CHAPTER ONE

The New Global Economic Order

THIS BOOK analyzes the globalization of the world economy and its real as well as its alleged implications for the international political economy. Since the end of the Cold War, globalization has been the most outstanding characteristic of international economic affairs and, to a considerable extent, of political affairs as well. Yet, as I shall argue throughout this book, although globalization had become the defining feature of the international economy at the beginning of the twenty-first century, the extent and significance of economic globalization have been greatly exaggerated and misunderstood in both public and professional discussions; globalization in fact is not nearly as extensive nor as sweeping in its consequences (negative or positive) as many contemporary observers believe. This is still a world where national policies and domestic economies are the principal determinants of economic affairs. Globalization and increasing economic interdependence among national economies are indeed very important; yet, as Vincent Cable of the Royal Institute of International Affairs has pointed out, the major economic achievement of the post–World War II era has been to restore the level of international economic integration that existed prior to World War I.[1]

My 1987 book lacked an adequate domestic dimension. It analyzed the international economy as if domestic economic developments were of only minor importance. In part, this neglect was due to my desire to help advance an autonomous, self-contained *international* political economy. The present book attempts to overcome this unfortunate weakness through a focus on what I call "national systems of political economy" and their significance for both domestic and international economic affairs. As national economies have become more and more integrated, the significance of the fundamental differences among national economies has greatly increased. The 1987 book had several other serious limitations, including its treatment of the multinational corporation, economic development, and economic regionalism; although I discussed all three of these important subjects

[1] Vincent Cable, "The Diminished Nation-State: A Study in the Loss of Economic Power," in *What Future for the State?, Daedalus* 124, no. 2 (spring 1995): 24.

at that time, much more needs to be said, especially in light of subsequent developments.

In the mid-1980s, a revolution in international economic affairs occurred as multinational firms (MNCs) and foreign direct investment (FDI) began to have a profound impact on almost every aspect of the world economy. In the 1960s and 1970s, increased international trade transformed international economic affairs. Subsequently, in the 1980s, the overseas expansion of multinational firms integrated national economies more and more completely. Moreover, whereas the term "multinational" had been synonymous with the expansion of American firms, in the 1980s firms of other nationalities joined the ranks of multinationals. Most importantly, MNCs led the way in internationalization of both services and manufacturing.

My discussion of economic development in the 1987 book has become totally outdated; scholarship at that time gave serious attention to quasi-Marxist dependency theory and the deep division between the less developed and the developed world. Today, the debate over economic development centers on the appropriate role for state and market in the development process. In the conclusion to the 1987 book, I referred to economic regionalism as the wave of the future. Today, economic regionalism has reached flood tide and is having a significant impact on the international economy. Financial developments since the mid-1980s have greatly increased the integration of the world economy and, therefore, deserve attention. This book also addresses the question of whether or not the increased importance of the market in the organization and functioning of the global economy means the end of the nation-state and of international political economy as that term is defined in this book. Those familiar with my past work will not be surprised to learn that I think not.

The principal purpose of this book is to draw upon these real-world and recent theoretical developments in order to formulate a more comprehensive understanding of international political economy than in my earlier publications. The eclectic 1987 book presented what I considered to be the three major perspectives on international political economy (IPE)—liberalism, Marxism, and nationalism; this book takes a consciously realist or state-centric approach to analysis of the international economy. Differing from many contemporary writings on the global economy, I believe that the nation-state remains the dominant actor in both domestic and international economic affairs. Believing that both economic and political analyses are necessary for an understanding of the workings of the international economy, this book integrates these distinct modes of scholarly inquiry.

Changes in the World Economy

This book has been motivated largely by the huge changes in the international economy that have occurred since 1987. The most important change, of course, has been the end of the Cold War and of the Soviet threat to the United States and its European and Japanese allies. Throughout most of the last half of the twentieth century, the Cold War and its alliance structures provided the framework within which the world economy functioned. The United States and its major allies generally subordinated potential economic conflicts to the need to maintain political and security cooperation. Emphasis on security interests and alliance cohesion provided the political glue that held the world economy together and facilitated compromises of important national differences over economic issues. With the end of the Cold War, American leadership and the close economic cooperation among the capitalist powers waned. Simultaneously, the market-oriented world grew much larger as formerly communist and Third World countries became more willing to participate in the market system; this has been exemplified by the much more active role taken by the less developed countries (LDCs) in the World Trade Organization (WTO). While this development is to be welcomed, it has made the task of managing the global economic system more daunting.

Economic globalization has entailed a few key developments in trade, finance, and foreign direct investment by multinational corporations.[2] International trade has grown more rapidly than the global economic output. In addition to the great expansion of merchandise trade (goods), trade in services (banking, information, etc.) has also significantly increased. With the decreasing cost of transportation, more and more goods are becoming “tradeables.” With the immense expansion of world trade, international competition has greatly increased. Although consumers and export sectors within individual nations benefit from increased openness, many businesses find themselves competing against foreign firms that have improved their efficiency. During the 1980s and 1990s, trade competition became even more intense as a growing number of industrializing economies in East Asia and elsewhere shifted from an import substitution to an

[2] For a strong attack on globalization and its alleged evils, see Richard Falk, *Predatory Globalization* (Oxford: Polity Press, 1999).

export-led growth strategy. Nevertheless, the major competitors for almost all American firms remain other American firms.

