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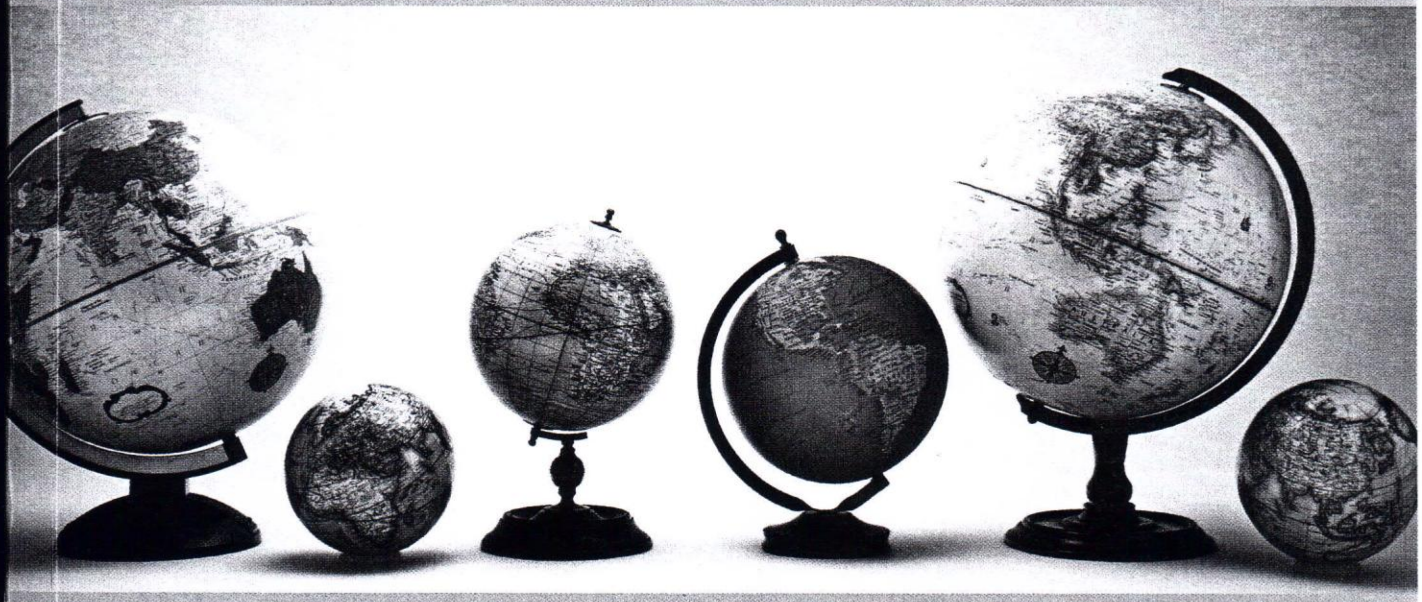

John Ravenhill

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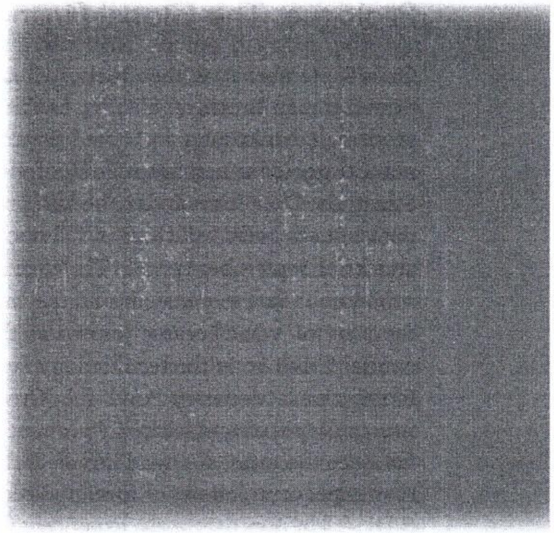
The Study of Global Political Economy

John Ravenhill



Chapter contents

Reader's guide

The contemporary international economic system is more closely integrated than in any previous era. The global financial crisis that began in 2008 provides a clear illustration of the relationship between trade, finance, international institutions, and the difficulties that governments face in coping with the problems generated by complex interdependence.

Before 1945, the spectacular increase in economic integration that had occurred over the previous century was not accompanied by institutionalized governmental collaboration on economic matters. International trade patterns also changed very little over several centuries before 1945. The end of the Second World War marked a significant disjunction: global economic institutions were created, the transnational corporation emerged as a major actor in international economic relations, and patterns of international trade began to change markedly from the traditional North–South exchange of manufactures for raw materials.

Since the emergence of global political economy (GPE) as a major subfield of the study of international relations in the early 1970s, GPE scholars have generated an enormous literature that has been the product of the employment of a wide variety of theories and methods. Most introductions to the study of GPE have divided the theoretical approaches to the subject into three categories: liberalism, nationalism, and Marxism. This threefold typology is of limited utility today, given the overlap between many of the approaches classified in different categories, and the wealth of theories and methodologies applied in the contemporary study of global political economy.

Prologue: The Global Financial Crisis

On 15 September 2008, the American financial services firm, Lehman Brothers, filed for bankruptcy, the largest single bankruptcy in United States history. The news triggered a massive sell-off of shares on Wall Street, the Dow Jones Index shedding more than 500 points (4.4 per cent), the biggest fall since the terrorist attacks of September 11, 2001. The effects of the bankruptcy soon reverberated around the world, marking the start of what became known as the Global Financial Crisis or, in the terminology favoured by the International Monetary Fund, the 'Great Recession'. In 2009, world output fell by 0.8 per cent, the first such fall since the 1930s; and world trade declined by more than 12 per cent. Inflows of **foreign direct investment (FDI)** fell by approximately 40 per cent in 2009.

The fall in global output masked substantial differences in national and regional performance: the industrialized economies were among the worst hit, with output in the European Union (EU) falling by 4 per cent and that in the United States by 3.2 per cent. Among the less developed economies, some of the worst affected were those such as Singapore and Taiwan which were most dependent on international trade. Although China and India continued to grow strongly (at 8.7 and 5.6 per cent, respectively), the 36 per cent decline in the price of oil, and the 19 per cent decline in the prices of non-fuel commodities in 2008, a repercussion of the drop in world manufacturing output, had a severe impact on many less developed economies. Output in Mexico slumped by nearly 7 per cent, in Brazil by 0.4 per cent, while growth rates in Africa declined from the 2008 figure of 5 per cent to under 2 per cent (all data from IMF 2010*b*: table 1.1). The dollar value of Africa's exports shrank by one-third in 2009 (Miller 2010).

The problems of Lehman Brothers stemmed in large part from its involvement in the sub-prime mortgage market. Lehman Brothers, like many other financial services firms, had become a substantial player in securitizing these mortgages (see Box 1.1).

