theories of war has masked important dynamics, including the myth that wars are fought to protect society's most vulnerable sections. For example, women form the bulk of refugees and civilian deaths in war, and mass rape has been an important form of gender violence. But rape as a weapon of war is not just another part of violence, and it is not only about women. When soldiers are allowed to rape, their leaders are using rape to *construct a particular masculinity.* In Darfur (and elsewhere), rape has been used to humiliate populations, to destroy families, and to drive people out of villages in order to access land. The importance of femininity and protecting women in people's ideas of family makes gender violence an effective tool for achieving a strategic military objective. In this way, gender is crucial for understanding questions of international security.

Structuralist Feminism

Marxist feminists challenge the idea that capitalism benefits women in almost any instance. Many see gender not as the key factor in exploitation but as a source of oppression that is facilitated by the capitalist system. Evelyn Reed, a prominent Marxist feminist, wrote in 1970: "It is the capitalist system—the ultimate stage in the development of class society—which is the fundamental source of the degradation and oppression of women."[25]

Other structuralist or radical feminists—often influenced by Marx—argue that patriarchy is part of a system of exploitation that requires a complete overhaul (though not necessarily a violent one). They may or may not believe that the best way to end exploitation is to end capitalism, but many would agree with Reed that there is a link between the power mechanisms that determine international relations and those that determine race, class, and gender relations. Women and people of color make up a disproportionate number of the poor in most countries, and structuralists argue that this is a result of systematic exploitation within and between countries.

Where liberal feminists criticize neoliberal economic policies when they hurt women, structuralist feminists see those policies as emblematic of a greater problem. Meanwhile, they criticize development initiatives like microfinance because these loans actively promote women's involvement in capitalist competition, often aggravating inequality between women by failing to benefit the most vulnerable. By highlighting the need to consider sources of inequality other than gender, the influence of structuralism challenged feminists to move beyond domestic policy and household relations toward more systemic and globally relevant arguments.

State-centric IPE scholars have overlooked how globalization has direct, specific effects on women. Many newly industrializing countries have encouraged foreign direct investment in export-oriented manufacturing facilities that employ a large number of women. Melissa Wright has studied how these factories in northern Mexico (called **maquiladoras**) and southern China treat women as "disposable," paying them low wages in dead-end jobs. Even though these women are important to global capital accumulation, a mythical discourse portrays them as "industrial waste" that can be easily "discarded and replaced" when they have lost the "physical and mental faculties" for which they were hired: dexterity, patience, and sacrifice.[26] Wright and others point out that many women resist this marginalization and disposability.

Women also tend to be disproportionately hurt by the restructuring of the global economy and adjustments to crises within it. Cuts in social services and public goods cause male and female unemployment, but have tended to force more women into poverty, double shifts, and informal activities like prostitution, which damage their physical and mental health.

Feminist scholars have made significant contributions to—and criticisms of—the way IPE is studied. Cynthia Enloe may have summed up best the importance of having a "feminist curiosity": "One cannot explain why the international system works the way it does without taking women's lives seriously. 'Experts' may be knowledgeable about banking interest rates, about the oil industry, about HIV/AIDS; nevertheless, if those experts fail to think seriously about women's lives, they are certain to produce deeply flawed understanding—explanation—of today's international political economy."[27]

SMUGGLING IN SENEGAL: GENDER AND TRADE POLICY

Senegal is one of the highly-indebted poor countries (HIPCs) in West Africa that has adopted a variety of economic liberalization measures advocated by the World Bank and the IMF. One exception is its sugar industry (actually one company, CSS), which has enough political power that the government protects it from international competition by setting sugar import tariffs so high as to effectively ban imports. The Gambia, the small country surrounded by Senegal, has much lower tariffs, and its government is only too happy to have traders buy its cheaper sugar imported from Denmark and Brazil. Here, we have a recipe for smuggling.

In West Africa, market women are very important because trade is one of the few occupations available to women and because villages need access to basic supplies (like sugar). Given Senegal's international trade policy and women's gendered role as traders, women have become the majority of sugar smugglers. Sugar manufactured in Denmark and Brazil is packed, transported, and shipped (mostly by men) to The Gambia where (mostly male) customs officers charge applicable tariffs or determine a combination of tariff and a bribe. The sugar is bought and stored by high-volume wholesalers, and it is eventually picked up by drivers and regional wholesalers, all of whom are men. Finally, it makes its way to rural markets where male and female traders buy 50-kg sacks.

A story will illustrate what happens from Senegal.[a] Fatou Cisse is a mid-level trader in a border town that hosts a market once a week. She makes about $100 during a good month. She pays a neighbor (a 20-year old man) to take her by horse-cart three times a week to The Gambia, where she buys a 50-kg sack of sugar on credit from her regular supplier, a male immigrant from Mauritania. Her driver knows the bumpy terrain well and tries to get back to the village using paths that are not easily reached by customs officers' cars. They are not in luck. A male ex-trader from a nearby village who knows their schedule works with the customs officers as a secret informant. An officer soon finds Fatou and they begin to negotiate. She apologizes for breaking the law, but explains that she is having a very difficult time and desperately needs money for her family. He agrees to seize only half of her sugar (25 kg). According to Senegalese social norms, a good man (reflecting gender) and a good customs officer (reflecting authority figures) must be flexible and generous occasionally. Upon return to the customs bureau, the officer, the informant, and the bureau chief each take 10 percent of the seized sugar (2.5 kg) and report a seizure of 12.5 kg that will be picked up by government officials and resold at auction. Having paid $28 for her sugar, Fatou will sell what she has left at her weekly village market for $17.50. Luckily, she has just enough leftover from the previous week to pay her supplier and try again.

Stories like this one illustrate both the complexity and the gendered nature of the globalization of production. Governments make international trade policies they hope will benefit their economies. For Senegal, this means some protectionism in response to powerful sugar lobbies—negotiations that are dominated by men. Because men and women have different obligations and opportunities, the roles they play are gendered and they will find different niches available to them. In the case of the sugar trade, both men and women make choices and establish norms that will allow them to benefit from the niche created by the trade policy. Although laws are broken, everyone in the story makes a profit, including the governments involved. On the other hand, the opportunities available to women are very different from those available to men.

If you were an IPE scholar hoping to study the impacts of Senegalese sugar policies, you might choose to study only the negotiations between governments and industry officials, but your conclusions would be much more limited than if you considered the role of gender and investigated multiple levels of analysis.

[a] A composite account from a survey of women smugglers in Cynthia Howson, "Trafficking in Daily Necessities: Women Cross-Border Traders in Senegal," unpublished PhD dissertation, School of Oriental and African Studies (London), 2009.

CONCLUSION

Ideas are very powerful and *should* be taken seriously. The constructivist and feminist theories both challenge us to think about IPE in new and different ways. As John Maynard Keynes noted famously in the closing pages of his *General Theory*,

> the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.[28]

The alternative perspectives discussed in this chapter provide us tools to better understand many global issues. They direct our focus to actors and forces that have been overlooked in the liberal, mercantilist, and structuralist perspectives. In so doing, they suggest that states and markets are not the only shapers of the world; other actors like individuals, women, and social movements profoundly influence global policies and struggles. They also remind us that the study of IPE cannot be divorced from moral and ethical questions. Unless we grapple with the different ways that individuals perceive the world, we will find it hard to explain what motivates their behavior.

KEY TERMS

constructivism 107
security community 109
nuclear taboo 110
transnational advocacy networks (TANs) 111
epistemic communities 111
social learning 112
framing 114
problematization 114
discourse analysis 115
life cycle of ideas 116
feminism 118
maquiladoras 124

DISCUSSION QUESTIONS

1. Do you think constructivism should get more attention as a social science theory? Why? Why not?
2. How might structuralist feminists respond to companies that outsource labor to sweatshops in poor countries?
3. Why do feminists argue that debates about national security need to consider gender? Do you agree?
4. What criticisms can be made of constructivism? Do constructivists underestimate the importance of material power in affecting global issues?
5. What tools do we have to measure that beliefs or norms actually influence an actor's outlook and actions?

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2. See Alexander Wendt, "Anarchy Is What States Make of It: The Social Construction of Power Politics," *International Organization, 46* (Spring 1992), pp. 391–425.
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PART II

Structures of International Political Economy

The first five chapters of this book have provided an intellectual foundation on which to build a sophisticated understanding of the international political economy. In those chapters, we addressed many of the fundamental assumptions about three principal IPE perspectives that are most often used to analyze and interpret IPE problems such as the recent global financial crisis, and two alternative IPE perspectives. The next five chapters examine the "structures" that tie together nation-states and other actors and that link national and global markets in the global political economy. As we suggested in Chapter 1, Professor Susan Strange, a leading IPE thinker, has proposed that the main elements and arrangements of the international political economy can be organized into four core structures: production and trade, money and finance, security, and knowledge and technology.

Each of the four network structures consists of a set of relationships and distinct rules (if not tacit understandings) between and among different political, economic, and social actors in each of these areas. We propose to study how the structures connect the people of the world and condition the behavior of states, markets, and society. In examining the characteristics of these four structures, Strange encourages us to ask the simple question, *Cui bono?* ("Who benefits?"). This question forces us to go beyond description to analysis and eventually evaluation—to identify not only the structure and how it works but also what benefits it provides to those who founded it or to those who manage it today, what sources of power were used to create it, and how it has been managed. Strange also encourages us to ask questions about the relationship of one structure to another. An interesting thing about IPE is that states, markets, and society are involved in a number of simultaneous relationships, often on different terms with different partners. A good example is the way many officials promote trade (an element of the production structure) as an "engine to growth" in development strategies, and at the same time often attempt to use it as a tool of foreign policy to punish another nation (an element of the security structure) by withholding trade from that nation.

In Chapter 6, we explain how production and trade are related to who gains as a result of this production, and what terms or conditions prevail in the exchange of goods and services. Because production and trade are closely connected to income, development, currency exchange rates, finance, technology, and security, they are some of the most controversial issues in IPE.

Our study of the finance and monetary structure is covered in two separate chapters. Chapter 7 examines in some detail the history, vocabulary, and basic concepts everyone needs to know about finance and the workings of various international monetary systems. Chapter 8 is a discussion of recent events surrounding several international financial crises including the global financial crisis that began in 2007. We focus on the causes, effects, and some of the measures put forth by the IMF to address them. The rest of Chapter 8 examines the ongoing "debt crisis" involving many of the poorest developing nations. The chapter ends with a discussion of the increasing role of NGOs in managing global debt.

In Chapter 9, we examine the relationships and rules of behavior that affect the safety and security of states, groups, and individuals within the global political economy. Some parts of the security structure are easy to recognize, such as the role of the major powers in affecting war and peace. Other aspects, such as the role of terrorists, are less visible or certain, but, as the events of September 11, 2001 demonstrated, of equally critical importance.

States, markets, and society are also linked by a set of relationships involving knowledge, ideas, and technology. In Chapter 10, we explore who has access to knowledge and technology, and on what terms. Knowledge and technology represent the ability "to make and do things" that dramatically affect the balance of power between actors in the finance, production, and security spheres. One particular issue is intellectual property rights (IPRs), which profoundly affect who derives benefits from legal claims of ownership of a number of products.

Finally, in contrast to previous editions of the text, in this edition we address each chapter's relationship to the current global financial crisis. Much like 9/11, this crisis has profoundly impacted these and other issues covered later in the text.

CHAPTER 6

The Production and Trade Structure

Trade connects markets, states, and cultures.

Jacob Silberberg

In the absence of a world government, cross border trade is always subject to rules that must be politically negotiated among nations that are sovereign in their own realm but not outside their borders.[1]

Robert Kuttner

Trade is *always* political, economist and columnist Robert Kuttner tells us. Just ask Chinese tire manufacturers who are upset that U.S. President Obama in 2009 imposed high tariffs on imports of Chinese tires into the United States. In fact, many IPE theorists believe that no topic is more quintessentially IPE than trade. If anything, Kuttner's words understate the issue: Trade has become one of the most debated topics in IPE. Not only does it continue to be very important for national officials, but the number of political actors and institutions outside the nation-state that shape international trade and manage the international production and trade structure has increased significantly since the end of the Cold War in the late 1980s.

The international production and trade structure is composed of the set of relationships between and among states, IOs, international businesses, and NGOs that together influence and manage international rules and norms related to what is produced, where, by whom, how, for whom, and at what price. Together with the international financial, technological, and security structures, trade links nation-states and other actors, furthering their interdependence and mutual benefits but also generating tensions between them.

This chapter surveys a variety of developments and changes that have occurred primarily in the post–World War II production and trade structure. Some experts argue that recent changes in production methods and products are greater than those that occurred leading up to the Industrial Revolution. Concurrently, in conjunction with the popularity of economic liberal ideas and policies many trade experts and officials in the Northern industrialized nations (the North) have sought ways to liberalize (open) the international trade system—that is, to reduce the level of protectionist barriers that limit or distort trade. The United States and its allies created the General Agreement on Tariffs and Trade (GATT) in 1947 to promote liberal trade values and objectives commensurate with U.S. political and military objectives. In an effort to further liberalize world trade, in 1995 the World Trade Organization (WTO) replaced the GATT.

The chapter concludes with a survey of other important trade issues, namely: the growing number of regional trade blocs, North–South trade relations and their effects on human rights and the environment, and the use of trade as an instrument of foreign policy. These issues make trade one of the most complex and politically contentious areas in the international political economy.

This chapter presents four major theses. First, controversies about production and international trade stem from the compulsion of nation-states (rich and poor alike) and businesses to capture the benefits of production and trade while limiting their negative effects on producers and society. Second, there is an impasse in current international trade negotiations, where many developing nations have resisted efforts to promote more free trade and have adopted protectionist measures. Third, we maintain that recent criticisms of neoliberalism and globalization, coupled with the current global financial crisis, have exacerbated the resistance of many emerging economies to further liberalization of trade. Fourth and finally, the public and state officials in many of the industrialized nations are increasingly resisting some aspects of free trade and globalization.