Underlying the expansion of global trade have been a number of developments. Since World War II, trade barriers have declined significantly due to successive rounds of trade negotiations. During the last half of the twentieth century average tariff levels of the United States and other industrialized countries dropped from about 40 percent to only 6 percent, and barriers to trade in services have also been lowered.[3] In addition, from the late 1970s onward, deregulation and privatization further opened national economies to imports. Technological advances in communications and transportation reduced costs and thus significantly encouraged trade expansion. Taking advantage of these economic and technological changes, more and more businesses have participated in international markets. Nevertheless, despite these developments, most trade takes place among the three advanced industrialized economies—the United States, Western Europe, and Japan, plus a few emerging markets in East Asia, Latin America, and elsewhere. Most of the less developed world is excluded, except as exporters of food and raw materials. It is estimated, for example, that Africa south of the Sahara accounted for only about 1 percent of total world trade in the 1990s.

Since the mid-1970s, financial deregulation and the creation of new financial instruments, such as derivatives, and technological advances in communications have contributed to a much more highly integrated international financial system. The volume of foreign exchange trading (buying and selling national currencies) in the late 1990s reached approximately $1.5 trillion per day, an eightfold increase since 1986; by contrast, the global volume of exports (goods and services) for all of 1997 was $6.6 trillion, or $25 billion per day! In addition, the amount of investment capital seeking higher returns has grown enormously; by the mid-1990s, mutual funds, pension funds and the like totaled $20 trillion, ten times the 1980 figure. Moreover, the significance of these huge investments is greatly magnified by the fact that a large portion of foreign investments is leveraged; that is, they are investments made with borrowed funds. Finally, derivatives or repackaged securities and other financial assets play an important role in international finance. Valued at $360 trillion (larger than the value of the entire global economy), they have contributed to the

[3] Gary Burtless, Robert Z. Lawrence, Robert E. Litan, and Robert J. Shapiro, *Globaphobia: Confronting Fears about Open Trade* (Washington, D.C.: Brookings Institution, 1998), 5–6.

complexity and the instability of international finance. It is obvious that international finance has a profound impact on the global economy.

This financial revolution has linked national economies much more closely to one another and increased the capital available for developing countries. As many of these financial flows are short-term, highly volatile, and speculative, international finance has become the most unstable aspect of the global capitalist economy. The immense scale, velocity, and speculative nature of financial movements across national borders have made governments more vulnerable to sudden shifts in these movements. Governments can therefore easily fall prey to currency speculators, as happened in the 1992 European financial crisis, which caused Great Britain to withdraw from the European Exchange Rate Mechanism, and in the 1994–95 punishing collapse of the Mexican peso, as well as in the devastating East Asian financial crisis in the late 1990s. Whereas, for some, financial globalization exemplifies the healthy and beneficial triumph of global capitalism, for others the international financial system is "out of control" and must be better regulated. Either way, international finance is the one area to which the term "globalization" is most appropriately applied.

The term "globalization" came into popular usage in the second half of the 1980s in connection with the huge surge of foreign direct investment (FDI) by multinational corporations. MNCs and FDI have been around for several centuries in the form of the East India Company and other "merchant adventurers." In the early postwar decades, most FDI was made by American firms, and the United States was host to only a small amount of FDI from non-American firms. Then, in the 1980s, FDI expanded significantly and much more rapidly than world trade and global economic output. In the early postwar decades, Japanese, West European, and other nationalities became major investors and the United States became both the world's largest home and host economy. As a consequence of these developments, FDI outflows from the major industrialized countries to the industrializing countries rose to approximately 15 percent annually. The largest fraction of FDI, however, goes to the industrialized countries, especially the United States and those in Western Europe. The cumulative value of FDI amounts to hundreds of billions of dollars. The greatest portion of this investment has been in services and especially in high-tech industries such as automobiles and information technology. Information, in fact, has itself become a "tradeable," and this raises such new issues in international commerce as the protection of intellectual property rights and market access for service industries. In combination with increased trade and financial flows, the increasing importance of MNCs has significantly transformed the international economy.

Although the end of the Cold War provided the necessary political condition for the creation of a truly global economy, it is economic, political, and technological developments that have been the driving force behind economic globalization. Novel technologies in transportation have caused the costs of transportation, especially transoceanic travel, to fall greatly, thus opening the possibility of a global trading system. In addition, the computer and advances in telecommunications have greatly increased global financial flows; these developments have been extremely important in enabling multinational firms to pursue global economic strategies and operations. The compression of time and space resulting from these technological changes has significantly reduced the costs of international commerce. Globalization has also been produced by international economic cooperation and new economic policies. Under American leadership, both the industrialized and industrializing economies have taken a number of initiatives to lower trade and investment barriers. Eight rounds of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT), the principal forum for trade liberalization, have significantly decreased trade barriers. In addition, more and more nations have been pursuing neoliberal economic policies such as deregulation and privatization. These developments have resulted in an increasingly market-oriented global economy.