That problems that began in the home lending market in the United States could plunge the world into its worst recession since the 1930s is powerful testimony to the integration of the contemporary global economy. Difficulties originating in the US financial sector were quickly transmitted to financial institutions in other advanced economies and then to the 'real' economy when banks curtailed their lending (and, in many instances, had to be bailed out by their governments). Firms (and households) lacked the finance not only to invest for the future but even to conduct their daily operations. Finance for international trade dried up. The world economy quickly went into reverse. With the slowdown in production, the demand for and prices of raw materials fell substantially. Hit by falling prices for their exports and by a curtailment of inflows of

BOX 1.1

Sub-Prime Lending and Securitization

Loans characterized as 'sub-prime' are those that are regarded by the market as carrying a higher-than-usual element of risk. Typically, they have been contracted with borrowers who, for a variety of reasons that might include limited experience in borrowing, poor credit history, or low or unreliable income, are regarded as more likely than average to default on their loans.

To offset the increased risks of lending in the sub-prime market, financial institutions took advantage of the practice of securitization, which had initially developed in the 1970s. Before that period, providers of mortgage finance typically held the loans they had made until borrowers repaid them: in other words, they bore all the risk of the lending and usually financed the loans from their own resources. As the demand for mortgage finance rose, however, and lenders became increasingly concerned about risk, they developed the practice (often with the assistance of other financial institutions) of pooling the loans; the pool was then split into shares that were on-sold to investors as tradeable securities (bonds) that carried either a fixed or floating interest rate. The investors in these securities thereby assumed much of the risk attached to the loans. The practice of 'securitization' spread from the United States to Europe in the late 1980s.

In the 1990s and the first decade of the current century, financial institutions developed ever more sophisticated means for pooling and on-selling loans. Individual securities were increasingly split into tranches, each of which carried a different level of risk: the higher tranches had the first claim on any income that the lender received; the lower tranches would be the first to absorb any losses. At the beginning of 2009, securitization accounted for approximately 28 per cent of outstanding credit in the United States: the figures for the UK and the eurozone were 14 and 6 per cent, respectively (IMF 2009*b*: box 1.2).

public and private lending, output in many developing economies either went into reverse or declined below the rate of population growth. The World Bank estimated that the recession would increase the number of people living in poverty by 65 million (see Chapter 12 in this volume by Robert Hunter Wade), and further delay realization of the Millennium Development Goals (see Chapter 13 in this volume by Nicola Phillips).

The International Monetary Fund (IMF) (2009*b*: 5) suggested that the crisis-induced write-downs of bad loans by financial institutions will total around US$3.4 trillion (including $230 billion in mortgage lending in the US alone)—imposing a potentially massive burden on the public purse for the recapitalization of these institutions. Because governments had to issue bonds to cover the costs of their bail-outs of financial institutions, risk was in effect transferred from private to public balance sheets. The bail-outs, coupled with the costs of the stimulus packages that most countries introduced to fight the recession, and with a steep reduction in tax revenues owing to the economic downturn, left public finances in most industrialized economies in a parlous state. The IMF anticipated that the average budget deficit in industrialized economies was 10 per cent of **gross domestic product (GDP)** in 2009, and 8.5 per cent in 2010. As a consequence, the ratio of public debt to GDP exceeded 100 per cent in many of the eurozone economies, the United States, and Japan (where it was in excess of 200 per cent in 2012) (IMF 2012*a*: table 2.1). The steep increase in sovereign debt threatened the credit ratings of some countries, particularly those in southern and eastern Europe, and left all governments with a challenge as to how to reconcile income and expenditure in the future.

On several key dimensions, the downturn precipitated by the recession was sharper than that of the 1930s. In the first year of the recession, global output and global trade fell more rapidly than in the 1930s—by 13 per cent and 20 per cent, respectively. Similarly, global stockmarkets fell more precipitously—by 50 per cent in the first twelve months (compared with only slightly over 10 per cent in the 1930s) (Eichengreen and O'Rourke 2010). How the recession most differed from the 1930s, however, was that the initial downturn was not so protracted—with recovery in global trade, output, and in stockmarkets beginning in the second half of 2009, this recovery in itself being a reflection of the effectiveness of concerted responses at the national and global levels (see later).

One reason for the severity of the recession that began in 2008 was that, unlike previous post-war downturns, all regions of the world were in economic decline simultaneously. The extent of the crisis provided evidence that not just a quantitative increase in interdependence had occurred in recent years but also a qualitative change. As the World Trade Organization (WTO) noted, the rapid spread of the recession worldwide was caused in part by the increasing presence of global supply chains in countries' trade (see Chapter 11 in this volume by Eric Thun). With components crossing national frontiers many times before a manufactured product reaches its final destination, a decline in the major global markets for finished products quickly affects trade—and then employment—in other parts of the world. Moreover, the extent of the recession, and the rapidity with which all regions of the world were affected, posed both practical and conceptual challenges for national and international governance. For the global financial institutions (the International Monetary Fund, the World Bank), the cessation of private and public lending posed a severe challenge to their efforts to minimize the impact of the recession on developing economies (and exposed the inadequacies of the resources they had available to fight recession).

Few observers anticipated the recession (or, at least, the severity with which it would strike). The world economy had enjoyed a sustained long boom, continuing on an upward trajectory despite the bursting of the 'dot.com' bubble and the shock of the 2001 terrorist attacks. For students of global political economy, however, the possibility that the processes of globalization might be interrupted or even thrown into reverse should come as no surprise (see Chapter 9 by Anthony McGrew in this volume). The causes of the crisis were similar to those that have afflicted the world previously (albeit with some new twists, reflecting aspects of contemporary financial globalization).

The recession was triggered by the bursting of an asset price bubble—in this instance, the inflated US housing market. The term 'bubble' was coined in the United Kingdom in 1720, following the crash of the South Sea Company, and the passing in that year of the so-called 'Bubble Act'—more formally, 'An Act to Restrain the Extravagant and Unwarrantable Practice of Raising Money by Voluntary Subscription for Carrying on Projects Dangerous to the Trade and Subjects of the United Kingdom'. As in previous crises, the collapse of the asset price bubble caused panic among investors, whose uncertainty over whether they could recoup the money they had paid, inter alia, for houses, caused them to flee the market (see Chapter 8 by Louis W. Pauly in this volume). Investor panic had significantly exacerbated the other major financial crisis to affect the global economy in the previous quarter of a century—that which afflicted East Asia in 1997/98 (Noble and Ravenhill 2000; Radelet and Sachs 2000). And, as with previous crashes, the bubble was associated with behaviour that was either outside the law or certainly contrary to its spirit—the 2,200-page report issued in March 2010 by Anton R. Valukas, an examiner appointed by the US Trustee to investigate the causes of the Lehman bankruptcy, for instance, found that Lehman had used accounting sleight of hand to conceal the extent of its bad loans (de la Merced and Sorkin 2010).

Globalization of finance did introduce some elements to the financial crisis that had not been seen before. The growth of financial intermediation, of which an important aspect was the securitization of mortgage debt, had two important consequences. The first was that what began as a national problem (defaults on US mortgages) was quickly transformed into a global crisis. The new mortgage-backed financial instruments had been marketed globally by American and European investment banks—with the consequence that, once the bubble burst, various institutional investors, ranging from local councils in Australia and Norway to the London Metropolitan Police's pension fund, suffered significant losses. In a low-inflation environment, these investors had been attracted to financial instruments that offered potentially higher rates of return than those available on more familiar investments and, in doing so, had either discounted or not understood the risks involved.