GLOBAL PRODUCTION

Because of its direct connection to trade, international production is of increasing significance to IPE students. A recurring theme in Thomas Friedman's work is the transformation in the production process associated with globalization. In an earlier work, *The Lexus and the Olive Tree*, Friedman focused on how people the world over, but mainly in the developed industrialized nations, are using sophisticated technology and communication systems in the form of multifunctional, "postindustrial" age products and services.[2] The Internet connects people all over the world in ways previously unthought of—both for good and for bad. New lines of cars and clothing are routinely mass-produced. After the Industrial Revolution, innovation and production have changed radically, occurring in quantum leaps and at an exponential rate. The production process has also shifted from one based largely on assembly lines to the use of robots and computers to make a wide variety of high-valued merchandise.

While all this has been happening, the production process has also become much more fragmented, resulting in vertical specialization and outsourcing. For example, in the case of Boeing commercial jets, many production plants do not make their own component parts, but assemble them after the components are produced somewhere else. In his latest work, *The World Is Flat*, Friedman focuses on the continuing transformation of the production process whereby, in just a few years, production processes have not only spread rapidly throughout much of the world (most recently to India and China) but have advanced to the point of empowering individuals to collaborate and compete globally. As anyone who has waited on the phone while speaking to a company "representative" in India can appreciate, the lever that enables individuals to go global so seamlessly is a wireless, satellite network that makes it easier to outsource production and services.

According to Friedman, "Every new product—from software to widgets—goes through a cycle that begins with basic research, then applied research, incubation, development, testing, manufacturing, support, and finally continuation engineering in order to add improvements."[3] Friedman's "flat world" is one of giant video screens, call centers, and the outsourcing of tax returns and flight reservations to places like India where workers are anxious to become part of the global economy and to affect it in some unique way. The transformation and globalization of the production process is not unique to the manufacturing of goods and the development of services; it has also occurred in agriculture and food production, other basic commodities such as cotton for textiles, and in sophisticated private and national security systems.

The World Bank reports that in 2008 the world's GDP totaled $60.5 trillion, with the high-income countries producing $43.2 trillion or 71 percent of the total (up from $34.5 trillion but down from 78 percent of the total in 2005). Middle- and low-income countries produced $17.4 trillion or 29 percent of the total, while low-income countries by themselves produced only $500 billion (down from $1.3 trillion in 2005) or just 0.8 percent of the world's total output (down significantly from 4 percent in 2005).[4] Undoubtedly, the recent global financial crisis has contributed to this reversal in economic growth in the poorer countries.

One way to think about production is in terms of foreign direct investment (FDI) connected to where production takes place. FDI consists mostly of private

TABLE 6-1

Net Inflows of Foreign Direct Investment (in billions of US dollars)

Region/Classification	1980	1990	2000	2004	2008
East Asia (including China)	1	9	116	106	186
India	0.08	0.2	4	6	42
Central and South America	7	8	88	64	121
European Union	21	97	680	223	503
United States	17	48	314	136	316
Middle East and North Africa	—	2	7	27	114
Sub-Saharan Africa	0.3	1.7	7	17	66
Developed Countries	47	172	1,118	414	962
Least Developed Countries	0.5	0.6	4	13	33
World	54	207	1,381	735	1,697

Source: UNCTAD, FDI/TNC database at www.unctad.org/fdistatistics, March 2010. Data is in current U.S. dollars and current exchange rates.

investments in factories, mines, and land, as well as foreign investments in stocks of local enterprises. As indicated in Table 6-1, between 1980 and 2008, the value of global FDI inflows increased from $54 billion to $1.7 trillion. Today most flows of FDI (57 percent) remain concentrated among the developed nations, although investment continues to spread out to every continent, especially amongst the emerging economies. Within the developed regions, most FDI has flowed to the United States and the EU, which at least until 1990 attracted 70 percent of all incoming FDI. Beginning in the 1990s, the share of total world FDI for developing nations like China, Hong Kong, Singapore, Brazil, Mexico, and some transition economies of Eastern Europe jumped significantly as investors deposited their capital in those countries. Until the mid-2000s, very little FDI flowed to India, the Middle East, and sub-Saharan Africa. But by 2008, India's booming economy enticed investors, as did the oil-rich Middle East. Africa has seen a bigger inflow in recent years, partly due to Chinese interest in commodities in the continent. However, the least developed, poorest countries of the world have since 1980 been unable to attract any significant amount of FDI, undermining their future prospects for economic development.

According to Eric Thun, these patterns of investment have contributed to the mobility of capital and to the tendency of industries to leave the industrialized nations in search of new markets, cheap labor, or other production advantages in developing parts of the world (see Chapter 17). Clearly, until the recent financial crisis, official development aid was falling off while private FDI increased. As expected, many mercantilists and structuralists note that these trends have important consequences for the distribution of the world's wealth and power through international trade as well as for labor conditions, the environment, and many other issues in developing nations that we will discuss in later chapters.

INTERNATIONAL TRADE

International trade occurs when goods and services cross national boundaries in exchange for money or the goods and services of another nation. Although most of the goods and services produced locally are consumed in confined markets, international trade has grown dramatically as a reflection of increased demand for goods and services that do not exist or cannot be produced locally. Increased international trade also reflects the growing internationalization of production. During the period from 1960 to 2006, for example, world trade in goods and services increased from a total of $62 billion to more than $23 trillion (both figures in constant 2000 dollars).[5]

Trade, then, ties countries together, generating significant economic, political, and social interdependence. For most states, trade is an easy way of generating income and jobs. For many developing nations, it is often a critical component of development plans. Thus, in a highly integrated international political economy, states are compelled to regulate trade in order to maximize its benefits and limit its costs to their economies. In so doing, states reserve the right to adopt a variety of policies to achieve these goals, which generates a good deal of tension between nations. And yet one state's trade policies can easily impose costly socio-economic adjustment problems on another state. Without a set of international rules and procedures, domestic-oriented trade policies could easily undermine the entire production and trade structure.

The production and trade structure pulls national leaders, IO and NGO officials, and the public in three directions at once. It is possible to support the principles of all three IPE perspectives of production and trade at the same time. On the whole economic liberals tend to emphasize that the rational thing for states to do is to agree on a common set of international rules and regulations that will maximize the gains from trade, in a competitive, interdependent international political economy. Likewise, without these rules, many states and groups they represent are likely to incur substantial economic losses. Mercantilists and structuralists agree that there are economic gains to be made from trade, but a variety of other issues related to how trade contributes to national wealth and power and how it benefits some groups more than others makes trade a much more complex and controversial topic.

What follows is a brief overview of trade history and a discussion of how the three perspectives view trade.

THE THREE PERSPECTIVES ON INTERNATIONAL TRADE

From the sixteenth through the eighteenth centuries, there were no international trade rules as we know them today. Early European states aggressively sought to generate trade surpluses as a source of wealth for local producers, for royalty, and later for the bureaucratic state. To help local industries get off the ground, imports of intermediate goods were discouraged if they meant people would purchase imports instead of buying locally-produced goods. For mercantilists, trade was one instrument that states tried to use to enhance their wealth, power, and prestige in relation to other states.

Economic Liberals

Many economic liberal ideas about trade are rooted in the late-eighteenth-century views of Adam Smith and David Ricardo, who were reacting to what they viewed as mercantilist abuses at the time. They proposed a distinctly liberal theory of trade that dominated British policy for more than a hundred years and is still influential today. Smith, of course, generally advocated laissez-faire policies (see Chapter 2). Ricardo went one step further; his work on the law of comparative advantage demonstrated that free trade increased efficiency and had the potential to make everyone better off. It mattered little who produced the goods, where, how, or under what circumstances, as long as individuals were free to buy and sell them on open markets.

The law of comparative advantage suggests that when people and nations produce goods and services, they give up something else they could have produced, but that would have been more expensive to make than the goods they actually created. This is what economists call opportunity cost. The law of comparative advantage invites us to compare the cost of producing an item ourselves with the availability and costs of buying it from others, and to make a logical and efficient choice between the two. In Ricardo's day, as we saw in Chapter 2, the law of comparative advantage specified that Great Britain should import food grains rather than produce them at home, because the cost of imports was comparatively less than the cost of local production.

For many economic liberals in the late 1800s, the world was supposedly becoming a global workshop where everyone could benefit from trade, guided by the "invisible hand" of the market. As we will see later in this chapter (and in Chapters 7 and 8), these ideas remain quite influential today and are the basis of free trade. Lightly regulated trade is also an integral part of other policies associated with the Washington Consensus promoted by the United States and other members of the World Trade Organization (WTO). A large (but far from universal) consensus exists that the benefits of a liberal, open international trade system far outweigh its negative effects.[6]

Mercantilists

As we outlined in Chapter 3, Alexander Hamilton and Friedrich List challenged what became accepted economic liberal doctrine about trade. From their mercantilist perspective, liberalism and free-trade policies were merely a rationale for England to maintain its dominant advantage over its trading partners on the Continent and in the New World. For Hamilton, supporting U.S. infant industries and achieving national independence and security required the use of protectionist trade measures. Likewise, List argued that in a climate of rising economic nationalism, protectionist trade policies such as import tariffs and export subsidies were necessary if Europe's infant industries were to compete on an equal footing with England's more efficient enterprises.[7] More importantly, List also maintained that in order for free trade to work for all, it must be preceded by greater equality between states, or at least a willingness on their part to share the benefits and costs associated with it.

Many neomercantilists today challenge the assumption that comparative advantage unconditionally benefits both or all of the parties engaged in trade. People employed in different industries or sectors of any economy can be expected to resist being laid off or moving into other occupations as comparative advantages quite easily shift around to different nations. In many cases, states can intentionally *create* comparative advantages almost overnight in the production of new goods and services simply by adopting strategic trade policies that invest heavily in those projects. New technology, skills, and other resources such as cheap labor can easily help one state's new industries gain a comparative (competitive) advantage over the industries of another state. This has been the case for auto, steel, and textile producers,[8] along with farmers, who almost continually seek trade protection for their commodities and products.

Another political reality that does not easily square with free trade is that in democratic nations with representative legislatures it is the state's *duty to protect* society and its businesses from the negative effects of trade. When many domestic groups and industries appeal to the state for protection, they are likely to receive help because legislators are threatened when these constituents face layoffs or competition from cheaper imports. In many cases, protection is a built-in feature of many democratic systems. Those who benefit from a small savings on the price of an imported article of clothing or new car, for instance, usually do not register their support for free trade as loudly as workers displaced by those policies and who seek protection.

Trade protection is also associated with a fear of becoming too dependent on other nations for certain goods, especially food and items related to defense. In some cases such as rice and energy imports, Japan has worried that too much dependency on another state can lead to either its economic or political exploitation. Such was the intention of the United States when it exported soybeans to Japan in the early 1970s and then cut off those exports when U.S. mothers complained of high meat prices and used soy as a replacement for meat.

Finally, some neomercantilists are concerned that the protectionist trade policies of a regional trade alliance such as North American Free Trade Agreement (NAFTA) or the EU (discussed below), which are designed to help local industries, might either intentionally or unintentionally disrupt another country. Often, this disruption is followed by an assortment of defensive or retaliatory neomercantilist policies meant to counter the original measures or in essence "even the score" with another state.

THE VOCABULARY OF INTERNATIONAL TRADE POLICY

Some of the more important protectionist measures include the following:

- *Tariffs:* Taxes placed on imported goods to raise the price of those goods, making them less attractive to consumers. These are used to raise government revenue (particularly in developing nations) or, more commonly, as a means to protect domestic industry from foreign competition.
- *Import quotas:* Limits on the quantity of an item imported into a nation. By limiting the quantity of imports, the quota tends to drive up the price of a good at the same time it restricts competition.

- *Export quotas:* Measures that restrict the quantity of an item a nation can export, with the effect of limiting the number of goods imported by another country. Examples include Voluntary Export Restraints (VERs) and Voluntary Restraint Agreements (VRAs). For example, the Multifibre Agreement (MFA) established an international set of rules for textile export quotas for both developed and developing countries.
- *Export subsidies:* Measures that effectively reduce the price of an exported product, making it more attractive to potential foreign buyers.
- *Currency devaluations:* The effect of making a nation's currency worth less makes exports to other countries cheaper and imports from abroad more expensive. Currency depreciation thus tends to achieve the effects, temporarily at least, of both a tariff (raising import prices) and an export subsidy (lowering the costs of exports). However, currency changes affect the prices of all traded goods, whereas tariffs and subsidies generally apply to one good at a time (see Chapter 7).
- *Nontariff barriers (NTBs):* Other ways of limiting imports, including government health and safety standards, domestic content legislation, licensing requirements, and labeling requirements. Such measures make it difficult to market imported goods and significantly raise the price of imported goods.
- *Strategic trade practices:* Efforts on the part of the state to *create* comparative advantages in trade by methods such as subsidizing research and development of a product or providing subsidies to help an industry increase production to the point at which it can move up the "learning curve" to achieve greater production efficiency than foreign competitors. Strategic trade practices are often associated with *state industrial policies,* that is, intervention in the economy to promote specific patterns of industrial development.
- *Dumping:* The practice of selling an item for less abroad than at home. Dumping is generally regarded as an unfair trade practice when used to drive out competitors from an export market with the goal of generating monopoly power.
- *Countervailing trade practices:* State defensive measures taken to counter the advantage gained by another state when it adopts protectionist measures. Such practices include antidumping measures and the imposition of countervailing tariffs or quotas.
- *Safeguards:* Other defensive measures, used when, after tariffs are reduced, a product is imported in quantities that threaten serious injury to domestic producers of like or directly competitive products.