Many observers believe that a profound shift is taking place from a state-dominated to a market-dominated international economy. Humanity, many argue, is moving rapidly toward a politically borderless world.[4] The collapse of the Soviet command economy, the failure of the Third World's import-substitution strategy, and the outstanding economic success of the American economy in the 1990s have encouraged acceptance of unrestricted markets as *the* solution to the economic ills of modern society. As deregulation and other reforms have reduced the role of the state in the economy, many believe that markets have become the most important mechanism determining both domestic and international economic and even political affairs. In a highly integrated global economy, the nation-state, according to this interpretation, has become an anachronism and is in retreat. Many also believe that the decline of the state is leading to

[4] The evolution and increasing importance of the market is the subject of John Hicks, *A Theory of Economic History* (London: Oxford University Press, 1969).

an open and truly global capitalist economy characterized by unrestricted trade, financial flows, and the international activities of multinational firms.

Although most economists and many others welcome this development, critics emphasize the "high costs" of economic globalization, including growing income inequality both among and within nations, high chronic levels of unemployment in Western Europe and elsewhere, and, most of all, environmental degradation, widespread exploitation, and the devastating consequences for national economies wrought by unregulated international financial flows. These critics charge that national societies are being integrated into a global economic system and are buffeted by economic and technological forces over which they have little or no control. They view global economic problems as proof that the costs of globalization are much greater than its benefits. Foreseeing a world characterized by intense economic conflict at both the domestic and international levels, and believing that an open world economy will inevitably produce more losers than winners, critics argue that unleashing market and other economic forces has caused an intense struggle among individual nations, economic classes, and powerful groups. Many assert that what former German chancellor Helmut Schmidt called "the struggle for the world product" could result in competing regional blocs dominated by one or another of the major economic powers.

The idea that globalization is responsible for most of the world's economic, political, and other problems is either patently false or greatly exaggerated. In fact, other factors such as technological developments and imprudent national policies are much more important than globalization as causes of many, if not most, of the problems for which globalization is held responsible. Unfortunately, misunderstandings regarding globalization and its effects have contributed to growing disillusionment with borders open to trade and investment and have led to the belief that globalization has had a very negative impact on workers, the environment, and less developed countries. According to an American poll taken in April 1999, 52 percent of the respondents had negative views regarding globalization.[5] Yet, even though globalization is an important feature of the international economy that has changed many aspects of the subject of international political economy, the fact is that globalization is not as perva-

[5] Andrew Kohut, "Globalization and the Wage Gap," *New York Times*, 3 December 1999, sec. 1, reporting on a Pew Research Center's national survey in April 1999, which found that 52 percent of all respondents were negative toward globalization. Low-income families were much more negative than wealthier ones.

sive, extensive, or significant as many would have us believe. Most national economies are still mainly self-contained rather than globalized; globalization is also restricted to a limited, albeit rapidly increasing, number of economic sectors. Moreover, globalization is largely restricted to the triad of industrialized countries—the United States, Western Europe, and, to a much lesser extent, Japan—and to the emerging markets of East Asia. Most importantly, many of the attacks on globalization by its critics are misplaced; many, if not most, of its "evils" are really due to changes that have little or nothing to do with globalization.

The end of the Cold War and the growth of economic globalization coincided with a new industrial revolution based on the computer and the rise of the information or Internet economy. Technological developments are transforming almost every aspect of economic, political, and social affairs as computing power provides an impetus to the world economy that may prove as significant as those previously produced by steam power, electric power, and oil power. The economics profession, however, has been deeply divided about whether or not computing power represents a technological revolution on the same scale as these earlier advances. Although the computer appears to have accelerated the rate of economic and productivity growth, it is still too early to know whether or not its ultimate impact will affect the overall economy on a scale at all equivalent to that produced by the dynamo. A growing number of economists, however, believe that computers have an important impact not only on productivity but also on economic affairs in general. For example, some economists believe that the organization of and the ways in which national economies function are experiencing major changes in response to the computer and the Internet. Although it is still much too early to gauge the full impact of the computer on the economy, it is certain that the computer and the information economy are significantly changing many aspects of economic affairs. Most importantly, in the industrialized countries, they have accelerated the shift from manufacturing to services (financial, software, retailing, etc.). This pervasive economic restructuring of the industrialized economies is economically costly and politically difficult.

During the last decades of the twentieth century, there was a significant shift in the distribution of world industry away from the older industrial economies—the United States, Western Europe, and Japan—toward Pacific Asia, Latin America, and other rapidly industrializing economies. Although the United States and the other industrialized economies still possess a preponderant share of global wealth and industry, they have declined in relative (not absolute) terms, while the industrializing economies, especially China, have gained economic importance. Before the 1997 financial crisis, which began in Thailand and eventually plunged East Asia into political and economic turmoil, Pacific Asia's economic success had been extremely impressive; many of these economies achieved average annual growth rates of 6 to 8 percent. And despite the financial crisis, such economic "fundamentals" as high savings rates and excellent workforces support the belief that these emerging markets will continue to be important actors in the global economy.

Economic regionalism has spread in response to these political, economic, and technological developments. Compared to the earlier regional movement of the 1950s and 1960s (the European Economic Community is the only surviving example of that movement), the new regionalism has much greater significance for the global economy. The movement at the beginning of the twenty-first century is nearly universal; the major economies, with a few exceptions that include China, Japan, and Russia, are members of a formal regional arrangement. Regionalism at the turn of the twenty-first century entails increased regionalization of foreign investment, production, and other economic activities. Although there is no single explanation for this development, every regional arrangement represents cooperative efforts of individual states to promote both their national and their collective economic and political objectives. Economic regionalism is an important response by nation-states to shared political problems and to a highly interdependent, competitive global economy. As the international economy has become more closely integrated, regional groupings of states have increased their cooperation in order to strengthen their autonomy, improve their bargaining positions, and promote other political/economic objectives. Regionalization is not an alternative to the nation-state, as some believe, but rather embodies the efforts of individual states to collectively promote their vital national interests and ambitions.