The second consequence was that the complexity of the new financial instruments exacerbated the problem of panic because of the uncertainty created in transactions among financial institutions (for a detailed discussion of the new 'structured financial products' see IMF 2008: ch. 2). Financial institutions found it very difficult to determine exactly what their liabilities were. Once panic set in, they were reluctant to lend to one another—and, here, another dimension of financial globalization entered the equation: the increasing dependence of bank-lending on funds borrowed in the international wholesale market, rather than on their own deposits or capital. The extreme case was that of Iceland, where the country's banks had been the main source of its international debts, which were estimated in 2008 to amount to $276,622 for every resident. In 2008/09 alone, the three largest Icelandic banks had €11 billion of debt obligations maturing (Brogger 2008). When no new financing was forthcoming, the banks collapsed. The debts were so great that the private banks could not be bailed out by the country's central bank and the losses of the financial sector were expected to total $90 billion (Wade 2009*b*). Financial sector deregulation in Iceland had, in Robert Wade's words created an 'accident waiting to happen' (Wade 2009*b*: 14). The value of Iceland's currency measured against the euro more than halved during 2008. Iceland may have been the extreme case but similar instances of reckless behaviour by financial institutions were commonplace in Europe (especially the UK) and the United States (financial institutions in most other regions of the world had been more conservative in their approach, in part because of better regulatory frameworks introduced in response to crises in the 1980s and 1990s).

The recession undermined triumphalist notions that governments had learned to master the factors driving business or economic cycles more generally, or that unregulated markets would generate optimal outcomes. A striking feature of the early governmental response to the recession was the acknowledgement of the inadequacies of previous policy approaches, particularly in the area of financial sector regulation ('Major failures in the financial sector and in financial regulation and supervision were fundamental causes of the crisis', admitted the Group of Twenty (G20) leaders in the communiqué from their London summit (G20 2009*a*: para. 13). One of the challenges faced by governments in the wake of the financial crisis was how to improve regulation of the financial system, and to decide whether this might best be pursued at the national, regional, or global level.

The recession prompted unprecedented policy interventions at the national and global levels, and produced significant changes in global economic governance—with the emergence of the G20 as the principal intergovernmental body for global economic management (Box 1.2). The crisis also saw the revitalization of the International Monetary Fund when the G20 agreed to make an additional $850 billion available to the **international financial institutions (IFIs)** and to endorse a more flexible response from the Fund to countries experiencing financial problems (see Chapter 7 by Eric Helleiner in this volume).

BOX 1.2

The G20

The Group of Twenty (G20) Finance Ministers and Central Bank Governors was established in 1999, following the financial crises that had primarily afflicted East Asia but had also spread to other developing economies, to bring together systemically important industrialized and developing economies to discuss key issues in the global economy. The inaugural meeting of the G20 took place in Berlin, on 15–16 December 1999.

The membership of the G20 comprises Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, the United Kingdom, and the United States. The European Union, represented by the rotating Council Presidency and by the European Central Bank, is the twentieth member of the G20. To facilitate policy coordination with the global financial institutions, the Managing Director of the International Monetary Fund and the President of the World Bank, plus the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate in G20 meetings on an *ex officio* basis.

The G20 remained a relatively low-profile and low-key grouping of finance ministers and central bankers until the 2008 recession, when an inaugural meeting of the political leaders of the G20 was held in Washington, DC, in November. The elevation of the G20 to summit status was recognition on the part of the leaders of the principal industrialized economies that their own grouping (the Group of Eight (G8)—see below) was not sufficiently representative to effectively manage the problems of an increasingly globalized economy. In particular, it was acknowledgement of the growing importance of the major developing economies—especially China, India, and Brazil. At their meeting in Pittsburgh in September 2009, the G20 leaders formalized the status of the grouping by designating 'the G20 to be the premier forum for our international economic cooperation' (G20 2009*b*: para. 19).

The Group of Seven (G7) industrialized countries had been established in 1975, the first of a series of annual meetings where politicians and officials from the world's leading economies discussed issues relating to macroeconomic policy coordination, trade, and financial policies, and relations with developing countries.

Six countries were present at the initial meeting in Rambouillet in France: Britain, France, (West) Germany, Italy, Japan, and the United States. Canada joined the group in 1976, at its second meeting. In 1977, the group allowed participation by a representative of the European Community. From 1994 onwards, the G7 met with representatives of Russia at each of its meetings; at the Birmingham meeting in 1998, Russia was accorded full membership, transforming the G7 into the G8. The G8 continues to exist alongside the G20.

For more details on the G20, see www.g20.org; for the G7/G8, see www.g7.utoronto.ca.

At the national level, most G20 economies implemented stimulus packages that the IMF estimated were equivalent to 1.5 per cent of their GDP in 2009 and 1.25 per cent in 2010. Half of the G20 countries cut personal income taxes; a third cut indirect taxes such as value-added taxes and excise duties. Three-quarters of the G20 members increased government expenditures on infrastructure, primarily on transportation networks (IMF 2009*a*: 18). Many also increased expenditures on programmes for the most vulnerable. The concerted international response was testimony to how the governance of the global economy had changed since the great depression of the 1930s. And although governments implemented measures designed to stimulate local industries, the widespread resort to beggar-thy-neighbour protectionist policies that characterized the 1930s was avoided. G20 leaders pledged repeatedly not to introduce protectionist measures or restrictions on investment. A report for the G20 estimated that the cumulative effect of the trade restriction measures that countries had implemented since October 2008 had, four years later, affected only 3 per cent of world merchandise trade (OECD/WTO/UNCTAD 2012: 6). By 2011, the value of global trade and production (but not foreign direct investment) had recovered to its pre-crisis levels.

For some observers, however, particularly those in Europe and the United States, the global recession did reflect one dimension of beggar-thy-neighbour policies that were at least as important in contributing to the recession as were regulatory failures: the mounting imbalances in international trade and payments, which they attributed primarily to China's determination to avoid a rapid appreciation of its currency against the US dollar. One of the missions with which the G20 has tasked the IMF is to analyse 'whether policies pursued by individual G20 countries are collectively consistent with more sustainable and balanced trajectories for the global economy' (G20 2009*b*: para. 7), a coordinating role that the IMF has singularly failed to perform since its foundation. With slow rates of growth lingering in many industrialized economies through 2013, governments in several major economies attempted to push down their exchange rates in an effort to stimulate demand for their exports—a worrying trend towards beggar-thy-neighbour policies that contributed to the severity of the Great Depression of the 1930s.