As many mercantilists see it, economic liberal theories about trade cannot account adequately for the real political world in which states manipulate production and trade for a host of social, political, and economic reasons. Because there is no guarantee of security in the international security structure, there is no guarantee that, even when states say they subscribe to free trade, they will not engage in protectionism of one form or another. Therefore, the rational thing for states to do is to be prepared to act in their own interest by protecting themselves.

Structuralists

Structuralists label the early mercantilist period as one of classical imperialism. The drive to colonize underdeveloped regions of the world by the major European powers originated in their own economies. Mercantilist policies that emphasized exports became necessary when industrial capitalist societies experienced economic depression. Manufacturers overproduced industrial products, and financiers had a surplus of capital to invest abroad. Colonies served at least two purposes: They were a place to dump these goods and a place where investment could be made in industries that profited from cheap labor and access to plentiful (i.e., inexpensive) quantities of natural resources and mineral deposits. Trade helped colonial mother countries dominate and subjugate the people and economies of the colonial territories.

Lenin and other Marxist theorists argued that national trade policies benefited most the dominant class in society—the bourgeoisie (see Chapter 4). During the early colonial period, developing regions of the world remained on the periphery of the international trade system and provided their mother countries with primary goods and mineral resources along with markets for manufactured products. In the period of modern imperialism toward the end of the nineteenth century, capitalist countries used trade to spread capitalism into underdeveloped regions of the world. Lenin was attempting to account for the necessity of states with excess finance to take colonies in order to postpone revolution in their capitalist economics. The "soft" power of finance as much as the "hard" power of colonial military conquest helped to generate empires of dependency and exploitation.

Structuralists argue that industrializing core nations converted these resources and minerals into finished and semifinished products, many of which were sold to other major powers and back to their colonies. To this day, trade plays a key role in helping the imperialist industrialized nations subjugate the masses of people in the developing regions of the world. Although particular sectors (enclaves) of core economies have developed, political and economic conditions for the masses of people within peripheral nations and regions *have become underdeveloped* since contact with the industrialized nations through trade.[9]

Immanuel Wallerstein stresses the linkage between capitalist core countries and periphery and semiperiphery regions of the world.[10] Today, patterns of international trade are determined largely by an international division of labor between core, semi-peripheral, and peripheral states that drives capitalism to expand globally. The integration of global markets and free-trade policies associated with globalization are an extension of the same economic motives of imperial powers of the nineteenth and twentieth centuries.

In sum, all three IPE perspectives on trade also contain a variety of different ideological outlooks. Today, a majority of academics and policy officials still favor an economic liberal international trade system within an order that is supposed to be *gradually* liberalizing or opening up. And yet, as we will see, in cases such as the recent global financial crisis, most nations tend to behave in a mercantilist fashion and adopt protectionist measures when their national interests are threatened. And as we will see in the next section, more than ever before, developing and industrialized nations are concerned that trade may be more exploitative than mutually advantageous.

GATT AND THE LIBERAL POSTWAR TRADE STRUCTURE

Until after World War II trade rules largely reflected the interests of the dominant states, especially Great Britain. Despite a few decades in which economic liberal ideas prevailed, protectionism was the order of the day. Trade rules were enforced at the point of a gun—or cannon, as in the case of the United States forcing Japan to open its doors to U.S. trade in the 1860s.

The post–World War II structure of much of the capitalist world's political economy was established in 1944 at the Bretton Woods conference in Bretton Woods, New Hampshire. There, Allied leaders, led by the United States and Great Britain, created a new economic order based on economic liberal ideas (see Chapter 2) they hoped would prevent many of the interwar economic conflicts and problems that had led to World War II. By the turn of the twentieth century, protectionist trade policies had been on the rise as the major powers raced to stimulate industrial growth. During the Great Depression of the 1930s, protectionism spiraled upward while international trade decreased significantly, by an estimated 54 percent between 1929 and 1933, strangled in part by the Smoot–Hawley tariffs in the United States and onerous trade barriers enacted elsewhere. According to some historians, the trade situation and the depressed international economy helped generate the bleak economic conditions to which ultranationalist leaders such as Mussolini and Hitler reacted. It is important to note that, in contrast to the common assumption that the United States has always supported free trade, it was not until 1934 that it officially adopted a free-trade policy, until then routinely protecting most of its traded items.

In conjunction with this effort the United States promoted the establishment of an International Trade Organization (ITO) that was to oversee new liberal trade rules that would gradually reduce tariffs, subsidies, and other protectionist measures, offsetting domestic protectionist and mercantilist tendencies. The ITO never got off the ground because a coalition of protectionist interests in the U.S. Congress forced the United States to withdraw from the agreement, effectively killing it. President Harry Truman advanced a temporary alternative structure for multilateral trade negotiations under the **General Agreement on Tariffs and Trade (GATT)**. In 1948, the GATT became the primary organization responsible for the liberalization of international trade[11] through a series of multilateral negotiations, called *rounds*, at which the world's main trading nations would each agree to reduce their own protectionist barriers in return for freer access to each other's markets.

Two basic principles of the GATT were **reciprocity** and **nondiscrimination**. Trade concessions were reciprocal—that is, all member nations agreed to lower their trade barriers together. This principle was conceived as a way to discourage or prevent nations from enacting unilateral trade barriers. The loss in protection of domestic industry was to be offset by freer access to foreign markets. Designed to prevent bilateral trade wars, the principles of nondiscrimination and the **Most Favored Nation (MFN)** trading status required that imports from all countries be treated the same, whereby imports from one nation could not be given preference over those from another. Theoretically, the GATT's membership was open to any nation, but until the 1980s most communist countries refused to join it, viewing it as a tool of Western imperialism.

Reciprocity and nondiscrimination would prove to be potent during the early years of GATT negotiations in a series of trading rounds, as members began slowly to peel away the protectionist barriers they had erected in the 1930s, which allowed international trade to expand dramatically. In many cases, however, it was not possible to divorce politics from trade, even under GATT rules. Some nations were not always willing to grant reciprocity to their trading partners automatically, but granted it selectively to those they favored politically or wanted to assist, while for any number of reasons withholding it from other states. Later in the chapter, we will discuss the case of the United States using trade as a strategic instrument by withholding MFN status from China to achieve a variety of U.S. foreign policy objectives.

Keep in mind that the GATT was not a set of rules that could be enforced by the organization but depended on the members to fulfill multilateral trade obligations with one another. Policy decisions were made on the basis of consensus, and thus implementation of polices often reflected a combination of political and economic interests. Written into the GATT were a series of exceptions from generalized trade rules for certain goods and services, including tariffs and quotas on textiles and agricultural products along with regional trade agreements (RTAs), discussed below. At first, these exemptions allowed many of the war-ravaged nations to resolve balance-of-payments shortages. In the case of agriculture they also reflected food shortages in Europe and the need for financial assistance to farmers and other groups.

Mercantilism on the Rebound

During the 1960s and early 1970s, the pace at which the Western industrialized economies had grown after the war began to slow appreciably. The OPEC oil crisis began in 1973 and soon resulted in economic recession in many of the Western industrialized nations. Throughout this period international trade continued to grow, but not at the rate at which it had earlier. Under increasing pressure to stimulate economic growth, many nations reduced their tariff barriers. At the same time, however, they devised new and more sophisticated ways of protecting their exports and otherwise limiting imports. By the time the Tokyo round of the GATT (1973–1979) got underway, the level of tariffs on industrial products had decreased to an average of 9 percent. The Tokyo GATT round tried to deal with a growing number of **nontariff barriers (NTBs)** that many believed were stifling world trade. Rules or codes covered a range of discriminatory trade practices, including the use of export subsidies, countervailing duties, dumping, government purchasing practices, government-imposed product standards, and custom valuation and licensing requirements on importers. Some new rules were also devised that covered trade with developing nations.

Many liberal trade theorists at the time argued that the Tokyo round did not go far enough, especially in dealing with the growing problem of NTBs or with enforcing GATT rules. In the 1970s and 1980s, the industrialized nations were encountering a number of old and also new kinds of trade problems. Trade among the industrialized nations quadrupled from 1963 to 1973, but increased only two and one-half times in the next decade. Meanwhile, trade accounted for increasingly higher percentages of GDP in the industrialized nations in the 1980s: around 20 percent for the United States, 20 percent for Japan, and an average of 50 percent for members of the EU. To put it mildly, trade policy continued to be a serious source of tension and disagreement among the industrialized nations, reflecting their increasing dependence on trade to help generate and maintain economic growth.

Japan, the quintessential mercantilist nation during this period, benefited from the liberal international trade system while erecting domestic trade and other protectionist policies. By the 1970s, Japan's export-led growth trade strategy began to bear fruit. Its Ministry of International Trade and Industry (MITI) helped pick corporate winners that it and other government officials felt would prosper in the international economy from state assistance. Most of these industries were high-employment, high-technology firms whose future looked bright. Working closely with their national firms, the Japanese and the NICs began assisting their firms in ways that would put them in a strong competitive position.

The term *strategic trade policy* became synonymous with state efforts to stimulate exports or block foreign access to domestic markets and included "the use of threats, promises, and other bargaining techniques in order to alter the trading regime in ways that improve the market position and increase the profits of national corporations."[12] In the United States, for instance, the Omnibus Trade and Competitiveness Act of 1988 produced **Super 301,** which required trade officials to list "priority" countries that unfairly threatened U.S. exports. Aside from export subsidies and the use of a variety of import-limiting measures, proactive strategic trade policy measures included extended support for "infant industries" complemented by import protection and export promotion measures. Some states went out of their way to form joint ventures with firms in the research and development of new technologies and products. An example was U.S. government assistance to the Microsoft Corporation in an effort to crack down on Chinese computer software pirates.[13]

With the acceptance of some amount of trade protection, a more liberal (open) GATT system seemed compromised. Free trade was slowly replaced as the central principle by the notion of **fair trade** or a "level playing field," where states sought to enact policies to counteract some policies of their trading partners. Trade policy moved from the multilateral arena of GATT to a series of bilateral discussions, as between the United States and Japan and between the United States and the EU. Under conditions of increasing protectionism but also in an effort to benefit more from trade, it was the United States during the Reagan administration that first sought to reassert the liberal vision of free trade. Thus was born the Uruguay round of the GATT.

The Uruguay Round

The eighth GATT round—the Uruguay round—began in 1986 in Punta del Este, Uruguay, and was completed on December 15, 1993. The Reagan administration had a hand in commencing the multilateral trade talks, not only for the sake of promoting free trade but also to open markets for U.S. goods to help defray the cost of a recession in the United States at the time. As realist-mercantilists point out, however, the administration's goals at the time included economic liberal policies to counter the influence of the "evil empire" (Soviet Union) in developing nations.

Generally speaking, economic liberals tend to view this round as a success because of the effect it had on the volume and value of international trade. Many import quotas were eliminated, and export subsidies were brought under control. FDI surged alongside growth in trade, further connecting national economies into an interdependent international trade network.

The Uruguay round established new rules and regulations related to limiting protectionist measures such as "dumping" (selling goods at below fair market prices) and the use of state subsidies. The round went beyond previous trade rounds and established 15 working groups that covered such items as market access for textiles and agricultural goods; **trade-related aspects of intellectual property rights (TRIPs)** that include such items as copyrights, patents, and trademarks; **trade-related investment measures (TRIMs)**; and the complicated issue of trade in services. TRIMs and service issues reflected recognition that as the nature of production changed and spread to different parts of the world, it affected both the amount and kind of international trade.

For the first time GATT trade negotiations dealt in a comprehensive manner with the contentious issue of agriculture. All of the major producers and importers of agricultural products routinely employ subsidies and other measures that, according to economic liberal critics, distort agricultural trade. Agricultural issues had been intentionally absent from previous GATT rounds because they were politically too contentious and would have prevented progress in areas where agreements were possible. This time trade officials made the issue of agricultural assistance and reform one of the main objectives of the Uruguay round.[14] The United States and the Cairns Group (composed of Australia and 17 other pro–free-trade countries) led a politically radical effort to phase out all agricultural subsidies. After resistance by some U.S. farm groups and government officials, the United States agreed to *gradually* eliminate its domestic farm programs and agricultural trade support measures. EU efforts to significantly reduce their agricultural subsidies were complicated by the EU's Common Agricultural Policy (CAP)—a community-wide farm program that reflected the combined interests of its 15 member states, with France most critical of efforts to decrease agricultural support. Bringing the EU's farm program in line with GATT reform proposals would be a politically difficult and complicated process that took almost five years to complete.

Many U.S. exporters expected a new multilateral agreement to produce 20,000 jobs for every $1 billion increase in exports and access to overseas markets for U.S. semiconductors, computers, and a variety of U.S. agricultural commodities.[15] However, agricultural trade remained one of the major sticking points of the negotiations, shutting down the entire negotiations on several occasions. Eventually, at the eleventh hour in November 1993, an agreement on agriculture was reached that opened the way for agreement on all other issues.

In order to arrive at a consensus the new agreement reflected numerous "deals" or compromises between nations or blocs of nations. Under the new agreement, all countries were to reduce their use of agricultural export subsidies and domestic assistance *gradually* over a period of years. The new rules allowed states to convert nontariff import barriers into tariff equivalents, which were then to be reduced in stages. However, because of the strength of farm lobbies and the importance of agricultural exports in many of these countries, the method for calculating tariff equivalents in most cases actually set new tariff levels *higher* than they had been, effectively nullifying efforts to reduce farm support.

It is important to note that the Uruguay round did produce some 60 or so agreements on a host of other issues, including safeguards, TRIPs, rules of origin, technical barriers to trade, and textiles and clothing. The Uruguay round also became famous for creating the WTO and for institutionalizing what would become a set of global trade rules and regulations. GATT rules and a number of procedures became a legal element of the WTO. Trade officials claimed that progress was made toward liberalizing agricultural trade in the Uruguay round, but in reality, protectionism remained a key feature of agricultural trade. Many delegates intended that problems remaining in agriculture, establishing a services code, and developing nation concerns about how TRIPs gave advantages to developed states would be dealt with more directly in the next round of trade negotiations.