These developments have made the governance of the global economy a pressing issue. Effective and legitimate governance requires agreement on the purpose of the international economy. During the Cold War, the purpose of the world economy was primarily to strengthen the economies of the anti-Soviet alliance and solidify the political unity of the United States and its allies; this goal frequently necessitated acceptance of trade discrimination and other illiberal policies. Today, many Americans and others assert that the purpose of governance should be to promote unrestricted free and open markets. The global economy and the rules governing it, they believe, should be guided by the policy prescriptions of neoclassical economics and be based on market principles. Free trade, freedom of capital movements, and unrestricted access by multinational firms to markets around the globe should be the goals of international governance. With the triumph of the market, economic logic and the relative efficiencies of national economies should determine the distribution of economic activities and wealth (and, of course, of power) around the world. Critics of globalization, on the other hand, challenge this emphasis on the importance of free trade and open markets.

Despite the growing importance of the market, historical experience indicates that the purpose of economic activities is ultimately determined not only by markets and the prescriptions of technical economics, but also (either explicitly or implicitly) by the norms, values, and interests of the social and political systems in which economic activities are embedded. Although economic factors will play an important role in determining the character of the global economy, political factors will be of equal, and perhaps greater, importance. The nature of the global economy will be strongly affected by the security and political interests of, and the relations among, the dominant economic powers, including the United States, Western Europe, Japan, China, and Russia. It is highly unlikely that these powers will leave the distribution of the global economic product and the impact of economic forces on their national interests entirely up to the market. Both economic efficiency and national ambitions are driving forces in the global economy of the twenty-first century.

In this book, I have taken a "political economy" approach that integrates economic and political analysis with other modes of scholarly analysis. Formal economic theories provide indispensable tools, facilitating comprehension of economic developments; the conventional theory of international trade, newly gained insights from the theory of industrial organization, and other theoretical developments in economic science provide important additional ideas. However, economic theories alone are not sufficient for an understanding of developments and their significance for economic and political affairs. One must also draw upon ideas and insights from history, political science, and the other social sciences. In brief, a true "political economy" is prerequisite to an improved comprehension of the implications of new developments for international (and, where relevant, domestic) economic affairs.

The intensity and importance of the debate over the nature of the changing world economy makes one aware of a troubling paradox. At the same time that economic issues have moved to the center of national concerns, the discipline of economics itself has become increasingly remote from the realities of public affairs. Over decades the increasing emphasis of the economics profession on abstract models and mathematical theories made economics less and less relevant to public discourse and inaccessible not only to the larger public but also to academic colleagues. This is especially unfortunate because economics, despite its frequently esoteric nature, is or at least should be at the heart of public discourse. The problem is particularly troubling because the intellectual vacuum left by economists is too frequently filled by individuals who misunderstand economics or deliberately misuse the findings of economics in their promotion of one panacea or another to solve the problems of both domestic and international economies.

Intellectual Perspectives

In 1987, I identified three ideologies or perspectives regarding the nature and functioning of the international economy: liberalism, Marxism, and nationalism. Since the mid-1980s, the relevance of these perspectives has changed dramatically. With the end of both communism and the "import-substitution" strategies of many less developed countries (LDCs), the relevance of Marxism greatly declined, and liberalism, at least for the moment, has experienced a considerable growth in influence. Around the world, more and more countries are accepting liberal principles as they open their economies to imports and foreign investment, scale down the role of the state in the economy, and shift to export-led growth strategies. Marxism as a doctrine of how to manage an economy has been thoroughly discredited, so that only a few impoverished countries such as Fidel Castro's Cuba and Kim Jong Il's North Korea cling to this once strong faith. Yet, Marxism survives as an analytic tool and a critique of capitalism, and it will continue to survive as long as those flaws of the capitalist system emphasized by Marx and his followers remain: the "boom and bust" cycle of capitalist evolution, widespread poverty side by side with great wealth, and the intense rivalries of capitalist economies over market share. Whether under the guise of Marxism itself or some other label, concerns over these problems will surface in discussions of the world economy.[6]

[6] An example is William Greider, *One World, Ready or Not: The Manic Logic of Global Capitalism* (New York: Simon and Schuster, 1997). Although Greider is not a Marxist, his book raises the specter of what Marxists call the "underconsumption" or "glut" theory of capitalist crisis; that is, the contradiction between the capacity of capitalism to produce goods and the inability of workers to purchase these goods.

One criticism of my 1987 book was that I did not adequately state my own intellectual position: Was I a liberal, a Marxist, or a nationalist? The short answer is "none of the above." However, before giving my longer answer, I must comment on the three perspectives and on a weakness in my 1987 book. I failed to make clear that each of these perspectives is composed of both analytic and normative elements. Economic liberalism, for example, is not only an analytic tool based on the theories and assumptions of neoclassical economics, but it is also a normative commitment to a market or capitalist economy. As I mentioned, Karl Marx himself accepted the basic analytical ideas of the liberal economics of his time, but he despised capitalism—a term he coined—and asked questions that he considered more fundamental than those asked by earlier nineteenth-century classical economists: questions about the origins of the capitalist system, the laws governing its evolution, and its ultimate destiny. As Joseph Schumpeter has emphasized, whereas economists are interested in the day-to-day functioning of the capitalist system, Marx and Schumpeter himself were interested in the long-term dynamics of the capitalist system.