The global financial crisis and the responses of the international community to it provide an excellent illustration of many of the themes of this book:

- the growing interdependence of countries in a globalizing economy;
- the vulnerability of the contemporary global financial system to periodic crises;
- the speed with which developments in one part of the world economy are transmitted to others;
- the increased significance of private actors in the contemporary global economy, especially in the financial sector;
- the way in which crises prompt governments to seek collaboration to regulate international markets—but concurrently the difficulties that states have in coordinating their behaviours to take effective action;
- the significant and evolving role of international institutions in responding to crises; and
- the manner in which the increased severity of financial crises has had an impact on poverty and inequality.

Although, as will become evident in later chapters, contributors to this book hold a variety of perspectives on the question of whether there is such a thing as a 'global' economy, all would accept that we live in a *globalizing* economy that differs in some fundamental ways from anything that the world has previously experienced. The following section briefly sketches how the world economy evolved to reach its present state.

The World Economy Pre-1914

The 'modern world economy', most historians agree, came into existence in the late fifteenth and sixteenth centuries. This was a period in which despotic monarchs in Western Europe, seeking to consolidate their power against both internal and external foes, pushed to extend the boundaries of markets. In this era of **mercantilism**, political power was equated with wealth, and wealth with power (Viner 1948). Wealth, in the form of bullion generated by trade surpluses or seized from enemies, enabled monarchs to build the administrative apparatus of their states and to finance the construction of military forces. The new concentration of military power could be projected, both internally and externally, to extract further resources. The consolidation of the state went hand in hand with the extension of markets. Gradually, most parts of the world were enmeshed in a Eurocentric economy, as suppliers of raw materials and 'luxury' goods. Britain adopted domestic reforms largely pioneered by the Netherlands (which had the world's highest per capita income in the seventeenth and eighteenth centuries) to supplant the Dutch in many world markets: armed conflict and the use of the Navigation Acts (1651–1849), which restricted the use of foreign vessels in British trade, enabled it to monopolize trade with its ever-expanding empire.

The era of mercantilism did not, however, bring a notable increase in overall global wealth. Before 1820, per capita incomes in most parts of the world were not significantly different from those of the previous eight *centuries* (they increased by less than an average of one-tenth of 1 per cent each year between 1700 and 1820). And despite the striking extension of the global market during the seventeenth and eighteenth centuries, the vast majority of commerce continued to be conducted within individual localities until the advent of the Industrial Revolution. The introduction of steam power revolutionized transportation, both internally and internationally. And in the second half of the nineteenth century, further technological advances—the introduction of refrigerated ships, the laying of submarine telegraph cables—contributed to a 'shrinking' of the world and to a deepening of the international division of labour. The value of world exports grew tenfold (from a relatively small base) between 1820 and 1870: from 1870 to 1913, world exports grew at an annual average rate of 3.4 per cent, substantially above the 2.1 annual increase in world GDP (Maddison 2001: 262, table B–19, and 362, table F–4).

Trade was becoming increasingly important to world welfare, yet the pattern of international commerce in 1913—indeed, even in 1945—was not dramatically different from that of the eighteenth century. The industrialized countries of the world—essentially a Western European core to which had been added the

United States and Japan by the turn of the twentieth century—exported principally manufactured goods, while the rest of the world supplied agricultural products and raw materials to feed the industrialized countries' workforces and to fuel their manufacturing plants (as a relative latecomer to industrialization, and an economy with significant **comparative advantage** in agricultural production, the United States was an exception to this generalization: cotton remained the single most important export for the United States in 1913, contributing nearly twice the value of exports of machinery and iron and steel combined; it was not until 1930 that machinery exports exceeded those of cotton, although by 1910 the US had become a net exporter of manufactured goods (data from Mitchell 1993: 504, table E3; and Irwin 2003).

With the exception of the United States, trade among the industrialized countries in manufactured goods remained relatively unimportant. In 1913, for example, agricultural products and other primary products constituted two-thirds of the total imports of the United Kingdom. To be sure, some changes had occurred in the composition of imports. Although the 'luxury' imports of the previous centuries—sugar, tea, coffee, and tobacco—had become staples in the diet of the new urban working and middle classes, their aggregate importance in European imports had shrunk relative to other commodities, notably wheat and flour, butter and vegetable oils, and meat (Offer 1989: 82, table 6.1).

For the early European industrializers, trade with their colonies, dominions, or with the other lands of recent European settlement, such as Argentina, was more important than trade with other industrialized countries. For the United Kingdom, a larger share of imports was contributed by Argentina, Australia, Canada, and India together than by the United States, despite the latter's importance in British imports of cotton for its burgeoning textiles industry. These four countries also took five times the American share of British exports in 1913 (Mitchell 1992: 644, table E2). Similarly, Algeria was a larger market for French exports in 1913 than was the United States.

Tariffs continued to constitute a significant barrier to international trade, even in what is often termed the 'golden age' of liberalism before 1914. Most industrialized countries (the significant exceptions being the United Kingdom and the Netherlands) had actually raised the level of their tariffs in the last three decades of the nineteenth century to protect their domestic producers against the increasing import competition that had been facilitated by lower transport costs. In 1913, the average tariff level in Germany and Japan was 12 per cent, in France 16 per cent, and in the United States 32.5 per cent (Maddison 1989: 47, table 4.4). The post-1870 increase in tariffs offset some of the gains from lower transportation costs. Lindert and Williamson (2001) estimate that nearly three-quarters of the closer integration of markets that occurred in the century before the outbreak of the First World War is attributable to these lower transport costs (see Table 9.3 in McGrew, Chapter 9 in this volume).

Governments continued to erect barriers to the movement of goods in the second part of the nineteenth century, but capital and people moved relatively freely across the globe, their mobility facilitated by developments in transportation and communication. From 1820 to 1913, 26 million people migrated from Europe to the United States, Canada, Australia, New Zealand, Argentina, and Brazil. Five million Indians followed the British flag in migrating to Burma, Malaya, Sri Lanka, and Africa, while an even larger number of Chinese are estimated to have migrated to other countries on the Western Pacific rim (Maddison 2001: 98). The opening up of the lands of 'new settlement' required massive capital investments—in railways in particular. By 1913, the United Kingdom, France, and Germany had investments abroad totalling over $33 billion: after the 1870s, Britain invested more than half its savings abroad, and the income from its foreign investments in 1913 was equivalent to almost 10 per cent of all the goods and services produced domestically (Maddison 2001: 100).

The spectacular growth in international economic integration was not accompanied by any significant institutionalization of intergovernmental collaboration. Even though the Anglo-French Cobden–Chevalier Treaty of 1860 had introduced the principle of **most-favoured nation status (MFN)** into international trade agreements (see Box 1.3), governments conducted trade negotiations on a bilateral basis rather than under the auspices of an international institution.