The WTO

The final agreement of the Uruguay round launched the new World Trade Organization, comprised of 146 members at the time.[16] Headquartered in Geneva, Switzerland, it accounts for over 90 percent of world trade. Its primary job is to implement the latest GATT agreement and to act as a forum for negotiating new trade deals, to help resolve trade disputes, to review national trade policies, and to help developing nations deal with trade policy issues through technical assistance and training programs. Theoretically, WTO decisions are still to be made by a consensus of the members. The WTO's decision-making structure includes a secretariat (administrative body), a ministerial conference that meets at least once every two years, and a general council composed of ambassadors and delegation heads that meets several times a year in Geneva.

The WTO has a **Dispute Settlement Panel** (DSP) that rules on trade disputes, giving the WTO an enforcement mechanism, something the GATT did not have. An impartial panel of experts oversees cases submitted to it for resolution, and members can appeal their findings. The DSP can impose trade sanctions on member states that violate trade agreements. Several cases have gained significant press attention, including a judgment against the EU's attempt to limit imports of hormone-fed U.S. beef into the EU. Likewise, the WTO ruled against the EU's banana import program, which tried to curtail imports of bananas produced by U.S. companies in the Caribbean. Still another case was the transatlantic conflict over the production and use of genetically modified foods and organisms (GMOs) (discussed in Chapter 18).

For the most part, since the founding of the WTO, trade disputes have become more complex and politicized. Some nations have even threatened to withdraw from the IO when DSP decisions go against them. In some cases state officials are accused of "losing state sovereignty" to the WTO when they lose a dispute. So far, however, most states have either accepted the panel's findings or arrived at a satisfactory resolution, because so much is at stake economically or politically or because they feel compelled to participate in the rule-making exercise rather than be left out of it.

The Doha "Development Round"

The next round of multilateral trade negotiations was to begin in 1999, but the WTO's ministerial talks in Seattle ended in deadlock, with riots in the streets and antiglobalization protestors blocking delegates from entering the negotiations. The "Battle of Seattle" became a rallying cry for many antiglobalization NGOs concerned about the violations of human rights in sweatshops, the large tracts of land farmed by agribusinesses in developing countries, the effects of large capitalist enterprises on the local environment, the lack of transparency in decision-making processes of the WTO, and a host of ethical issues.[17] Critics of all ideological persuasions, including President Bill Clinton, questioned the WTO's ability to deal with these popular issues as well as with institutional issues such as the connection between trade and such topics as investment, competition policy, and WTO decision making.

After the events of 9/11 many trade officials pushed to restart multilateral trade talks. At the 2001 ministerial meeting (far away from protestors), the next multilateral trade round began in Doha, Qatar. From the beginning many developing countries complained openly that agreements reached at the Uruguay round had not resulted in significant gains for them. As expected, they also argued that before new trade agreements could be reached, including those unresolved in the Uruguay round, the developed nations would have to make a concerted effort to include developing nations in the negotiation process. In recognition of this goal the Doha round was nicknamed the "Development Round" to reflect the growing importance of developing nations in the international trade system.

At Cancun, Mexico in November 2003, ministerial talks broke down once again. U.S. Special Trade Representative Robert Zoellick blamed developing nations and NGOs (especially those associated with the antiglobalization campaign) for resisting efforts to reach a new agreement. Many developing countries blamed the WTO for failing to fulfill promises it had made in the Uruguay Round. Some countries claimed to be suffering more poverty, along with environmental, social, and economic damage, after implementing the WTO's new rules. Outside the talks many developing countries were resisting efforts by the United States, the EU, Japan, and others to implement the "Washington consensus" or one-size-fits-all strategy of economic development that included trade liberalization. The Group of 20 (G20) (not to be confused with the financial G20), headed by Brazil, India, South Africa, and China, focused on cutting the farm subsidies of the rich countries. As a bloc, they dismissed 105 changes in WTO rules that would provide more access to their markets by the developed states.[18]

To restart the talks the United States offered to cut subsidies if others did the same. Meanwhile, the 2002 U.S. farm bill passed by Congress had *increased* U.S. farm and agribusiness support by $70 billion, making the U.S. commitment to trade liberalization seem hollow. The result, many critics point out, has been more overproduction and a distortion of world commodity prices, leading to the dumping of excess commodities onto world markets. This displaces local production in developing countries' markets and depresses prices local farmers receive. Even

President George W. Bush recognized that continued subsidies of farm commodities in the United States and the EU hurt poorer farmers in developing nations.[19]

Late in 2005 India, China, Brazil, and the rest of what became the G20 pushed the United States and the EU to cut domestic agricultural support significantly. The United States and the EU complained about each other's support for agricultural subsidies. At the Group of 8 (G8) meeting in the summer of 2006 in St. Petersburg, Russia, the major powers made yet another effort to come to an agreement that would end the Doha round talks. Only days later, however, the Doha round reached yet another impasse when once again agriculture was the major sticking point, blocking agreements on all other trade-related issues.

Other issues on the Doha agenda included TRIPs, which many developing countries argued limited their access to generic medicines by protecting patents held mainly by U.S. companies (see the box "Patent Rights vs. Patient Rights" in Chapter 10). The United States retorted that allowing developing nations to produce cheaper generic drugs with what are called compulsory licenses would hurt (the profits of) major drug manufacturers. The WTO failed to reach consensus on specific measures regarding "cultural products" (such as movies), insurance companies, security firms, banking across national borders, and protectionist "local content" legislation. Another stumbling block has been special and differential treatment (S&DT) rules that define market access to individual developing countries with a *unique* approach in terms of trade policy.

Without an agreement on agriculture and some of the other contentious issues, many OELs and trade officials fear that the Doha round will never be successfully concluded, possibly leading to the demise of the WTO altogether. Some believe that the inclusion of the developing nations in the WTO has created an agenda that has become too large to find consensual positions. Still another result could be "Doha lite"—a watered-down compromise that does not require nations to give up too much.

Finally, some HILs and mercantilists express the view that without an assertive hegemon, the globalization of trade has made it too difficult for states to reconcile economic liberal objectives with domestic pressures to limit the dislocating effects of trade. President Obama has not actively sought to make the United States a global hegemon, let alone push other states into signing off on Doha.

REGIONAL TRADE BLOCS

Some mercantilist and economic liberal critics of the Doha round suggest that, instead of multilateral talks, the United States and other states ought to pursue bilateral and regional trade agreements. In fact, the United States has already agreed to more than 300 bilateral agreements with other countries, with more on the way. It also belongs to a number of **regional trade agreements (RTAs)** such as NAFTA and Asia-Pacific Economic Cooperation (APEC) (see below), where it is easier for the United States to dictate terms and not face pressures from some pro–free-trade businesses to complete the Doha round, which in most cases has a bigger payoff than an RTA. RTAs also have less bureaucracy and more room to account for the idiosyncrasies of partner states or to reconcile conflicting interests on a geographically regional level.

Regional trade blocs are defined as a formal intergovernmental collaboration between two or more states in a geographic area.[20] They promote a mix of economic liberal and mercantilist trade policies, reducing barriers within the trade bloc while retaining trade barriers with nonmember nations. RTAs number well over 300 and have grown prodigiously since the end of the Cold War. They are estimated to have controlled 43 percent of world trade in 2000. The most well-known regional trade blocs are the EU and the NAFTA. Others include the Central American Free Trade Association (CAFTA), Mercosur, the Association of Southeast Asian Nations (ASEAN), the Economic Community of West African States (ECWAS), and the Asia-Pacific Economic Cooperation (APEC). APEC is an **intraregional trade bloc** that attempts to integrate 18 Pacific and Asian nations into a nonbinding arrangement that would gradually remove trade barriers among members by 2020. As a promoter of the agreement, the United States hopes to further liberalize trade among the members while accelerating economic growth in the Asia-Pacific region. The EU, NAFTA, and ASEAN accounted for 60 percent of all global trade (imports and exports) of merchandise and commercial services in 2008. The EU alone accounted for 39 percent of global trade, compared to NAFTA's 15 percent, ASEAN's 6 percent, and Mercorsur's 1.6 percent. [21]

Why so many RTAs? Are they good for trade? Technically, RTAs violate the GATT and WTO principle of nondiscrimination, but they are nonetheless legal entities. Article XXIV of the GATT and Article V of the General Agreement in Trade and Services (GATS) exempt them, as long as they make an effort to liberalize trade within the bloc. In some cases, RTAs generate more efficient production within the bloc, either while infant industries are maturing or in response to more competition from outside industries. In other cases they attract FDI when local regulations and investment rules are streamlined and simplified. For many economic liberals, regional trade blocs are stepping-stones toward the possibility of a global free-trade zone as they gradually spread and deepen economic integration.

Not all economic liberals support RTAs. The noted supporter of globalization Jagdish Bhagwati is concerned that bilateral and regional agreements are likely to generate a "spaghetti bowl effect" of multiple tariffs and preferences, making it harder to eventually reduce trade protection measures significantly.[22] Other economic liberals believe that RTAs undermine the WTO process and the ultimate goal of *world* free trade, because protectionist measures tend to beget more trade protectionism. A good example is the decision by the Obama administration to impose tariffs on Chinese tires. What many construe as a move to support the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) labor union to "help preserve American manufacturing" generated a retaliatory threat from China to impose tariffs on U.S. chickens and car parts.[23]

Thus, mercantilists tend to focus on the political rationale behind RTAs as well as the way in which they serve a variety of political and economic objectives. For some nations they can be bargaining tools used to prevent TNCs from playing one state off against another. Another classic case, for example, was one of the arguments President Clinton made in support of U.S. efforts to help organize NAFTA—that the United States should be able to penetrate and secure Mexican markets before the Japanese did.[24] If the United States did not quickly bring Mexico into its trade orbit in 1993, Japanese investments in Mexico would negate U.S. influence over Mexico's future trade policies. As discussed in Chapter 3, these sorts of cases will always exist as long as states are the dominate actor in the international political economy and trade is one of many tools in their arsenal of instruments to generate wealth, power, and security.

North–South Trade Issues

Tensions between the Northern industrialized and Southern developing nations over trade issues are not new. However, WTO G20 resistance to some of the measures of the Doha round that resulted in a deadlock does reflect the increasing importance and influence of Southern developing nations in the international production and trade structure.

In 1973, when the OPEC nations dramatically raised the price of oil for the first time, a coalition of developing nations in the UN called the Group of 77 (G77) demanded an entirely new international economic order (NIEO).[25] Based on complaints about the terms of trade favoring the developed states, part of the G77's demands included major changes in trade policies that permitted more access of their primary commodities into the heavily protected markets of the Northern industrialized regions of the world. The G77 also demanded a TNC "Code of Conduct" to assure developing nations control over their own resources along with a stronger voice in GATT decision making.

Consistent with the political environment at the time, these demands produced no fundamental change in GATT, IMF, or World Bank policies. The United States and other states responded that, rather than trying to change system rules and procedures, developing nations should become more integrated into the international economy. Because trade is an "engine to growth" and an essential element of development, developing nations would benefit from efficiencies gained from trade if they brought down their tariff barriers on their commodities and products and opened their economies to FDI.

In the 1980s, these same economic liberal ideas became the basis of Northern nation solutions to the debt crisis that emerged early in the decade, when many developing countries borrowed heavily from Western banks and some international finance agencies (see Chapter 8). Again, instead of changing the fundamentals of the international production and trade and monetary structures, the Northern industrialized nations recommended what was essentially the same set of policies they had suggested a decade earlier when it came to trade, this time packaged as the "Washington Consensus." Developing nations should grow their way out of debt by liberalizing their trade policies and opening up their economies to FDI. Many of these economic liberal ideas also served as justification for **structural adjustment policies (SAPs)**—conditions the IMF and the World Bank required developing nations to adhere to when they borrowed money from these institutions to overcome their long-term debt or short-term financial crises (see Chapter 8).

In the 1990s, these same economic liberal ideas about trade also served as an ideological justification for the globalization campaign, and they are still quite popular today. The WTO and the World Bank support the views of many trade experts who argue that countries that have experienced strong export growth have lower levels of import protection than countries with declining exports.[26] They contend that much of the economic growth that has occurred in many developing nations since the 1970s is due, for the most part, to an emphasis on manufactured goods for export (see Table 6-2).

Today, many economic liberals continue to support the objectives of the Doha trade round, especially trade policies that ensure the success of developing countries. The WTO continues to suggest that if developing nations remain committed to the new trade rules, they will attract new foreign and domestic investors. Likewise, the Uruguay round included special provisions that allowed developing nations longer time periods for implementing commitments and provisions requiring WTO members to safeguard the interests of developing nations.

Structuralist and Neomercantilist Versions of Trade and Globalization

Many structuralists are critical of these ideas about trade and their effects on North–South relations. Some mercantilists do support economic liberal ideas and globalization to the extent that they serve state interests—usually those of the major powers. For others, though, the numbers quoted to demonstrate the gains from trade do not reflect a clear understanding of the consequences of economic liberal trade policies. In the 1960s, 1970s, and even into the 1980s, many structuralists would have recommended that developing countries do as China and insulate themselves from the inherently exploitative capitalist international trade system. At the end of the Cold War, however, many hard-core Marxist structuralists seemed to accept the necessity of trade but continued to criticize the international trade system and shifted their attention to reforming it.