Nationalism or, more specifically, economic nationalism, is also composed of both analytic and normative elements. Its analytic core recognizes the anarchic nature of international affairs, the primacy of the state and its interests in international affairs, and the importance of power in interstate relations. However, nationalism is also a normative commitment to the nation-state, state-building, and the moral superiority of one's own state over all other states. Although I accept "economic nationalism," or what I below call a "state-centric" approach, as an analytic perspective, I do not subscribe to the normative commitment and policy prescriptions associated with economic nationalism. My own normative commitment is to economic liberalism; that is, to free trade and minimal barriers to the flow of goods, services, and capital across national boundaries, although, under certain restricted circumstances, nationalist policies such as trade protection and industrial policy may be justified.

In retrospect, I should have distinguished clearly between economic nationalism as a normative position and political realism as an analytic perspective. Or, to put the matter another way, while all nationalists are realists in their emphasis on the crucial role of the state, security interests, and power in international affairs, not all realists are nationalists in their normative views regarding international affairs. Therefore, in this book I employ the broader term "realism" or, more specifically, "state-centric realism" to characterize my approach to analysis of the international political economy. But even the very term "realism" requires further elaboration.

My Perspective: State-centric Realism

Realism is a philosophical position and an analytic perspective; it is not necessarily a moral commitment to the nation-state. Many realists, in fact, lament a world in which the nation-state is not adequately restrained by international rules and moral considerations. Nor is realism a scientific theory. As a philosophic or intellectual perspective, realism is not subject to the Popperian criterion of falsifiability and, like other philosophic positions such as liberalism and Marxism, realism can neither be proved nor disproved by empirical research.[7] However, international relations scholarship in the realist tradition has led to a number of theories or hypotheses such as the theories of the balance of power and hegemonic stability that can be and have been subjected to empirical testing to determine their validity.

Several years ago, I was asked if there was a difference between realism and nationalism. The question startled me, as I had always thought that any reader of Hans Morgenthau, Hedley Bull, and other prominent realist writers would be fully aware that while these scholars were realists in their analysis of international affairs and their sober expectations regarding human possibilities, they were by no means nationalists. The realist diagnosing the illnesses of the human condition is not endorsing what he or she sees any more than a physician endorses the cancer found in a patient. Morgenthau's writings, in fact, attacked unbridled nationalism and, in *Politics Among Nations* (1972), he set forth rules for diplomatic behavior that could assist nations to live in peace with one another at the same time that they safeguarded their national interests. As critics charge, Morgenthau may have been naive in believing that it was possible to prescribe moral and diplomatic principles based on his own realist assumptions. The point, however, for Morgenthau and other realists (myself included), is that realism and nationalism are not identical. Nationalists may be realists, but realists are not necessarily nationalists.

Although realists recognize the central role of the state, security, and power in international affairs, they do not necessarily approve of this situation. The teacher who first introduced me to realism as an

[7] According to the philosopher of science Karl Popper, if an idea or hypothesis, etc., cannot be refuted, at least in principle, it is not a "scientific" statement.

analytic perspective, Professor George Little of the University of Vermont, was a Quaker pacifist; yet, when I was an undergraduate, Little once chided me for my naive and unrealistic views on a particular development in international politics. Martin Wight, the author of one of the most important tracts on realism in this century, *Power Politics* (1986), was also a Christian pacifist.[8] Even Hans Morgenthau in his influential *Politics Among Nations*, having Adolf Hitler in mind, condemned "universal nationalism," that is, imperialistic behavior, as immoral. One of his basic messages was that states should try to respect the interests of other states.[9] It is possible, I believe, to analyze international economic affairs from a realist perspective and at the same time to have a normative commitment to certain ideals.

As Michael Doyle reminds us in his *Ways of War and Peace* (1997), there are many varieties of realist thought.[10] Yet all realists share a few fundamental ideas such as the anarchic nature of the international system and the primacy of the state in international affairs. However, one should distinguish between two major realist interpretations of international affairs, that is, between state-centric and system-centric realism. State-centric realism is the traditional form of realism associated with Thucydides, Machiavelli, and Morgenthau, as well as many others; it emphasizes the state (city, imperial, or nation-state) as the principal actor in international affairs and the fact that there is no authority superior to these sovereign political units; this position asserts that analysis should focus on the behavior of individual states. Systemic realism, or what is sometimes called structural realism or neorealism, is a more recent version of realist thought and is primarily associated with Kenneth Waltz's innovative and influential *Theory of International Politics* (1979).[11] In contrast to state-centric realism's emphasis on the state and state interest, Waltz's systemic version emphasizes the distribution of power among states within an international system as the principal determinant of state behavior.

The state-centric realist interpretation of international affairs makes several basic assumptions regarding the nature of international

[8] Wight's essay can be found in the collection of his writings edited by Hedley Bull and Carsten Holbraad, *Power Politics* (Harmondsworth, England: Penguin Books, 1986).