The international financial system was similarly characterized by a lack of institutionalization. The rapid growth of economic integration was facilitated by the international adoption of the **gold standard** (see Box 1.4). The origins of the nineteenth-century gold standard lay in action by the Bank of England in 1821 to make all its notes convertible into gold (although Britain had operated a de facto gold standard from as early

BOX 1.3

Most-Favoured Nation Status (MFN)

Under the most-favoured nation (MFN) principle, a government is obliged to grant to any trading partner with which it has signed an agreement treatment equivalent to the best ('most preferred') it offers to any of its partners. For example, if France had a trade treaty with Germany in which it had reduced its tariffs on imports of German steel to 8 per cent, it would be obliged, under the most-favoured nation principle, if it signed a trade treaty with the United States, to reduce its tariffs on imports of US steel also to 8 per cent. The MFN principle is the foundation for non-discrimination in international trade, and is often asserted to be the 'cornerstone' of the post-1945 trade regime (see Winham, Chapter 5 in this volume). The MFN principle makes a significant contribution to depoliticizing trade relations because: (*a*) countries are obliged to give equivalent treatment to all trading partners, regardless of their economic power; and (*b*) countries cannot discriminate in their treatment of the trade of certain partners simply because they do not like the political complexion or policies of the governments of these countries.

BOX 1.4

The Gold Standard

A gold standard requires a country to fix the price of its domestic currency in terms of a specific amount of gold. National money (which may or may not consist of gold coins, because other metallic coins and banknotes were also used in some countries) and bank deposits would be freely convertible into gold at the specified price.

Under the gold standard, because the level of each country's economic activity is determined by its money supply, which in turn rested on its gold holdings, a disequilibrium in its **balance of trade** in principle would be self-correcting. Let us assume, for example, that Britain is running a trade deficit with the United States because inflation in Britain has made its exports relatively unattractive to US consumers. Because British exports do not cover the full costs of imports from the United States, British authorities would have to transfer gold to the US Treasury. This transfer would reduce the domestic money supply, and hence the level of economic activity in Britain, having a deflationary effect on the domestic economy, and depress its demand for imports. In the United States, the opposite would occur: an inflow of gold would boost the money supply, thereby generating additional economic activity in the United States and increasing inflationary pressures there. Higher levels of economic activity would increase the country's demand for imports. Changes in the money supplies in the two countries brought about by the transfer of gold, therefore, would bring their demand for goods back into balance and lead to a restoration of the ratio of the two countries' prices to that reflected in the exchange rate between their currencies.

In principle, the gold standard should act to restore equilibrium automatically in international payments. Central banks, however, were also expected to facilitate adjustment by raising their interest rates when countries were suffering a payments deficit (thereby further dampening domestic economic activities and making domestic investments more attractive to foreigners) and, conversely, to lower interest rates when their economies were experiencing a payments surplus. For most of the period from 1870 to 1914, the Bank of England played by the rules of the game fairly consistently. Other central banks—including those of France and Belgium—did not. They frequently intervened to attempt to shield the domestic economy from the effects of gold flows (to 'sterilize' their effects) by buying or selling securities (thereby reducing or increasing the volume of gold circulating in the domestic economy).

The gold standard was vulnerable to shocks, which were often transmitted quickly from one country to another. The discovery of gold in California in 1848, for example, led to an increase in the US money supply, domestic inflation, and an outflow of gold to its trade partners, which in turn raised their domestic price levels. Countries on the periphery were particularly vulnerable to shocks: interest-rate increases in the industrialized countries, for example, often drew capital from the periphery, leaving the peripheral countries with the major burden of adjustment.

For further discussion, see Eichengreen (1985) and Officer (2001).

as 1717). The United States, though formally on a bimetallic (gold and silver) standard, switched to a *de facto* gold standard in 1834 and turned this into a *de jure* arrangement in 1900. Germany and other industrializing economies followed suit in the 1870s. Because every country fixed the value of its national currency in terms of gold, each currency had a fixed exchange rate against every other in the system (assume, for example, that the United States sets the value of its currency as \$100 per ounce of gold, while the United Kingdom sets its value at £50 per ounce of gold: the exchange rate between the two currencies would be £1 = \$2).

The great contribution of the gold standard to facilitating international commerce was that economic agents generally did not have to worry about foreign exchange risks: the possibility that the value of the currency of a foreign country would change *vis-à-vis* their domestic currency and thus, for example, reduce the value of their foreign investments. British investors in American railways could be confident that the dollars they had bought with their sterling investments would buy the same amount of sterling at the date their investment matured, and that the US Treasury would convert the dollars back into gold at this time. Meanwhile, they received interest on the sums invested. Confidence in the gold standard did not rest on any international institution but rather on the commitment of individual governments to maintain the opportunity for individuals to convert their domestic currencies into gold at a fixed exchange rate. Ultimately, the implementation of the gold standard rested on the assumption that governments had both the capacity and the will to impose economic pain on their domestic populations when deflation was needed in order to bring their economy back into equilibrium when experiencing trade deficits. These domestic costs became less acceptable with the rise of working-class political representation, and with the growth of expectations that a fundamental responsibility of governments was to ensure domestic full employment.

KEY POINTS

- The modern world economy came into existence in the fifteenth and sixteenth centuries.
- Despite the significant changes that occurred in the three centuries before the outbreak of the First World War, the fundamental composition and direction of international trade remained unchanged.
- Neither in the field of trade nor of finance was any significant international institution constructed in the years before 1914.
- Advances in technology were the main driving force behind the integration of markets, and they facilitated the enormous growth in investment and migration in the nineteenth century.
- The great merit of the gold standard was that it provided certainty for international transactions because it largely removed the risk of foreign exchange losses.

The World Economy in the Inter-War Period

The outbreak of the First World War was a devastating blow to cosmopolitan liberalism: it destroyed the credibility of the liberal argument that economic interdependence in itself would be sufficient to foster an era of peaceful coexistence among states. The war brought to an end an era of unprecedented economic interdependence among the leading industrial countries. As discussed in the chapters by McGrew and Hay in this book, for many industrialized economies, indicators of economic openness and interdependence did not regain their pre-First World War levels until the 1970s.

The war devastated the economies of Europe: subsequent political instability compounded economic disruptions. Economic reconstruction was further complicated by demands that Germany make reparations for its aggression, and that Britain and other European countries repay their wartime borrowings from the United States. The economic chaos of the inter-war years was a sorry reflection of the inability of governments to agree on measures to restore economic stability, and of their resort to beggar-thy-neighbour policies in their efforts to alleviate domestic economic distress. Although the collapse of international trade in the 1930s is the feature of the inter-war economy that figures most prominently in stories of this era, the most fundamental problem of the period was the inability of states to construct a viable international financial system.

The international gold standard broke down with the outbreak of war in August 1914, when a speculative attack on sterling caused the Bank of England to impose exchange controls—a refusal to convert sterling into gold and a *de facto* ban on gold exports. Other countries followed suit. Leading countries agreed to reinstate a modified version of the international gold standard in 1925. They failed to act consistently, however, in re-establishing the link between national currencies and gold. The United Kingdom restored the convertibility of sterling at the pre-war gold price, despite the domestic inflation that had occurred in the intervening decade. The consequence was that sterling was generally reckoned to be overvalued by at least 10 per cent, making British exports uncompetitive. It proved very difficult for the British government to establish an equilibrium in its **balance of payments** without imposing severe deflation domestically. Other countries—notably France, Belgium, and Italy—restored convertibility of their currencies at a much lower price of gold than had prevailed before 1914.