Today, many structuralists argue that the WTO has perpetuated the exploitative relationship of the North to the South. Northern trade and development policies have resulted in economic growth for many states but not for the greater number of people within the poorer ones. Robert Hunter Wade, for example, has carefully calculated that while trade has raised per capita incomes in many states, especially China and India, it has also generated significant inequality between and especially within the developing nations.[27]

Other numbers for developing nations do not look good either. Trade has accounted for as much as 75 percent of the foreign exchange earnings of many developing nations. Many developing nations quadrupled their percentage share of world merchandise exports, from 7 percent in 1973 to 29.7 percent in 2004 (see Table 6-2).[28] However, the vast majority of developing nations still account for only about one-fifth of the world's trade in manufactured goods. Some 40 percent of those exports came from emerging economies (especially the Asian Tigers) in the last quarter-century. During this same period, the share of developing nation trade in agricultural and mining products and fuel declined. Many states in Africa and Latin America suffer chronic trade deficits and have large international debt (see Chapter 8).

The recent financial crisis has only worsened this tendency as a result of weaker global commodity, fuel, and mineral prices, which have contributed to increased LDC deficits and increased dependency on external financing of their

TABLE 6-2

World Merchandise Exports by Region

Region/Country	Value (Billions of $) 2008	Global Share (%) 1995	2000	2004	2008
World	15,717	100.0	100.0	100.0	100.0
North America	2,043	17.1	19.5	12.9	13.0
United States	1,289	11.7	12.5	9.2	8.2
South and Central America	597	3.0	3.1	3.1	3.8
Brazil	204	0.9	0.9	1.1	1.3
Europe	6,444	46.5	42.0	45.2	41.0
European Union (27)	5,611	—	38.9	41.7	35.7
Commonwealth of Independent States (CIS)	707	2.2	2.3	3.0	4.5
Russian Federation	—	1.6	1.7	2.1	—
Africa	550	2.2	2.3	2.6	3.5
South Africa	78	0.6	0.5	0.5	0.5
Middle East	1,022	3.0	4.3	4.4	6.5
Asia	4,354	26.0	26.4	26.8	27.7
China	1,430	3.0	4.0	6.7	9.1
Japan	786	8.8	7.6	6.4	5.0
Six East Asian traders	1,414	10.3	10.4	9.7	9.0

Note: The Six East Asian traders are Hong Kong, Malaysia, Singapore, South Korea, Taiwan, and Thailand.
Source: World Trade Organization, *International Trade Statistics 2009.*

debt. Likewise, demands for trade protection have increased in most developing nations as they have in developed states. As Table 6-3 indicates, poor developing countries are much more dependent on trade than wealthy developed countries. By 2008, trade as a percentage of GDP in heavily indebted countries, especially in Africa, had reached more than 70 percent, compared to approximately 50 percent in high income countries. Countries that are highly trade-reliant are more likely to be affected by volatility in prices of exports and imports due to protectionist measures and changes in global demand.

Aside from these numbers, some structuralists and mercantilists focus more on the effects that trade has on specific societies instead of on general trends that provide distorted pictures of consequences. As we discuss in more detail in Chapter 18, Walden Bello and others claim that new trade rules for agriculture have hurt small rice farmers in Malaysia and rice and corn farmers in the Philippines. Trade liberalization and globalization have served the interests of the U.S. agricultural "dumping lobby" and a "small elite of Asian agro-exporters."[29] Many experts argue that the effects of NAFTA on Mexican small farmers have been devastating: Between 1993 and 2002 two million were driven off the land. According to economic liberals, this consequence flows naturally from the shift from an agricultural to a manufacturing-based economy. Yet, the problem for

TABLE 6-3

Trade as a Percent of Gross Domestic Product by Region

Region/Classification	1980	1990	2000	2004	2008
East Asia and the Pacific	34	47	67	82	64
Latin America and Caribbean	28	32	41	46	47
Europe and Central Asia	—	44	67	69	68
South Asia	21	20	30	39	52
Middle East and North Africa	60	57	52	64	79
Sub-Saharan Africa	63	52	63	64	77
High Income	40	38	48	50	—
Highly Indebted Poor Countries	56	47	59	67	71
World	39	38	49	52	—

Note: Trade is exports and imports of goods and services.

Source: World Bank, *World Development Indicators* database, February 2010.

many structuralists is that the outcome is usually not what society would choose for itself but what is imposed on it by the Northern states.

Some mercantilists note that countries such as the United States have favored free trade when it benefits them but not when it might benefit producers in developing nations at the expense of U.S. producers. As pointed out earlier in the chapter, the developed states have an extensive history using protectionist trade measures to promote their own economic growth at the expense of other states. After World War II, the United States and its allies used the GATT and the WTO, along with other trade and finance organizations, to lower tariff barriers and thereby expose the infant industries of developing nations to competition with the more mature industries of the industrialized nations.

Yet, even a supporter of managed globalization such as Dani Rodrik points out that many of the world's faster growing economies, such as China, Vietnam, and Malaysia, insulated themselves from the international economy during the recent Asian crisis and now in response to the global financial crisis (see Chapter 8). According to Rodrik, in the past, high-tariff countries grew *faster* than those without tariffs.[30] Now the developed states want to "kick away the ladder" (take away protection) from under the developing nations.[31] Rodrik and Chang would support Bello's argument that protection serves a variety of "socially worthy objectives such as promoting food security for society's low income people, protecting small farmers and biodiversity, guaranteeing food security, and promoting rural social development."[32]

Economic Liberal and NGO Critics of Globalization

Two other recent developments have influenced North–South relations. The first routinely makes headlines. In the 1990s, a growing number of NGOs, many with structuralist views and closely connected to the antiglobalization movement, have focused attention on the connection between trade and issues such as the environment, global labor conditions, drugs, and even terrorism. NGOs such as Oxfam, Global Trade Watch, and Global Exchange attempted to acquire first-hand information about the effects of Northern trade policies on developing nations and publicized it in speeches, newspapers, journals, and on their websites.[33] Production and trade affect the environment in ways that states and businesses never anticipated, as the demand for more energy resources increasingly makes the true cost of trade incalculable. To some extent, constructivist theorists (see Chapter 5) posit that these civil groups are responsible for changing the way the general population of developed countries thinks about globalization and "free trade."

Polls in the United States indicate that support for free trade has gradually decreased without a consensus about its benefit to the U.S. economy.[34] Two factors have contributed to this shift. First, a large number of jobs in industrialized states have been outsourced to countries such as China. Even though a good case can be made that outsourcing generates more jobs globally than it takes away, the plight of a middle-aged, hard-working U.S. citizen losing her job to a poorly paid Chinese worker is politically hard to swallow. Second, the global financial crisis has seen many states question trade liberalization and globalization in the face of the impact this disaster has had on their societies. Even economic liberals have begun to question the appropriateness of liberal trade for developing nations. In his new book *Making Globalization Work*, Joseph Stiglitz, a former chief economist of the World Bank, argues that states should cooperate to protect the legitimate interests of those hurt by globalization.[35]

NGOs have played a role in monitoring the effects of TNCs on various societies, casting light on many of the ethical and judicial dimensions of outsourcing and job displacement. In some cases, NGOs have been a source of information for WTO dispute hearings. A growing number of NGOs and university students have developed alternative trade strategies. One such effort is the "fair trade" movement that seeks to give workers in developing countries higher prices for certified goods such as coffee, chocolate, handicrafts, quinoa, and timber.[36]

TRADE AS A FOREIGN POLICY TOOL

Finally, as alluded to above, many state officials over the years have attempted to use trade as an instrument to achieve political, social, and economic objectives. In the 1980s, the Reagan administration applied trade restrictions on nations it felt were either supporters of communist revolutionary movements (for example, Vietnam, Cambodia, and Nicaragua), sponsors of terrorism (Libya, Iran, Cuba, Syria, and the People's Democratic Republic of Yemen), or states such as South Africa that practiced *apartheid* (racial segregation).

After the first Persian Gulf War, the UN sponsored sanctions against Iraq to punish it for invading Kuwait and to compel it to stop producing weapons of mass destruction (WMD). While the use of sanctions as a tool of foreign policy has lost some popularity, the UN Security Council imposed them in the fall of 2006 against North Korea for its failure to stop producing and testing nuclear and other WMDs. These sanctions included inspections of goods coming into and out of North Korea by boat, plane, or train.

By the mid-1990s many states came to view trade sanctions as morally repugnant because of the pain they inflict on ordinary people. Many critics of trade sanctions point out that they usually do not effect any real change in a targeted state's policies.[37] Businesses and governments often can get around trade sanctions because goods produced in one country are hard to distinguish from those produced in another. It is also difficult to determine how the target state will react and adjust to an embargo or boycott. In cases such as Nicaragua in the 1980s, Iraq in the 1990s, North Korea in 2006, and most recently Iran, economic sanctions have helped generate popular support for authoritarian leaders who resist the sanctions-imposing, "imperial aggressors."

These cases demonstrate that there is more to the use of sanctions than simply using trade to punish or reward a state. When it comes to which trade sanctions to use in a given situation, tensions often reflect conflicting interests of different domestic businesses and foreign policy officials. However, many states are reluctant to use trade and other sanctions because they do not always work and often have unintended side effects. For the most part, trade remains a tool many states use to help discipline or send a distinct message to another state.

CONCLUSION

The International Production and Trade Structure in Repose

Many economic liberal objectives associated with the production and international trade structure have been achieved since World War II, resulting in a dramatic shift in production both within developed states and into less developed regions of the world. Until recently, this helped increase the volume and value of international trade. However, a number of countertrends coexist within this liberal trade order, demonstrating that its values are not shared by many developing nations and NGOs.

Through a series of multilateral negotiation rounds, the industrialized nations have pushed for the liberalization of international trade in manufactured goods and some services associated with information and communication systems. Many trade experts still contend that economic liberal trade rules that are part of the U.S.-backed globalization campaign will further integrate the global economy and help developing nations grow. And yet, in the Doha round many developing nations have resisted these policies.

From the perspective of many trade experts of all ideological stripes, what was supposed to have been a "sweetheart" deal for developing countries has become an issue of political sensitivity for the Northern industrialized states, who are reluctant to decrease protection for agriculture, textiles, and government procurement. Negotiations have been drawn out over a variety of other issues including information products, pharmaceuticals, TRIPs, and services.

Difficulties in multilateral negotiations also reflect tensions between the North and the South. The WTO's economic liberal trade regulations reflect predominantly the interests of the Northern industrialized nations. Developing countries now have increasing influence in multilateral negotiations, based on their importance to developed states as markets and sources of labor for TNCs. Antiglobalization groups and NGOs have challenged the assumed benefits of free trade and other policies associated with globalization.

One reaction by some of the more developed states to these developments has been to shift attention away from the multilateral trading system and the WTO toward more bilateral and regional trade agreements. RTAs simultaneously embrace both the principle of free trade and the practical need for protectionism, making them acceptable to both mercantilists and economic liberals. In a changed international security environment since 2001, trade has sometimes been an effective tool to achieve any number of political and economic goals.

As we will see in the next two chapters, the money and finance structure has been in dynamic flux recently, especially since the global financial crisis erupted in 2008 (see Chapters 7 and 8). For now, the production and trade structure appears to almost be in a recline position, waiting for recovery from the latest financial crisis and for new developing country coalitions to find their position in an entirely new global order. Thus, for us, the WTO members' current mixture of economic liberal, mercantilist, and sometime structuralist trade practices is best described as a **managed trade system.**

Unless the production and trade structure undergoes major reform, it may paradoxically be undermined by economic forces and policies that will only generate *more* demand for protection in the developed and developing nations. In many cases the state is relatively too weak to prevent private interests from playing the role of gatekeepers between domestic and international interests. At the same time, many states are as yet strong enough in the face of international calamities to fend off many of the forces that would weaken their power. Some fear that, much like the 1930s, trade protection will increase in the face of the global financial crisis. We anticipate that for now, the straightjacket of globalization, as Thomas Friedman likes to refer to it,[38] may be weakening the likelihood that states can be pulled into a truly integrated global production and trade network. If anything, more walls seemed to have gone up rather than come down over trade issues in the last 15 years.

KEY TERMS

production and trade structure 131
specialization 132
outsourcing 132
law of comparative advantage 135
free trade 135
Washington Consensus 135
World Trade Organization (WTO) 135
strategic trade policies 136
General Agreement on Tariffs and Trade (GATT) 139
reciprocity 139
nondiscrimination 139
Most Favored Nation (MFN) 139
nontariff barriers (NTBs) 140
Super 301 141
fair trade 141
trade-related intellectual property rights (TRIPs) 142
trade-related investment measures (TRIMs) 142
Dispute Settlement Panel (DSP) 143
regional trade agreements (RTAs) 145
intraregional trade bloc 146
Structural Adjustment Policies 147
managed trade system 153

DISCUSSION QUESTIONS

1. Discuss and explain the roles of production and trade in the international production and trade structure. Why is trade so controversial?
2. Outline the basic ways that mercantilists, economic liberals, and structuralists view trade. (Think about the tension between the politics and economics of trade.)
3. Outline and discuss some of the basic features of the GATT and WTO and issues related to the Uruguay and Doha rounds. Are you hopeful the Doha round WTO will be able to continue? Why? Why not?
4. Outline the basic features of RTAs. Do you see them as being primarily liberal or mercantilist in

nature? Explain. Of what consequence is it that officials view them as primarily one or the other?
5. Which of the three IPE approaches best accounts for the relationship of the Northern industrialized nations to the Southern developing nations when it comes to trade? Explain and discuss.
6. How have the United States and other nations used trade as a tool to achieve foreign policy objectives? Be specific and give examples. Research some other examples.