[9] Hans J. Morgenthau, *Politics Among Nations* (New York: Knopf, 1972).

[10] Michael W. Doyle, *Ways of War and Peace: Realism, Liberalism, and Socialism* (New York: W. W. Norton, 1997).

[11] Kenneth N. Waltz, *Theory of International Politics* (Reading, Mass.: Addison-Wesley, 1979).

affairs. Because it assumes that the international system is anarchic, this interpretation views the state, in the absence of a higher authority, as the principal actor in international affairs. The existence of anarchy, however, does not mean that international politics is characterized by a constant and universal Hobbesian war of one against all; states obviously do cooperate with one another and do create institutions in many areas.[12] Anarchy means rather that there is no higher authority to which a state can appeal for succor in times of trouble. In addition, although the state is the primary actor in international affairs, realism should acknowledge the importance of such nonstate actors as multinational firms, international institutions, and nongovernmental organizations (NGOs) in the determination of international affairs. Realism, however, insists that the state remain the principal actor.

The central concerns of the state are its national interests as defined in terms of military security and political independence; however, state-centric realism does not reject the importance of moral and value considerations in determining behavior. While it follows that power and power relations play the major roles in international affairs, power can assume the form of military, economic, and even psychological relationships among states, as E. H. Carr has pointed out. Moreover, despite this emphasis on power, other factors such as ideas, values, and norms do play an important role in interstate affairs.[13] The criticism, for example, that all realists are unaware of the role of ideas or intellectual constructs in international affairs is patently false. As Morgenthau argued in his classic *Scientific Man vs. Power Politics* (1946), the liberal beliefs of the Western democracies made them incapable of recognizing and being able to react decisively to the threat of fascism in the 1930s. Recognizing the importance of ideas, Morgenthau warned that it was dangerously unwise to place one's faith solely in the power of ideals.[14]

In this book I define "global political economy" as the interaction of the market and such powerful actors as states, multinational firms,

[12] An important critique of the realist emphasis on anarchy is Alexander Wendt, "Anarchy Is What States Make of It: The Social Construction of Power Politics," *International Politics* 46, no. 2 (spring 1992): 391–425.

[13] On the role of ideas or "epistemic communities" in international affairs, consult Peter M. Haas, ed., "Knowledge, Power, and International Policy Coordination," *International Organization* 46, no. 1 (special issue; winter 1992). See also E. H. Carr, *The Twenty Years' Crisis, 1919–1939*, 2d ed. (London: Macmillan, 1951).

[14] Hans J. Morgenthau, *Scientific Man vs. Power Politics* (Chicago: University of Chicago Press, 1946).

and international organizations, a more comprehensive definition than in my 1987 book, *The Political Economy of International Relations,* although both take a state-centric approach to the subject.[15] While I do assume that the territorial state continues to be the primary actor in both domestic and international economic affairs, I do not contend that the state is the *only* important actor. Other significant players include the World Bank, the International Monetary Fund (IMF), and the Commission of the European Union. Despite the importance of these other actors, however, I emphasize that national governments still make the primary decisions regarding economic matters; they continue to set the rules within which other actors function, and they use their considerable power to influence economic outcomes. The major political players, namely Germany, France, and the United Kingdom, are central in even such a highly integrated international institution as the European Union. Whatever the ultimate shape of the European Union, national governments will continue to be important actors within this regional arrangement.

My interpretation of international political economy assumes that the interests and policies of states are determined by the governing political elite, the pressures of powerful groups within a national society, and the nature of the "national system of political economy." As I argued in *War and Change in World Politics* (1981), the economic/foreign policies of a society reflect the nation's national interest as defined by the dominant elite of that society.[16] As conceptualists correctly argue, there is a subjective element in an elite's definition of the national interest. However, objective factors such as the geographic location of a society and the physical requirements of the economy are of great importance in determining the national interest. Only objective factors, for example, can explain why Great Britain's foremost national interest for approximately four hundred years was to prevent the occupation of the lowlands (Belgium and the Netherlands) by a hostile power. Clearly, British behavior and the numerous wars England fought to keep these lands out of unfriendly hands suggest that the English nation under many different rulers and political regimes possessed interests that transcended the more narrowly defined interests of the governing elite of the moment.

My state-centric position assumes that national security is and always will be the principal concern of states. In a "self-help" interna-

[15] Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987).

[16] Robert Gilpin, *War and Change in World Politics* (New York: Cambridge University Press, 1981), 18–19.

tional system, to use Kenneth Waltz's apt expression, states must constantly guard against actual or potential threats to their political and economic independence. Concern with security means that power—military, economic, and/or psychological—will be vitally important in international affairs; states must be continually attentive to changes in power relations and the consequences for their own national interests of shifts in the international balance of power. Although, as Richard Rosecrance correctly argues, the "trading state" has become a much more prominent feature of international affairs, it is important to recognize that successful development of the international economy since 1945 has been made possible by the security system provided by the alliances between the United States and its allies in Europe and Asia. Trading states like Japan and (West) Germany emerged and grew while protected by American military power; moreover, toward the end of the twentieth century they established and began to maintain an independent military option.[17] Indeed, these trading states now possess substantial defensive military forces and defense industries as an insurance policy; even Japan, with its "peace" constitution, has become one of the world's foremost military powers.