The resulting misalignment of currencies was compounded by higher trade barriers than had existed before 1914, the absence of a country / central bank with the resources and the will to provide leadership to the system, and by a failure of central banks to play by the 'rules of the game' of the gold standard. Their inclination to intervene to 'sterilize' the domestic impact of international gold flows was symptomatic of a more fundamental underlying problem: in an era when the working class had been fully enfranchised, when trade unions had become important players in political systems, especially in Western Europe, and when governments were expected to take responsibility for maintaining full employment and promoting domestic economic welfare, the subordination of the domestic economy to the dictates of global markets in the form of the international gold standard was no longer politically acceptable. Polanyi (1944) is the classic statement of this argument; on the misguided attempts by Britain to restore the convertibility of sterling at pre-1914 levels, see Keynes (1925).

The abandonment of the international gold standard followed another speculative attack on sterling in the middle of 1931. The Bank of England lost much of its reserves in July and August of that year, and Britain abandoned the gold standard in September, a move that precipitated a sharp depreciation of the pound (testimony to its overvaluation in the brief period in which the gold standard was restored). Other countries again quickly followed in breaking the link between their currencies and gold. By then, the world economy was in depression, following the shocks to the world economy transmitted from the United States after the Wall Street collapse of October 1929. The gold standard almost certainly exacerbated the effects of the depression, because government efforts to maintain the link between their currencies and gold constrained the use of expansionary (inflationary) policies to combat unemployment and low levels of domestic demand (Eichengreen 1992).

The world economy was already in depression before the US Congress, in response to concerns about the intensification of import competition for domestic farmers, passed the infamous Smoot–Hawley Tariff of 1930. This raised US tariffs to historically high levels (an average *ad valorem* tariff of 41 per cent, although tariff rates were already very high as a result of the Tariff Act of 1922, the Fordney–McCumber Tariff). Retaliation from US trading partners quickly followed, with the European countries giving preferential tariff treatment to their colonies. The value of world trade declined by two-thirds between 1929 and 1934, and became increasingly concentrated in closed imperial blocks.

As in the pre-1914 period, international institutions played no significant role in the governance of international economic matters. The League of Nations had established an Economic and Financial Organization with subcommittees on the various areas of international economic relations. It enjoyed success in the early 1920s in coordinating a financial reconstruction package of £26 million for Austria. It also held various conferences aimed at facilitating trade by promoting common standards on customs procedures, compilation of economic statistics, and so on. But the economic and political disarray of the inter-war period simply overwhelmed the League's limited resources and legitimacy: the move to restore international economic collaboration awaited effective action by the world's leading economy, the United States. This began with the passage by Congress in 1934 of the Reciprocal Trade Agreements Act (RTAA), which gave the president the authority to negotiate foreign trade agreements (without Congressional approval). The RTAA and the subsequent signature before 1939 of trade agreements with twenty of America's trading partners laid the foundations for the multilateral system that emerged after the Second World War (the reasons why US trade policy changed so dramatically between 1930 and 1934 have been a focus of significant recent work in international political economy; see Hiscox 1999; Irwin and Kroszner 1997).

KEY POINTS

- Misalignment of exchange rates contributed to the problems of economic adjustment in the 1920s.
- The world economy was already in recession before tariffs were raised in the early 1930s—but higher tariffs exacerbated the decline in international trade.
- States did not negotiate any significant institutionalization of international economic relations in the inter-war period.

The World Economy Post-1945

The world economy that emerged after the Second World War was qualitatively different from anything experienced before. John Ruggie, a leading contemporary theorist of political economy, has identified two fundamental principles that distinguish the post-war economy from its predecessors: the adoption of what Ruggie (1982), following Polanyi (1944), terms **embedded liberalism**, and a commitment to **multilateralism** (Ruggie 1992).

Embedded liberalism refers to the compromise that governments made after 1945 between safeguarding their domestic economic objectives, especially a commitment to maintaining full employment, on the one hand, and an opening up of the domestic economy to allow for the restoration of international trade and investment on the other. The 'embedding' of the commitment to economic openness—the liberal element—within domestic economic and political objectives was attained through the inclusion of provisions in the rules of international trade and finance that would allow governments to opt out, on a temporary basis, from their international commitments should these threaten fundamental domestic economic objectives. Moreover, an acknowledgement of the legitimacy of the principle that governments should give priority to the pursuit of domestic economic objectives was also written into the rules of the game. The adoption of the principle of embedded liberalism was a recognition by governments that international economic collaboration rested on their capacity to maintain domestic political consensus—and that international economic collaboration was, fundamentally, a political bargain. This recognition explains, for example, why the agricultural sector was for many years excluded from trade liberalization: the domestic political costs for governments of negotiating freer trade in agricultural products were judged to be so high as to jeopardize otherwise politically feasible trade liberalization in other sectors.

The institutionalization of international economic cooperation is another fundamental change in international economic relations in the post-war period. Neither in the period of relative stability of the pre-First World War gold standard era nor in the chaos of the 1930s did leading economies create significant international economic institutions. A commitment to multilateralism is one of the defining characteristics of the post-1945 order. For Ruggie (1992: 571), multilateralism is not merely a matter of numbers—it involves collaboration among three or more states, not necessarily all members of the system—but it also has a *qualitative* element in that the coordination of relations is on 'the basis of "generalized" principles of conduct—that is, principles which specify appropriate conduct for a class of actions, without regard to the particularistic interests of the parties or the strategic exigencies that may exist in any specific occurrence'. A classic example is the most-favoured-nation principle, with its requirement that products from all trading partners must be treated in the same manner regardless of the characteristics of the countries involved. This principle for the conduct of trade contrasts, for example, with the largely bilateral trade agreements of the inter-war years, where governments, rather than applying a generalized principle to their trade relations, discriminated in their treatment of individual trading partners.

The commitment to multilateralism that developed in the late 1930s and during the Second World War bore immediate fruit in the founding of the **Bretton Woods** multilateral financial institutions: the International Monetary Fund and the World Bank (see Box 1.5). Note, however, that these global or universal institutions, membership of which is open to all states in the international system, are just one form of multilateralism. For the whole of the period since 1945, but especially since the mid-1990s, regional institutions have also played an important role in international economic (as well as security) affairs (see Ravenhill, Chapter 6 in this volume). States have increasingly enmeshed themselves in a dense web of multilateral institutions.