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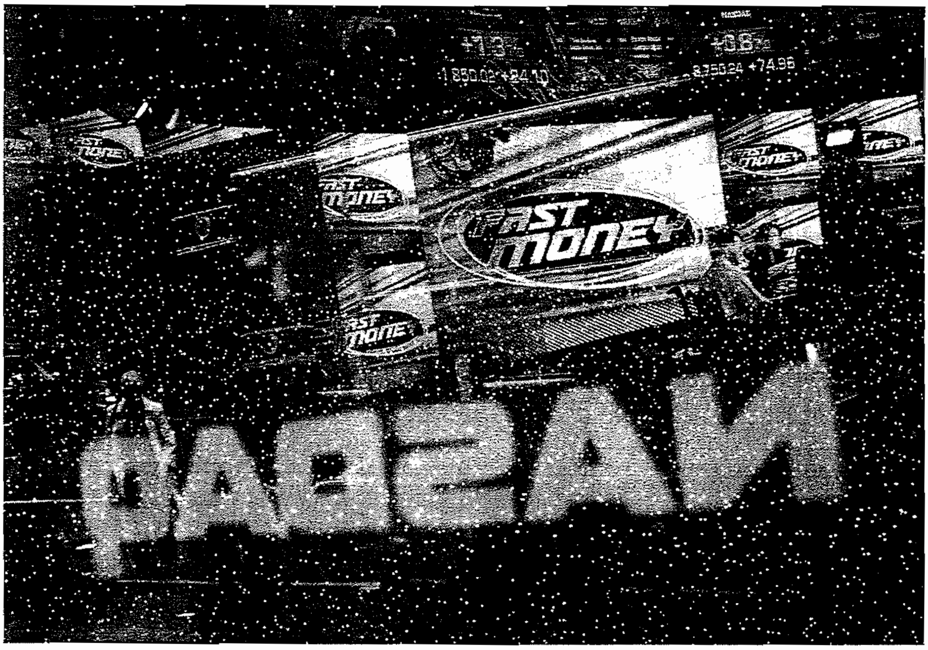
CHAPTER 7

The International Monetary and Finance Structure[1]



Life in the fast lane.

Jacob Silberberg

Since the 1990s the globalization of the international political economy has enhanced the speed and extended the reach of cross-border flows of capital. Like the other three international structures, oftentimes the monetary and finance structure is embroiled with tensions that render it difficult to manage effectively. As one expert notes, "In all modern societies, control over the issuing and management of money and credit has been a key source of power, and the subject of intense political struggles."[2]

With globalization and deregulation of the global economy since the 1980s have come increased currency exchange and transnational financial flows that influence employment, trade, and foreign direct investment, but also state programs and its security. One of the themes that stands out in this chapter is that, although economic liberal ideas called for states to deregulate their economies and cooperate with other states and IOs to open the global economy, some negative effects of globalization—including the recent global financial crisis—have compelled many states to re-regulate their societies and the monetary and finance structure.

We make six interconnected arguments in this chapter. First, after World War II the United States and its allies constructed a fairly tightly controlled international monetary and finance system that complemented their mutual goals of containing communism and gradually deregulating currency and finance markets. These measures manifested a situation where the United States could pursue "hegemony on the cheap," work toward the stabilization of Western capitalist economies, and contain communism. Second, as some of the security and economic interests of the Western alliance changed and diverged, exchange rates and capital controls were gradually allowed to reflected market conditions. The 1970s and 1980s, however, were marked by OPEC oil price hikes, increasing interdependence among states, and later globalization, along with many efforts to open up international currency and finance markets. At the same time, many states made efforts to control direct economic growth in ways that gradually weakened the international monetary and finance structure.

Third, since the end of the Cold War and pursuant to its continued hegemonic role in the international political economy, the United States has continued to run huge deficits in the current account of its balance of payments. Recently emerging economies such as China and Saudi Arabia have been investing their surplus capital into the United States and other current account deficit nations, which has enabled the United States to cover its balance-of-payments deficits. Fourth, the current financial crisis jeopardizes this U.S. strategy and continues to weaken the U.S. dollar and U.S. leadership of the current monetary and finance structure.

Fifth, the financial crisis has also severely weakened efforts by IOs, others states, and many nongovernmental organizations (NGOs) to resolve problems in debtor countries as well as help the developing nations overcome poverty. Sixth and finally, the global monetary and finance structure remains vulnerable to fluctuating market conditions, which should lead to increased state cooperation to deal with a number of problems, that if not resolved, could result in a global financial meltdown.

This chapter describes a number of fundamental elements of the international monetary and finance structure, including its institutions and who manages them, who determines its rules, how and why these rules change, and who benefits from its operation. This topic has its own specialized vocabulary. Once a student understands and appreciates the role of the basic pieces of this puzzle, it is easier to grasp other important ideas related to international political economy.

We begin the chapter by explaining the role of exchange rates in the international political economy and then move on to discuss three distinct international monetary and finance systems that have existed since the nineteenth century. We have found this history to be especially useful to students because it makes the entire topic easier to understand. In each period, we inquire into the major actors, the interplay of market forces and social interests that shape policies, and what accounts for shifts from one system to another. Inter-spliced between the first and second historical periods we explain the role of the IMF and why its primary functions have shifted over time. We also explain the balance-of-payment problem and its connection to management functions of the IMF.

The chapter moves to a discussion of the role of the U.S. dollar in the international political economy today. Some experts are concerned that confidence in the world's strongest currency has deteriorated, in part due to the financial crisis. The chapter concludes with an assessment of the management of the monetary and finance structure. This discussion is also a conduit to Chapter 8, in which we analyze in more detail short- and long-term international debt and two financial crises, including the recent global financial crisis. As is our practice throughout the book, we use parts of the three major IPE perspectives to help us understand some of the more controversial aspects of this structure.

A PRIMER ON FOREIGN EXCHANGE

Foreign or currency exchange affects the value of *everything* a nation buys or sells on international markets. It also impinges on the cost of credit and debt, and the value of foreign currencies held in national and private banks. A special vocabulary is used when discussing currency or foreign exchange. Just as people in different nations speak different languages (requiring translation to understand one another), they also do business in different currencies, requiring the exchange of money from one denomination to another. Travelers and investors are often exposed to currency exchanges when they decide how much of their national currency it will cost to buy or invest in another country. Travelers can go to a local bank, exchange kiosk, or automated teller machine (ATM); slip in their debit card; and withdraw the needed amount of local currency. The machine (representing the banks that sponsor them) automatically calculates an exchange rate. Table 7-1 is an example of foreign exchange rates at particular points in time for the amount of local currency in your possession.

No wonder exchange rates are more important to banks and investors than to travelers: Each day they are buying and selling millions of dollars, British pound sterling, yen, euros, and other currencies. A change in the value of one currency (contrast 2006 with 2009 in Table 7-1) can mean huge gains or losses depending on how much market prices for currencies have changed in the recent past or might change in the future. What concerns states the most are short- and long-terms shifts in the values of certain currencies to one another (discussed in more detail below).

Before moving on let's look at how currency exchange rates work. While most people no longer pay much attention to the math behind these transactions, it is important to learn more about the connection between foreign exchange and the money in your own bank at home. Until the advent of ATMs, most travelers quickly became accustomed to exchange-rate math used to convert one currency into

TABLE 7-1

Foreign Exchange Rates for Selected Countries, Various Dates

Country	Currency	August 2006 Currency Rate Per US$[a]	November 20, 2009, Currency Rate Per US$[b]
Argentina	Peso	NA	3.8173
Great Britain	Pound	.53	.67
EU	Euro	.78	.67
Sweden	Krona	7.1890	6.9648
Japan	Yen	115.9200	88.9650
Mexico	Mexican Peso	10.8730	13.0908
Canada	Canadian Dollar	1.1182	1.0708
China	Renminbi	7.9897	6.8258[c]
South Korea	Won	960.95	1,159.15
Russia	Rouble	26.8337[d]	29.0020
India	Indian Rupee	46.45	46.6050
South Africa	Rand	6.9503	7.5994
Malaysia	Ringgit	3.6730	3.3855
Indonesia	Rupiah	9,100[d]	9,485.00
Israel	Shekel	4.371[d]	3.8100
Brazil	Real	2.1553	1.735[c]

[a]Federal Reserve Statistical Release.
[b]*Financial Times.*
[c]UBC Sauder School of Business PACIFIC Exchange Rate Service.
[d]IMF.

another and back again. If the exchange rate was around \$1.50 per British pound sterling, as it often was in the 1990s, it follows that a £10 theater ticket in the West End of London really cost \$15 in U.S. currency (£10 at \$1.50 per £ = \$15). In the same way, that ¥1,000 caffé latte at the airport in Tokyo really cost \$10—if the yen–dollar exchange rate was ¥100 per US\$ (¥1,000 ÷ ¥100 per \$ = \$10). Before long, tourists found themselves able to perform complex mental gymnastics to convert from one money, especially the longer they visited another country.

Yet another important feature of foreign exchange is related to how hard or soft certain currencies are. **Hard currency** is money issued by large countries with reliable and predictably stable political economies. This legal tender is traded widely and has recognized value associated with the wealth and power of many industrialized developed nations, including the United States, Canada, Japan, Great Britain, Switzerland, and the Eurozone (European countries that use the Euro—see Chapter 12). A hard-currency country can generally exchange its own currency directly for other hard currencies, and therefore for foreign goods and services—giving it a distinct advantage. Therefore, a hard currency like the U.S. dollar (USD), the euro or the yen is easily accepted for international payments.

Soft currency is not as widely accepted, usually limited to its home country or region. Its value may be too uncertain or the volume of possible transactions insufficient based on an absence of trade with other countries or conditions that raise suspicions about the stability of its political economy. Many less developed countries (LDCs) have soft currencies, as their economies are relatively small and less stable than those of other countries. A soft-currency country must usually acquire hard currency (through exports or by borrowing) in order to purchase goods or services from other nations. Another problem with a soft currency is that international lenders are generally unwilling to accept payment in soft currencies. These countries need to earn hard currency to pay their debts, which tend to be denominated in hard currency. Because only hard currencies get much international use, we focus on hard currencies in this chapter.

An important point to remember is that the exchange rate is just a way of converting the value of one country's unit of measurement into another's. It does not really matter what units are used. What *does* matter is the *acceptability* of the measurement to the actors (banks, tourists, investors, and state officials in different countries) involved in a transaction at any given time, and how much values *change* over time. Shifts in exchange rates can vary over different periods of time, depending on a variety of circumstances that impact the demand for one currency or another. Any number of political and economic forces affect exchange rates. These include the following:

- currency appreciation and depreciation
- currency-rate manipulation
- whether one's currency is fixed to the value of another currency
- interest rates and inflation
- speculation.

When a currency's exchange price rises—that is, when it becomes more valuable relative to other currencies—we say that it **appreciates**. When its exchange price falls and it becomes less valuable relative to other currencies, we say it **depreciates**. For example, the USD *depreciated* relative to the European euro (EUR) between 2002 and 2003. A USD cost EUR 1.05 in June 2002, but only EUR 0.88 in July 2003. The fact that the USD *depreciated* relative to the EUR also means that the EUR *appreciated* against the USD. Or simply put, in terms of the USD, the EUR increased in price from about 95 cents to $1.13 during this period. In the case of trade, changes in the exchange rates tend to alter the competitive balance between nations, making one country's goods a better value than another.

Changes in currency values have profound political and social consequences. As currency values change, there are always winners and losers. As we saw in Chapter 6, for example, as a nation's currency appreciates, companies that export goods and services will be hurt as their products become less competitive internationally. However, importers in the same country (consumers of foreign goods and services and companies using foreign inputs in their production processes) will benefit as those imports become cheaper.

Often exchange rates are set by the market forces of supply and demand. Later in the chapter, however, we will see that there is also considerable temptation for nations to purposefully manipulate currency values so as to achieve a desirable outcome for that state. At times, states (secretly) intervene in currency markets, buying up their own currency or selling it in an attempt to alter its exchange value. A central bank will buy (demand) and sell (supply) enough of its own currency to alter the exchange rate. At other times when the demand for the country's currency declines, a central bank will use its foreign reserves to buy (demand) its own currency, pushing up the value of its currency again.

Regardless of market conditions, for many states an *undervalued currency* that discourages imports and increases exports can be politically and economically good for some domestic industries. This shifts production and international trade in that state's favor. The dark side of currency depreciation is that when goods such as food or oil must be imported, they will cost more if the currency is undervalued. Undervaluation can also reduce living standards and retard economic growth, as well as cause inflation. As we will see in the case of China (see the box "The Tangled Web of China's Currency Manipulation"), the nation appears to have benefited more than lost from keeping its currency undervalued.

Sometimes LDCs *overvalue* their currency to gain access to cheaper imported goods such as technology, arms, manufactured goods, food, and oil. This may benefit the wealthy and shift the terms of trade in their favor. Although their own exported goods would become less competitive abroad, these LDCs could at least enjoy some imported items at lower cost.

In practice, it is hard for LDCs to reap the benefits of overvaluation in any meaningful way because their currencies are usually soft and not used much in international business and finance. This does not stop them from trying, depending on political circumstances. In many cases, this invariably winds up choking domestic production and leaving the LDCs dependent on foreign sellers and lenders for help. Agriculture seems to be especially sensitive to this problem. In some cases, developing countries with overvalued currencies have unintentionally destroyed their agricultural sectors and become dependent on artificially cheap foodstuffs.

In the 1990s until the end of the decade, the value of the USD steadily climbed relative to the value of the currencies of many developing nations. While this helped the exports of the emerging nations, their consumers paid higher prices for many technological imports and value-added products. To stabilize the relationship between the USD and other currencies many countries decided to peg (fix) their currency to the dollar. China pegged the yuan at 8.28 per USD. Because the United States and the EU are major importers of Chinese goods, if the USD depreciated relative to the euro and most other world currencies, so did the yuan. While the weaker currencies gained some stability in their relationship to the USD, developments in the U.S. economy were easily transferred into the developing nations, depriving them of some flexibility in currency exchange rates.

Two other important issues are inflation and interest rates. *All else being equal*, a nation's currency tends to *depreciate* when that nation experiences a *higher inflation* rate than other countries. Inflation—a rise in overall prices—means that currency has less real purchasing power within its home country. This makes the currency less attractive to foreign buyers, and it tends to depreciate on foreign exchange markets to reflect its reduced real value at home.