One of the most important contemporary critiques of realism is "constructivism."[18] According to this increasingly influential position, international politics is "socially constructed" rather than constituting an objective reality. As defined by Alexander Wendt, the two basic tenets of constructivism are that (1) human structures are determined mainly by shared ideas rather than material forces, and (2) the identities and interests of human beings are constructed or are the product of these shared ideas rather than being products of nature. If valid, these ideas undermine not only realism, Marxism, and liberalism but also neoclassical economics and much of political science. Although constructivism is an important corrective to some strands of realism and the individualist rational-choice methodology of neoclassical economics, the implicit assumption of constructivism that we should abandon our knowledge of international politics and start

[17] Richard N. Rosecrance, *The Rise of the Trading State: Commerce and Conquest in the Modern World* (New York: Basic Books, 1986); Rosecrance, *The Rise of the Virtual State: Wealth and Power in the Coming Century* (New York: Basic Books, 1999).

[18] Alexander Wendt, *Social Theory of International Politics* (New York: Columbia University Press, 1999); and Peter. J. Katzenstein, ed., *The Culture of National Security: Norms and Identity in World Politics* (New York: Columbia University Press, 1996).

afresh from a tabula rasa wiped clean by constructivism is not compelling.

Constructivism's principal critique of realism is that realism is purely materialistic and analyzes the political world only in terms of technological forces, physical circumstances, and other objective factors; realists are said to be overly deterministic and to portray a political world over which human beings have no control (or "agency"). Constructivism, on the other hand, is said to emphasize the role of ideas, social structures, and human volition in political affairs; people can construct a better political and more humane universe than that described by realists. Although I cannot do justice in several paragraphs to these ideas, several comments are in order. Constructivism makes too great a distinction between realism, at least as I use the term in this book, and constructivism with respect to the role of ideas, ideology, and constructs. Classical realists from Thucydides forward have emphasized the role of ideas and "identity" in political affairs. What better example than the powerful idea of nationalism and the importance of national identity that have been staples of realist thought since Machiavelli and Hobbes! While constructivists are right in stressing the importance of shared ideas and the social construction of the world, it is not clear how far they are willing to take this position. Ideas are obviously important, but the world is composed of many economic, technological, and other powerful constraints that limit the wisdom and practicality of certain ideas and social constructions. Any theory that seeks to understand the world must, as do liberalism, Marxism, and realism, seek to integrate both ideas and material forces.

One of the key ideas in constructivist analysis of international affairs is the idea of identity, or how a society defines itself; for example, whether a society is democratic or authoritarian in nature affects its behavior. According to constructivists, realists neglect the importance of identity and focus only on material interests and power considerations. In some cases, this criticism is valid. In general, realists do stress "interest" over "identity." However, many state-centric realists recognize the importance of identity in state behavior; for example, the nature of the domestic political system. As I have already mentioned, I myself emphasize the importance of the national system of political economy in determining the economic behavior of individual states. Whether a national society defines itself as a stakeholder (e.g., Germany or Japan) or a shareholder (Great Britain or the United States) economy, the type of economy has a significant impact on its economic behavior.

Political and economic identities or ideologies can have a strong influence on national behavior. Certainly, one can not explain the Cold War without reference to the ideological conflict between the democratic-capitalist identity of the United States and the totalitarian-communist identity of the Soviet Union. In fact, George Kennan, a realist to the core, based his "containment" doctrine on the authoritarian identity of the Soviet state.[19] In time, Kennan correctly predicted, the policy of containment would transform this identity and hence the behavior of the Soviet state. Morgenthau also emphasized the importance of identity. The theme of *Scientific Man versus Power Politics* was that liberal democratic societies exhibited moral failure when they did not recognize the evil nature (identity) of Nazi Germany in the 1930s.[20] The sociopolitical nature of a society, the national ideology, and the political identity all contribute to a society's definition of its interests and influence its behavior. Realists disagree, however, with the constructivist's position that identity is the most important or the only determinant of a nation's foreign policy.

The state-centric interpretation of international political economy (IPE) rejects a belief popular among many scholars, public officials, and commentators that economic and technological forces have eclipsed the nation-state and are creating a global world economy in which political boundaries and national governments are no longer important.[21] It is certainly true that economic and technological forces are profoundly reshaping international affairs and influencing the behavior of states. However, in a highly integrated global economy, states continue to use their power and to implement policies to channel economic forces in ways favorable to their own national interests and the interests of their citizenry. These national economic interests include receipt of a favorable share of the gains from international economic activities and preservation of national autonomy. Movement toward such regional arrangements as the European Union (EU) and the North American Free Trade Agreement (NAFTA) exemplifies collective national efforts to reach these goals.

Many commentators correctly point out that the nation-state in the last quarter of the twentieth century increasingly came under attack from within and from without; both transnational economic forces

[19] For Kennan's views, see John Lewis Gaddis, *Strategies of Containment: A Critical Appraisal of Postwar American National Security Policy* (New York: Oxford University Press, 1982).

[20] Morgenthau, *Scientific Man vs. Power Politics*.