The unprecedented rates of economic growth achieved in the years after 1945 attest to the success of the pursuit of multilateral economic collaboration in this period. Global GDP grew at close to 5 per cent in the period 1950–73. Although the recessions that followed the oil price rises of 1973–4 and 1979–80, and the debt crises that afflicted Latin America and Africa, contributed to a slowing of growth in the quarter-century after 1973, world GDP nonetheless grew at an average of 3 per cent per annum, a faster rate than during any period before 1945 (Maddison 2001: 262, table 8–19). Moreover, world trade grew more rapidly than world production: world exports expanded by close to 8 per cent per annum in the years 1950–73, and by 5 per cent annually in the subsequent twenty-five-year period (Maddison 2001: 362, table F–4). The internationalized

BOX 1.5

Bretton Woods

In 1944, the Western allies brought together their principal economic advisers for a conference at the Mount Washington Hotel in the village of Bretton Woods, New Hampshire, to chart the future of the international economy in the post-war period. The forty-four governments represented at what was officially known as the United Nations Monetary and Financial Conference agreed on the principles that would govern international finance in the post-war years, and to create two major international institutions to assist in the management of these arrangements: the International Monetary Fund; and the World Bank (formally known as the **International Bank for Reconstruction and Development**). For details of the discussions at the conference see van Dormael).

These institutions and the rules for managing international finance that were agreed became known collectively as the Bretton Woods regimes. In 1947, a United Nations Conference on Trade and Employment in Havana, Cuba, drew up a charter (www.wto.org/english/docs_e/legal_e/havana_e.pdf) for an **International Trade Organization (ITO)**, to complement the Bretton Woods financial institutions. The ITO never came into existence, however—see Winham, Chapter 5 in this volume.

sector consequently grew in importance in most economies, with important implications for the balance of domestic political interests on trade policy issues (see Hiscox, Chapter 4 in this volume).

Aggregate rates of growth, however, disguised substantial variations across different regions of the world economy. The gap between rich and poor widened substantially (see Figure 1.1). In 1500, little difference had existed in per capita incomes across various regions of the world. Incomes per head in the United States did not exceed those of China until the second quarter of the eighteenth century. By the third quarter of the nineteenth century, however, a marked gap had developed between incomes per capita in the United States and Western Europe on the one hand, and those of the rest of the world. Per capita incomes in Africa and in most parts of Asia stagnated (and in China actually regressed for a century). Despite the economic turmoil and slower rates of growth of the inter-war years, the absolute gap between the industrialized economies and the rest of the world continued to widen: the divergence increased rapidly in the post-1945 era. Only a handful of previously **less developed countries (LDCs)**, mostly in East Asia, made significant progress in closing the gap. Africa, meanwhile, became increasingly detached from the globalizing economy: its exports, measured in constant prices, barely expanded in the years between 1973 and 1990. The poor export performance contributed to falls in per capita income that occurred in the majority of years between 1973 and 1998. By the latter date, the average per capita income in Africa was no more than Western Europe had experienced in 1820 (all data drawn from Maddison 2001). Growing international inequality has been a fundamental part of the modern globalizing economy (see Wade, Chapter 12 in this volume).

Another defining characteristic of the post-1945 international economy was the growth in the number of **transnational corporations (TNCs)** (also referred to in some chapters of this volume as multinational enterprises). A growth of significant private economic enterprises with international operations had accompanied the emergence of the modern world economy in the fifteenth century. These, however, were primarily trading companies, such as the East India Company, specializing in moving goods between national markets. And when foreign investment took off in earnest, in the half-century before the First World War, the vast majority of it was **portfolio investment**—that is, investment in bonds and other financial instruments that did not give investors management control over the borrowing company. Companies that engaged in foreign direct investment—that is, the ownership and management of assets in more than one country for the purposes of production of goods or services (the definition of a TNC)—were relative rarities before 1945 (with some notable exceptions, such as the major oil companies and IBM). In the post-Second World War years, FDI took off, and has grown more rapidly than either production or international trade (see Thun, Chapter 11 in this volume).

The TNC has become the key actor in the globalizing economy. By 2009, it was estimated that there

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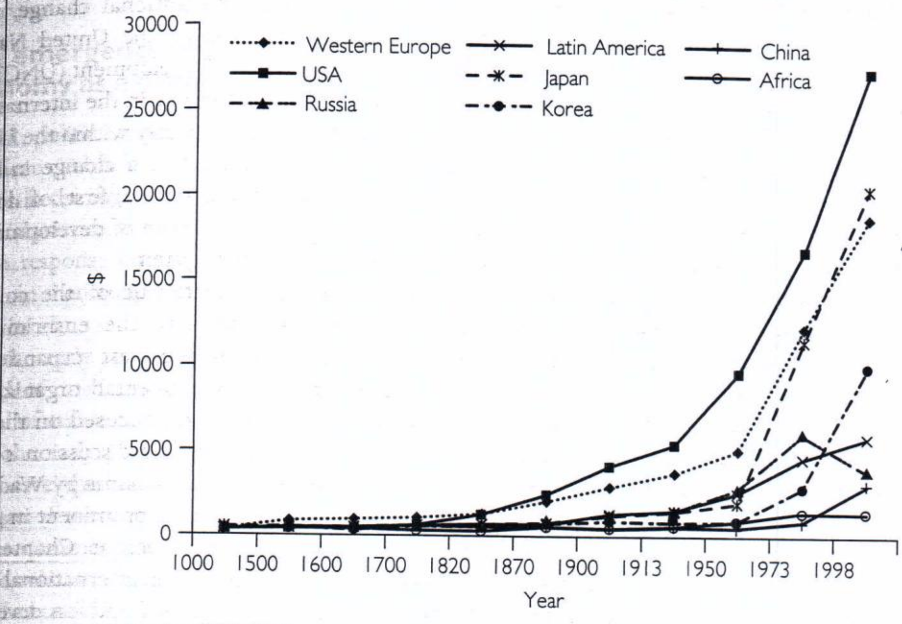
Figure 1.1 Per capita income, 1000–1998 (US$)



Source: Data in Maddison (1989, 2001)

were 82,000 TNCs in operation, controlling more than 810,000 subsidiaries worldwide (UNCTAD 2009*b*: 18). By 2011, the global stock of FDI amounted to about $20 trillion, and the value added by TNC subsidiaries was equal to about 10 per cent of the world's GDP. Moreover, sales by the subsidiaries of TNCs were nearly double the total value of world trade: an estimated $28 trillion (UNCTAD 2012*a*: 23). Whereas in the period before 1960, the vast majority of FDI and TNCs came from the United States, in subsequent years the American presence has been supplemented by corporations with their headquarters in Europe, Japan, Korea, and, increasingly, in less developed countries such as Brazil, China, and India (for further discussion, see Dicken 2003). Sovereign wealth funds have also become major sources of foreign investment.

The activities of TNCs, in turn, have fundamentally transformed the nature of international trade. In particular, the composition of trade has changed dramatically since 1945. Whereas in the inter-war years the composition of trade differed little from that of the previous centuries—that is, it was based on the exchange of raw materials and agricultural products for manufactured goods, since the post-war reconstruction of Europe and Japan, the principal component of trade has been the international exchange of manufactured goods. At first, this trade was primarily among the industrialized countries. In many instances, it involved **intra-industry trade**, that is, the international exchange of products from the same industry. For example, intra-industry trade occurs when Sweden exports Volvo cars to Germany and imports BMW vehicles from Germany. As this example suggests, product differentiation by brand name often provides the basis for intra-industry trade, and bears little resemblance to the comparative advantage-based explanation for trade that underlies conventional economic theory. In the last quarter of a century, the growth in intra-industry trade has occurred not so much in the exchange of finished products but of components that are often moved across several national boundaries before assembly and then exported to their final markets—a process that economists have termed the 'fragmentation' of production.