Likewise, interest rates and investment returns in general influence the value and desirability of the investments that a particular currency can purchase. If *interest rates decline* in the United States, for example, as they did in the 1990s and throughout the 2000s, then the demand for dollars to purchase U.S. government bonds and other interest-earning investments decreases, pushing the dollar's exchange rate to a lower value. In the same way, higher interest rates lead to an increased demand for the dollar, as dollar-denominated investments become more attractive to foreigners.

Finally, one of the major currency and finance issues that concerned Keynes a great deal (see Chapter 2) was speculation, that is, betting that the value of a currency or market price for a certain item or service will go up and earn the owner a profit when it is sold. A currency generally rises and falls in value according to the value of goods, services, and investments that it can buy in its home market. If those who invest in currencies (speculators) believe (based on their understanding of the foreign exchange market model and anticipated changes in the various determinants of demand and supply) that a currency like the peso will appreciate in the future, they will want to buy pesos now to capitalize on the exchange rate fluctuations.

However, the increase in demand for pesos can easily raise their price as a direct result of investors speculating—predicting the value of the peso will rise because the Mexican economy is steadily growing or that it has discovered a new oil field in Baja California. This sort of speculation, which occurred in U.S. real estate most recently after 2001, can drive up the value of an item, generating a big gap (bubble) between the normal market value of the item and a new value that reflects what Alan Greenspan labeled "irrational exuberance." Most real estate agents would say that actually the higher market value is the real price, to the extent that someone is willing to buy the item at that price.

Yet, as we will see in the cases of the Asian and now the current global financial crises (see Chapter 8), bubbles can form when **hot money** (foreign investment in stocks and bonds not regulated by the state) moves quickly into a country, and bubbles can burst when investors rapidly pull their money out in anticipation that market prices will fall. While bubbles in the past caused hardship for many people, the severity of the current global financial crisis has caused many to question whether states and the IMF should not do more to regulate global capital movements.

THREE FOREIGN EXCHANGE RATE SYSTEMS

Since the nineteenth century, there have been three structures and sets of rules related to foreign exchange rates.[3] The first was the **gold standard**, a tightly integrated international order that existed until the end of World War I. The second was the Bretton Woods fixed-exchange-rate system created by the United States and its allies before the end of World War II and managed by the IMF. The current system is the "flexible" or floating exchange-rate regime. As we explore some of the basic features of these systems, we will also highlight capital mobility across national borders, an issue directly related to currency exchange.

The Classic Gold Standard: Phase I

We tend to think of the related issues of interdependence, integration, and globalization as post–Cold War phenomena, but from the end of the nineteenth century until the end of World War I, the world was supposedly even more interconnected than it is today. Cross-border flows of money increased in response to, among other things, interest rates and inflation in other countries. The leading European powers also invested heavily in their colonies. The currencies of these nations were part of a *fixed exchange-rate* system that linked currency values to the price of gold, thus the "gold standard." Similar to the EU today, some countries in specific geographic regions created "monetary unions" in which their currencies would circulate.[4]

Under the prevailing liberal economic theory of the time, the system was a *self-regulating* international monetary order. Different currency values were pegged to the price of gold. If a country experienced a balance-of-payments deficit—that is, it spent more money for trade, investments, and other items than it earned—corrections occurred almost *automatically* via wage and price adjustments. A country's gold would be sold to earn money to pay for its deficit. This resulted in tighter monetary conditions that curtailed the printing of money, raised interest rates, and cut government spending in response to a deficit. In turn, higher interest rates were supposed to attract short-term capital that would help finance the deficit. Domestic monetary and fiscal policy was "geared to the external goal of maintaining the convertibility of the national currency into gold."[5] Before World War I Great Britain's pound sterling was the world's strongest currency. And as the world's largest creditor, Great Britain loaned money to other countries to encourage trade when economic growth slowed.

The gold standard had a stabilizing, equilibrating, and confidence-building effect on the system. But by the end of the war the gold standard had died, though it was temporarily resurrected again in the early 1930s during the Great Depression. After World War I Britain became a debtor nation and the U.S. dollar took the place of the pound sterling as the world's strongest and most trusted currency. According to many hegemonic stability theorists, the gold standard folded because the United States acted more in its own interest and failed to meet the international responsibility commensurate with its economic and military power.

Another argument is that while elites were committed to economic liberal values, public policy often reflected the growing influence of labor unions, the poor, and foreign investors who often controlled monetary policy in the colonies. The extension of the electoral franchise produced more government intervention, pressuring governments to avoid the automatic policy adjustments the gold standard required in order to meet domestic needs. Some states preferred to depreciate their currencies to generate trade rather than slow the growth of their economies or cut state spending. In a move to further insulate their economies, many of them adopted capital controls (limits on how much money could move in and out of the country). Even John Maynard Keynes supported these measures, saying, "Let finance be primarily national."[6]

An important point is that many states gradually found that the "embedded" economic liberal ideas of a self-regulating economy did not work. The structuralist economic historian and anthropologist Karl Polanyi wrote that, by the end of World War I, 100 years of relative political and economic stability ended when economic liberal ideas no longer seemed appropriate given world events and conditions.[7] As the European and U.S. economies became more industrialized and interdependent (even more so than today), they had been willing to cooperate with one another in order to live under the rules of a fixed exchange-rate system. However, the negative effects of capitalism led to increased demands for more and different types of protection in various states. Many societies sought relief from a brand of capitalism that periodically failed as evidenced during the Great Depression.

The Bretton Woods System: The Qualified Gold Standard and Fixed Exchange Rates: Phase II

During the Great Depression the international monetary and finance structure was in a shambles. "Beggar thy neighbor" trade policies that put national interests ahead of international interests resulted in some of the highest trade tariffs in history. The nonconvertibility of currency was also blamed for increasing hostility among the European powers that ultimately resulted in World War II.

In July 1944 the United States and its allies met in Bretton Woods, New Hampshire, to devise a plan for European recovery and create a new postwar international monetary and trade system that would encourage growth and development. In an atmosphere of cooperation, most of the 55 participating countries wanted to overcome the high unemployment conditions of the Great Depression and the malevolent *competitive currency devaluations* of the 1930s. Keynes, Great Britain's representative, believed that unless states took coordinated action to benefit each other, their individual efforts to gain at the expense of their competitors would eventually hurt them all.

At Bretton Woods the Great Powers created the International Monetary Fund (IMF), the World Bank, and what would later become the General Agreement on Tariffs and Trade (GATT) (see Chapter 6). Many argue that these institutions were empty shells that represented only the values and policy preferences of the major powers, especially the United States.[8] The World Bank was to be concerned with economic recovery immediately after the war and then development issues. The IMF's primary role was to facilitate a stable and orderly international monetary system and investment policies. It is still the IMF's role to facilitate international trade, stabilize exchange rates, and help members with balance-of-payments difficulties on a short-term basis. However, today the IMF also attempts to prevent and resolve currency and financial crises that have recently occurred in developing countries (see Chapter 8).

Two distinct IPE perspectives give primary responsibility for the institutional design and mission of the IMF to different players. From the economic liberal perspective (see Chapter 2), John Maynard Keynes was instrumental in convincing the Allied powers to construct a new international economic order based on liberal ideas proposed at the time. Note though that the "Keynesian compromise" allowed individual nation-states to *continue* regulating domestic economic activities within their own geographic borders. In the international arena, in order to avoid another Great Depression, the IMF would collectively manage financial policies with the goal of eventually freeing up financial markets and trade. Global financial crises and collapse were to be avoided by isolating each nation's financial system and then regulating it in consideration of international conditions and developments.

At the conference Keynes himself worked on setting up the World Bank. He was committed to creating an institution that could provide generous aid to both the victors and the vanquished nations after World War II. He especially wanted to prevent a repeat of the brutal and ultimately destructive terms the winners imposed on the losers at the end of World War I. He was adamant that creditors should help debtors make adjustments in their economies. Meanwhile, U.S. Treasury official Harry Dexter White's plan for the bank was to put nearly *all* of the adjustment pressure on debtor countries, without any symmetric obligation for creditors to make sacrifices.

In the case of the IMF, White's suggestions reflected the best interests of the United States, which emerged from World War II as the world's biggest creditor nation, and with no plans to give up that role. The U.S. Congress would not have approved a treaty that forced the United States to sacrifice just because Britain or another debtor country could not pay its bills. (In fact, the United States was adamant that Great Britain honor its wartime debts once the war was over.) The IMF, then, was designed to provide *temporary* assistance to all debtor countries while they adjusted their economic structures to the emerging international economy. The burden of adjustment ultimately fell on the debtors, not on both debtors and creditors, as Keynes had intended.

Immediately after the war, many realists viewed the United States as an *emerging but reluctant* major power, unwilling to assume the hegemonic role that Great Britain had played in the nineteenth century. The United States, which had the most votes on policy decisions (based on holding 31 percent of the IMF reserves at the time), used the IMF as an indirect way to promote an orderly liberal financial system that would lead to nondiscrimination in the conversion of currencies, confidence in a new order, and eventually more liquidity. These goals complemented U.S. liberal values, beliefs, and policy preferences at little cost to the United States.

For both mercantilists and realists, the IMF's institutional structure and monetary rules also reflected the interests of the Great Powers (as they were called at the time). Under pressure from the United States, the IMF adopted a modified version of the former gold standard's *fixed-exchange-rate system* that was more open to market forces, but not divorced from politics. At the center of this modified gold standard was a fixed-exchange-rate mechanism that fixed the rate of an ounce of gold at $35. The values of other national currencies would fluctuate against the dollar as supply and demand for those currencies changed. Additionally, governments agreed to intervene in foreign exchange markets to keep the value of currencies within 1 percent above or below par value (the fixed exchange rate).

As supply and demand conditions for other currencies changed, the trading bands established by the IMF defined limits within which exchange rates could fluctuate. (Note: see Figure 7-6 on the IPE web page at www.upugetsoundintroipe.com for a representation of this arrangement). If the value of any currency increased above or fell below the band limits, central banks behind those currencies were required to step in and buy up excess dollars or sell their own currency until the currency value moved back into the trading bands limits, reestablishing a supply–demand equilibrium (par value). As in the earlier system, central banks could also buy and sell gold to help settle their accounts, which the United States often did. What officials liked about this system was that its *quasi-self-adjusting mechanism* allowed for diverse levels of growth in different national economies.

Confidence in the system relied on the fact that dollars could be converted into gold at a set price. At the end of World War II, the United States started with the largest amount of gold backing its currency. This arrangement politically and economically stabilized the monetary system, which desperately needed the members' confidence and a source of liquidity if recovery in Europe was to be realized. Once the Cold War began in 1947, the United States consciously accepted its hegemonic role of providing the collective good of security for its allies. This arrangement boosted Western European and Japanese recovery from the war and preserved an environment for trade and foreign investment in Western Europe. These policies also helped tie together the allies into a liberal-capitalist, U.S.-dominated monetary and finance system that complemented U.S. efforts to *divide* the West from the Soviet-dominated Eastern Bloc. Capital movements into and out of the communist nations were severely limited.

In this monetary arrangement, the U.S. dollar became the hegemonic currency, or top currency, one in great demand often used in international trade and financial transactions. This position afforded the United States many privileges when it came to using the dollar as a tool of foreign policy, but also imposed on it many management responsibilities. The United States benefited both economically and politically from this arrangement because, as part of the postwar recovery process, dollars were in great demand in most of Western Europe and in other parts of the world. When it came to trade and investments, other states often had to convert their currencies into U.S. dollars, which saved the United States a good deal of money on foreign exchange transactions and helped maintain the strength of the U.S. dollar against other currencies. The dollar was also the **reserve currency** that, because its international market value was fixed to gold, was held in central banks as a store of value.

THE IMF AND THE BALANCE OF PAYMENTS

At Bretton Woods the IMF was set up to create stable and responsive international financial relations, just as central banks seek to create a favorable financial climate within the borders of each country. As of July 2009, it had a membership of 184 countries, a staff of 2,716 from 165 countries, and reserves of $317 billion. As of November 2009, the IMF had made loans of $28 billion to 74 countries. The IMF director heads a board made up of 25 members from different countries who meet twice a year. Although members try to reach consensus, major policy decisions are decided on a weighted voting basis. The weight of a state's vote is related to how much it contributes to the IMF's reserves. Currently the United States has the most votes, with 17.8 percent. Japan is a distant second at 6 percent, with Great Britain and France both at 5 percent.

TABLE 7-2

Elements of Balance-of-Payments Accounts

	Current Account	Capital and Financial Account
Current account surplus examples: Japan, China	Foreign receipts for exports, receipts of investment income (interest and profit), and unilateral transfers are greater than equivalent foreign payments.	Increase in domestic ownership of foreign assets: "creditor" nation. Technically termed a capital and financial account deficit to balance the current account surplus
Current account deficit examples: United States, Mexico	Foreign payments for imports, payments of investment income (interest and profit), and unilateral transfers are greater than equivalent receipts.	Increase in foreign ownership of domestic assets: "debtor" nation. Technically termed a capital and financial account surplus to balance the current account deficit.

The balance of payments registers an accounting of all the international monetary transactions between the residents of one nation and those of other nations in a given year. It reflects what a nation produces, consumes, and buys with its money. Much like a personal check register (see Table 7-2 above), the *current account* records "deposits" or money inflows. For each nation, these deposits are derived from sales of currently produced goods and services, receipts of profits and interest from foreign investments, and unilateral transfers of money or income from other nations. This includes foreign aid a nation receives, private aid flows, and money migrants send home to friends and families. According to the IMF, these receipts *should equal* money outflows related to the purchase of goods and services from other countries, payments of profits and interest to foreign investors, and unilateral transfers to other nations.

When a state has a *current account surplus*, its receipts or earnings are greater than its "withdrawals" or expenditures, so that on net these international transactions have increased national income. However, when a nation has a *current account deficit*, outflows or withdrawals are greater than inflows or deposits in a particular year, and the net effect of these international transactions is to reduce the national income of the deficit country.