[21] For an early expression of this "end of the state" thesis, see Edward Hallett Carr, *Nationalism and After* (London: Macmillan, 1945).

and ethnic nationalisms were tearing at the economic and political foundations of the nation-state. Yet the nation-state remains of supreme importance even though there is no certainty that it will exist forever. Like every human institution, the nation-state was created to meet specific needs. The state arose at a particular moment in order to provide economic and political security and to achieve other desired goals; in return, citizens gave the nation-state their loyalty. When the nation-state ceases to meet the needs of its citizens, the latter will withdraw their loyalty and the modern state will disappear as did the feudal kingdoms, imperial systems, and city-states that it displaced. However, there is no convincing evidence that such a transformation in human affairs has yet occurred. On the contrary, the world is witnessing a rapid increase in the number of nation-states accompanied by creation of powerful military forces.[22] Moreover, if and when the nation-state does disappear, it will be displaced by some new form of formal political authority.

Economic issues certainly have become much more important since the end of the Cold War and have displaced, for the United States and its allies, the prior overwhelming concern with military security. It is misleading, however, to draw too sharp a distinction between international economic and security affairs. While the weight placed on one or the other varies over time, the two spheres are intimately joined, always have been, and undoubtedly always will be. Although the two policy areas can be distinguished analytically, it is extremely difficult to isolate them in the real world. Their intimate connection was set forth initially by Jacob Viner in his classic "Power versus Plenty as Objectives of Foreign Policy in the Seventeenth and Eighteenth Century."[23]

As the British economist Ralph Hawtrey demonstrated in his important *Economic Aspects of Sovereignty* (1952), the relationship of economic affairs and national security, at least over the long term, is

[22] In 1945, there were about 50 states in the UN. At the end of the century there were nearly 200. They all seek to possess the accoutrements of nationhood: currency, airlines, and national armies. Obviously, statehood is attractive.

[23] Jacob Viner, "Power versus Plenty as Objectives of Foreign Policy in the Seventeenth and Eighteenth Centuries," in Jacob Viner, *The Long View and the Short: Studies in Economic Theory and Practice* (Glencoe, Ill.: Free Press, 1958). More recent writings on economics and security are discussed in Michael Mastanduno, "Economics and Security in Statecraft and Scholarship," *International Organization* 52, no. 4 (autumn 1998).

reciprocal.[24] The international political and security system provides the essential framework within which the international economy functions; domestic and international economies generate the wealth that is the foundation of the international political system. Then, over time, the economic base of the international political system shifts according to "the law of uneven growth";[25] the resulting transformation of the international balance of power causes states to redefine their national interests and foreign policies. Such political changes frequently undermine the stability of the international economic/political system and can even lead to international conflict.

The ways in which the world economy functions are determined by both markets and the policies of nation-states, especially those of powerful states; markets and economic forces alone cannot account for the structure and functioning of the global economy. The interactions of the political ambitions and rivalries of states, including their cooperative efforts, create the framework of political relations within which markets and economic forces operate. States, particularly large states, establish the rules that individual entrepreneurs and multinational firms must follow, and these rules generally reflect the political and economic interests of dominant states and their citizens. However, economic and technological forces also shape the policies and interests of individual states and the political relations among states, and the market is indeed a potent force in the determination of economic and political affairs. The relationship of economics and politics is interactive.

Purpose of Economic Activity

Most economists, trained in the discipline of neoclassical economics, believe that the purpose of economic activity is to benefit individual consumers and maximize efficient utilization of the earth's scarce resources. While other values and goals may be important, they are not of fundamental concern to economists qua economists. The basic task of economists is to instruct society on how markets function in the

[24] Ralph G. Hawtrey, *Economic Aspects of Sovereignty* (London: Longmans, Green, 1952). Hawtrey's book is still one of the very best ever written on the subject of economics and national security. A more recent and excellent discussion of the relationship of power and plenty is Theodore H. Moran, "Grand Strategy: The Pursuit of Power and Plenty," *International Organization* 50, no. 1 (winter 1996): 176–205.

[25] Gilpin, *War and Change in World Politics*, 94.

production of wealth and how these markets can be made most efficient. How societies then choose to distribute that wealth among alternative ends is a moral and political matter lying outside the realm of economic science.

In the study of political economy, however, the purpose of economic activity is a fundamental issue: Is the purpose of economic activity to benefit individual consumers, to promote certain social welfare goals, or to maximize national power? The question of purpose is at the core of political economy, and the answer is a political matter that society must determine. The purpose that a particular society (domestic or international) chooses to pursue in turn determines the role of the market mechanism in the economy. Whether a society decides that the market or some other mechanism should be the principal means to determine the allocation of productive resources and the distribution of the national product is a political matter of the utmost importance. The social or political purpose of economic activities and the economic means to achieve these goals cannot be separated. In every society, the goals of economic activities and the role of markets in achieving those goals are determined by political processes and ultimately are responsibilities delegated by society to the state. Yet, the market has its own logic, and its dictates must be heeded; as economists are fond of reminding us, every benefit has a cost and in a world of scarcity, painful choices must be made. Therefore, the market and economic factors do impose limits on what states can achieve.

Conclusion

The functioning of the world economy is determined by both markets and the policies of nation-states. The political purposes, rivalries, and cooperation of states interact to create the framework of political relations within which economic forces operate. States set the rules that individual entrepreneurs and multinational firms must follow. Yet, economic and technological forces shape the policies and interests of individual states and the political relations among states. The market is indeed a potent force in determination of economic and political affairs. For this reason, both political and economic analyses are required to understand the actual functioning and evolution of the global economy. A comprehensive analysis necessitates intellectual integration of both states and markets.