What is commonly referred to as the *balance of trade* is usually defined and analyzed separately from other items in the current account. It registers a nation's payments and receipts for the exchange of goods and services only (receipts for exports minus payments for imports). Therefore, the balance of trade only *partially* reflects a nation's current account and so provides only a glimpse of the changes in a nation's financial position. The trade balance is important because of its direct effect on employment, as a large number of jobs in most economies rely on trade.

The other IMF account—the *capital and financial account*—includes money borrowed or acquired as interest payment on an investment. These are longer-term economic transactions related to foreign investments, borrowing and lending, and sales and purchases of assets such as stocks and real estate. The capital account is an indicator of the effect of international transactions on changes in a nation's holdings of assets or wealth with respect to other countries. If there is an overage (surplus) or net inflow of money to the capital and financial account, foreigners are net purchasers of a country's assets. If there is a net outflow (deficit) of funds, the country has increased its net ownership of foreign assets.

The technical language of the balance of payments is quite confusing. It is common practice to say that a nation has a "balance-of-payments deficit." However, normally, a surplus in one account must be offset by a deficit in another—establishing an accounting balance of 0. What people usually mean by a balance-of-payments deficit or surplus is shorthand for a *current account deficit or surplus*, with payments for goods, services, and transfers exceeding the corresponding receipts.

When determining whether a nation is going into debt, state officials tend to regard the current account as being more important than the capital account. A nation with a current account deficit must either borrow funds from abroad or sell assets to foreign buyers to pay its international bills and achieve an overall payments balance. A current account deficit also requires a capital account surplus. Likewise, a current account surplus generates excess funds to purchase foreign assets. There are many political consequences of any nation's balance-of-payments status. If a state has a large foreign debt, for instance, it will need to increase output at home to generate more exports and/or decrease consumption of imports.

Economically, politically, and socially, these are not easy choices for states and their societies to make. Increasing output, for instance, might mean asking workers to accept lower wages, giving tax incentives to business firms, or removing regulatory roadblocks to more efficient production. Decreasing consumption might also involve raising consumer taxes, reducing government subsidies, cutting government programs, or increasing interest rates to discourage consumption, attract savings, and encourage foreign investment in the home economy. In these circumstances, it is easy to see why currency devaluation is so attractive to states, as it can quickly generate more exports by making goods less expensive. As we noted earlier, however, such a move is also likely to invite retaliatory "defensive" moves by other states, negating the economic gains of the first state and generating tension between states, as was the case during the interwar years.

Mexico and the United States, for example, tend to have current account deficits. The current global financial crisis highlights the extent to which the United States pays out more for imports, investment income to foreigners, and unilateral transfers for wars in Iraq and Afghanistan than it receives from exports, investment income, and international transfers. To pay such bills, Mexico and the United States are usually pressed to raise funds on the capital and financial account by increasing their foreign debt or attracting investment funds from abroad, which the United States has been doing as of late (see also Chapter 8).

Table 7-3 includes the current account surplus of different states along with the amounts of **sovereign wealth funds** (SWFs) of various economies. As we discuss later in the chapter, SWFs are income states generate from international transactions (especially oil exports) that can be used to purchase foreign assets or to pay off foreign debts incurred in the past. To finance its growing debt the United States has looked primarily to countries like China, Japan, Germany, Saudi Arabia, and other exporters with huge capital reserves earned from trade, to purchase U.S. Treasuries, property, and industries.

TABLE 7-3

Current Account Balances and Sovereign Wealth Funds

Current Account Balance[a]		Sovereign Wealth Funds[b]		
G20 Major Economies	$Bil.	Country	Total $Bil.	No. of Funds
China	+364.4 Q2	China	787.4	4
Germany	+158.0 Jul	UAE	676.5	7
Saudi Arabia	+134.0 2008	Norway	445.0	1
Japan	+114.0 Jul	Saudi Arabia	436.3	2
Russia	+55.3 Q2	Singapore	369.5	2
Republic of Korea	+34.3 Aug	Kuwait	202.8	1
Argentina	+10.4 Q2	Russia	178.5	1
Indonesia	+4.4 Q2	Hong Kong	139.7	1
Mexico	−14.0 Q2	Libya	65.0	1
South Africa	−15.8 Q2	Qatar	65.0	1
Turkey	−16.2 Jul	Australia	49.3	1
Brazil	−17.6 Aug	Algeria	47.0	1
Canada	−19.1 Q2	US	42.0	3
India	−26.6 Q2	Kazakhstan	38.0	1
Australia	−29.0 Q2	Ireland	30.6	1
United Kingdom	−50.6 Q2	Brunei	30.0	1
France	−54.0 Jul	Malaysia	28.1	2
Italy	−59.8 Jul	France	28.0	1
EU	−137.2 Jul	South Korea	27.0	1
US	−542.3 Q2	Chile	21.8	1

[a] *The Economist*, *392*(8651), September 29, 2009, pp. 121–122.
[b] Sovereign Wealth Fund Institute, November 30, 2009.

Ideally, the IMF would like to see an equilibrium in a state's balance of payments. Theoretically, nations should spend only as much as they take in. Yet, in order for businesses to expand and the economy to grow, banks lend out more than they have on deposit to back their loans. So the international economy needs a source of liquidity (assets that can be converted to cash) for new investments and production that comes when a country runs a balance-of-payments deficit, which the United States did for all but two years under the Bretton Woods monetary and finance system. A country that performs this collective good for the rest of the system is usually a hegemon, and in these circumstances it is often referred to as a "locomotive." When the hegemon's economy heats up, it helps generate growth that benefits other members of the system. On the other hand, if the United States cut its deficit by buying fewer automobiles, then Japan would probably produce fewer autos and Saudi Arabia would probably produce less petroleum. In essence, one state's falling deficit would be another's decreased surplus. Likewise, our political and economic tensions become their tensions. And as we noted in Chapter 2, the economic and political roles and responsibilities of hegemons are difficult to separate from political costs and benefits.

The Bargain Comes Unstuck

On the whole, hegemony and the provision of collective goods to U.S. allies after World War II came cheaply to the United States. During these heyday years of the Bretton Woods system from 1956–1964, the rules of the monetary and finance structure gave the United States many benefits and advantages when it came to monetary and security relations between the United States and Western Europe. The United States could spend freely for a variety of domestic programs such as the Great Society and, at the same time, fund the Vietnam War, by merely printing more money. The costs of those programs could not weaken the dollar against the value of gold, because under the rules at that time, the value of the dollar was fixed—or could not depreciate in value against gold. However, the artificially overvalued dollar also resulted in less demand for U.S. exports, which benefited Japan and Western Europe. Given that the United States was relatively less dependent on trade than Western Europe and Japan, the loss of business for the United States was a politically acceptable exchange for successfully achieving other political and economic objectives.

Because the United States was free to continue spending and running a deficit in its balance of payments, it effectively exported inflation (an oversupply of dollars) through the monetary system to its allies. As part of the arrangement Western European banks were committed to buying up surplus dollars to bring the value of their currencies back inside the trading bands (relative to par value). However, the more the United States invested in Europe and spent for the Vietnam War, the more others complained of the United States' privilege, undermining political relations between the allies. Increasingly the United States came under pressure to cut back on government spending or to sell its gold in order to repurchase surplus dollars. At one point, French President Charles DeGaulle complained that France was underwriting the Vietnam War by holding weak dollars in its banks instead of converting them to gold, which would have nearly emptied the U.S. gold reserve.

Furthermore, the Western European economies had recovered sufficiently that they no longer needed or wanted as many U.S. dollars. In the words of Benjamin Cohen, the result was that the "political bargain" made between the United States and its allies after World War II, whereby the United States managed the monetary and finance structure to the benefit of all, had become unstuck.[9] In effect, the fixed-exchange-rate system was restricting the economic growth of U.S. allies and limiting the choices of state officials in politically unacceptable ways. The *success* of the fixed-exchange-rate system was also undermining the value of the U.S. dollar, weakening many of the monetary structure's institutions and rules, and weakening U.S. leadership of the structure as well. The structure had become too rigid, making it difficult for states to grow at their own pace and to promote their own interests and values.

To prevent a recession at home, in August 1971 President Richard Nixon *unilaterally* (without consulting other states) decided to make dollars nonconvertible to gold. The United States devalued the dollar, and, to help correct its deficit in the balance of payments, it imposed a 10 percent surcharge on all Japanese imports coming into the United States. Some scholars have suggested that the United States purposefully abandoned its role as a benevolent hegemon for the sake of its own interests. Both the United States and Western Europe accused one another of not sacrificing enough to preserve the fixed-exchange-rate system. From the U.S.

perspective, Western Europe should have purchased more goods from the United States to help correct the balance-of-trade and balance-of-payments problems. On the other hand, the Europeans argued that trade was not the primary problem; instead, the United States needed to reform its own economy by cutting spending, which meant getting out of Vietnam and/or reducing domestic spending—two things that were politically unacceptable to the administration at the time.

The Float- or Flexible-Exchange-Rate System: Phase III and the Changing Economic Structure

In 1973 a new system emerged that is commonly referred to as the float- or **flexible-exchange-rate system**, or **managed float system**. The major powers authorized the IMF to further widen the trading bands so that changes in currency values could more easily be determined by market forces. Some states independently floated their currencies, while many of the countries that joined the European Economic Community (EEC) promoted regional coordination of their policies. Many states still had to deal with balance-of-payments issues, but the framework of collective management was meant to be less constraining on their economies and societies.

Several other developments contributed to the end of the fixed-exchange-rate monetary system. In the early stages of the Bretton Woods system, investment funds could *not* move easily among countries to take advantage of possible higher returns on interest or investments. Capital controls and fixed-exchange rates were manipulated to allow states to respond to domestic political forces without causing exchange-rate instability. Policy makers intentionally limited the movement of finance and capital between countries for fear that financial crises like those in the 1920s and 1930s could easily spread from one country to many others. Widespread currency convertibility (achieved by 1958), the large numbers of U.S. dollars pumped into the international economy via U.S. current account deficits, and the expansion of U.S. transnational corporation investments in Western Europe all led to pressure on state officials to bring down capital controls and to allow money to move more freely in the international economy.

By the late 1960s many officials and businesses were looking outward for new markets and investments, leading to increased private capital flows in the form of direct TNC investments, portfolio investments (such as purchases of foreign stocks by international mutual funds), commercial bank lending, and nonbank lending. Flexible-exchange rates complemented the relaxation of capital controls, which added yet another source of global liquidity to complement lending by states and loans by the IMF, the World Bank, and regional banks.

The adoption of and structure of the flexible-exchange-rate system reflected several other influential political and economic developments including: the growing influence of the Japanese and West European economies, the rise of the Organization of the Petroleum Exporting Countries (OPEC), and the shift toward a multipolar security structure (see Chapter 9). By the early 1970s Japan's rising living standards and high rates of economic growth turned Japan into a major player in international monetary and finance issues. Robert Gilpin and other realists make a strong case for the connection between the diffusion of international economic growth and wealth at the time and the emergence of a new multipolar security structure.[10] The flexible-exchange-rate system helped entrench a multipolar international security structure that would be cooperatively managed by the United States, the EU, Japan, and (later) China.

The rise of OPEC and tremendous shifts in the pattern of international financial flows after oil price increases in 1973–1974 and 1978–1979 transformed the system into a *global* financial network. Almost overnight, billions of dollars moved through previously nonexistent financial channels as OPEC states demanded dollars as payment for oil. This increased the demand for U.S. dollars in the international economy, which helped maintain the dollar's status as the top currency. Many of the OPEC "petrodollars" deposited in Western banks were recycled in the form of loans to developing countries that were viewed as good investment risks because of the increasing demand for consumer goods and natural resources (especially oil). However, between 1973 and 1979, the debt of developing nations increased from $100 billion to $600 billion, generating a debt crisis that will be discussed in more detail in Chapter 8.[11]

In the early 1980s trade imbalances in the developed countries contributed to stagflation, or slow economic growth accompanied by rising prices—two phenomena that do not usually occur together. As the oil crises subsided, the U.S. dollar weakened in value. U.S. officials focused on fighting domestic inflation by raising interest rates to tighten the money supply, which slowed down the economy and contributed to an international recession. At this time a change in political-economic philosophy occurred in Great Britain and the United States. The prevailing Keynesian orthodoxy was swept aside in favor of a return to the classical liberal ideas of Adam Smith and Milton Friedman discussed in Chapter 2.

The governments of British Prime Minister Margaret Thatcher and U.S. President Ronald Reagan privatized national industries, deregulated financial and currency exchange markets, cut taxes at home, and liberalized trade policy. Theoretically, these measures were supposed to produce increased savings and investments that would stimulate economic growth. In 1983, economic recovery did begin, especially in the United States, stimulated by higher rates of consumption, a less restrictive monetary policy, and attention to fighting inflation—all policies that mainly benefited wealthier people. However, many experts suggest that a drop in world oil prices—more than anything else—stimulated economic growth in the industrialized nations.

Despite the laissez-faire rhetoric, Reagan's defense budget was the biggest since World War II, aimed at renewing the West's effort to contain the Soviet Union and communist expansion. These expenditures and a strong dollar led to increased prices for U.S. exports and lower import prices, which resulted in record U.S. trade deficits, especially with Japan. In order to shrink the U.S. trade deficit, rather than cutting back on government spending or raising taxes, the Reagan and first Bush administrations pressured Japan and other states to adopt adjustment measures that included revaluing the yen. Many mercantilist-oriented trade officials also accused Japan, Brazil, and South Korea of not playing fair when they refused to lower their import barriers or reduce their export subsidies (see Chapter 6).

Paradoxically, much like the case of China today, this situation also *benefited* the United States to the extent that high U.S. interest rates attracted foreign investments in U.S. businesses and real estate. The Reagan version of "hegemony on the cheap"