This change in the composition of world trade has been associated with the growing role of TNCs.

They now account for two-thirds of global trade: trade among the various subsidiaries of TNCs—that is, trade within the same firm—constitutes fully a third of all world trade.

Since the 1980s, in particular, less developed countries have also been integrated into the international production networks led by TNCs (see Thun, Chapter 11 in this volume). An increasing number of developing countries have changed the structure of their tariffs to give preference to the processing and assembling of components that are subsequently exported. The World Trade Organization estimates that such processing activities account for more than 80 per cent of the exports of the Dominican Republic, close to 60 per cent of the exports of China, and nearly 50 per cent of the exports of Mexico (WTO 2000*a*). This participation in global production networks is the most significant factor in a dramatic change in the commodity composition of the exports of less developing countries. Contrary to some popular impressions, by the end of the 1990s, manufactured exports constituted 70 per cent of the total exports from the developing world. The share of manufactures in their exports had increased threefold since the end of the 1970s (UNCTAD 2001: xviii).

Reference to these less developed economies provides a timely reminder of another dramatic change in international economic relations since 1945—a huge augmentation in the number of independent states in the system. As noted in Box 1.5, only forty-four countries were represented at the Bretton Woods conference, which was dominated by the industrialized countries of Europe and North America, but also included a few of the long-independent countries of Central and South America. Within two decades, almost all of the colonies of the European countries had gained their independence. This development had profound implications for the international system. One was simply the consequence of an increase in both the number of states and in the diversity of the international community: the number of states in the system more than doubled. Collaboration in international economic relations and the management of various dimensions of this collaboration became increasingly complex, illustrated very clearly in the trade sphere by the difficulties in negotiating the Uruguay and Doha Rounds of WTO talks (see Winham, Chapter 5 in this volume, for details of these discussions; and Aggarwal and Dupont, Chapter 3, for a discussion of the problems that larger numbers pose for collaboration). The growth in the number of less developed countries also brought institutional change, most notably in the foundation of the United Nations Conference on Trade and Development (UNCTAD) in 1964. And the new arithmetic in the international system generally, and particularly within the United Nations system, contributed to a change in international norms with the adoption, first, of decolonization (Jackson 1993), and then of development as core norms of the modern system.

Another defining characteristic of the contemporary system contributed to the enshrining of the development norm—the vast expansion in the number of non-governmental organizations (NGOs), many of which were focused on the alleviation of poverty (for further discussion of this topic, see the chapters in this volume by Wade and Phillips). NGOs have also been prominent in global environmental affairs (see Dauvergne, Chapter 14 in this volume) and, increasingly, in international trade. Relations between industrialized and less developed countries, and issues relating to global poverty and inequality, emerged as an important dimension of the study of international political economy, the evolution of which is discussed in the next section of this chapter.

KEY POINTS

The post-war international economy was qualitatively different from anything that preceded it, on several dimensions:

- states made a commitment to multilateralism, reflected in the construction of institutions at the global and regional levels;
- the world economy grew at unprecedented rates after 1945—the internationalized component of economies became more significant as trade and foreign investment grew more rapidly than production;
- TNCs and foreign direct investment (FDI) emerged as key agents in the process of internationalization;
- the composition and direction of international trade changed dramatically, with intra-industry trade among industrialized economies constituting the vast majority of aggregate world trade; and
- the number of countries in the international system rose substantially.

The Study of Global Political Economy

The emergence of global political economy as a distinct subfield

Global political economy (GPE) developed as a significant subfield in the study of international relations in the 1970s. As has so often been the case in political science, the emergence of a new subject area was a response both to real-world changes and to trends in theorizing within and outside the discipline (see Box 1.6).

In the early 1970s, the global economy entered a period of turbulence following an unprecedented period of stable economic growth. The 'long boom' from the early post-war years through to 1970 benefited developed and less developed economies alike. Because of the comparative stability of this period, it was commonplace to regard international economic relations as a relatively uncontentious issue area that could be left to technocrats to manage. All this changed in the late 1960s, however, when the US economy encountered increasing problems because its commitment to a **fixed exchange rate** constrained its policy options at a time when domestic inflation was being fuelled by high levels of government expenditure—domestically, on social programmes, and internationally on the pursuit of the Vietnam War. In August 1971, a new era of instability in the global economy was ushered in when the Nixon administration unilaterally devalued the dollar (for further discussion, see Helleiner, Chapter 7 in this volume). In doing so, it set in train events that were to end the system of fixed exchange rates, one of the pillars of the Bretton Woods financial regime.

The new instability in international finance reinforced perceptions that the global economy was about to enter an era of significant upheaval. Commodity prices had risen substantially in the early 1970s; Western concerns about the future availability and pricing of raw materials were compounded by the success of the Organization of the Petroleum Exporting Countries (OPEC) during the Arab–Israeli war of 1973 in substantially increasing the price of crude oil. Less developed countries believed that they could use their new-found 'commodity power' to engineer a dramatic restructuring of international economic regimes, a demand they made through calls at the United Nations for a **New International Economic Order (NIEO)** (see Phillips, Chapter 13 in this volume). Industrialized economies were already having difficulty in coping with a surge in imports of manufactured goods from Japan and the East Asian **newly industrializing economies (NIEs)**, causing them to revert to various discriminatory measures to protect

BOX 1.6

What's in a Name? International Versus Global Political Economy

When international relations scholars began to examine economic issues in depth, the new subfield inherited the rather misleading adjective 'international' as the leading word in its title. Commentators have often pointed out that 'international' relations is a misnomer for its subject matter in that it confuses 'nation' with 'state', and fails to acknowledge the significance of private actors in global politics. But labels, like institutions, are often 'sticky'—once adopted, it is difficult to displace them, even if a better alternative is available. The abbreviation, IPE, has become synonymous with the field of study. Even though we prefer 'global political economy' for the title of the book because it reflects more accurately the contemporary subject matter of this field, many of the contributors follow conventional usage in employing the abbreviation IPE and in referring to 'international' political economy.

While the study of global political economy achieved a new prominence in the 1970s, a variety of work in what would now be recognized as the field of GPE was published much earlier than this. A prominent example is Albert Hirschman's (1945) study of Germany's economic relations with its East European neighbours. Much of the work in the field of development economics that blossomed in the post-war period included a significant focus on political and international components. And the Marxist tradition of political economy remained vibrant, particularly in Europe.

To confuse matters, the study of economics was known in the eighteenth and nineteenth centuries as political economy (see, for example, John Stuart Mill's (1970), *Principles of Political Economy*). The titles of some leading journals in the field of economics—for example, the *Journal of Political Economy*, first published in 1892—reflect this older usage.

their domestic industries, in disregard of their obligations under the international trade regime. In trade and finance regimes alike, new pressures were causing governments to seek to rewrite the rules governing international economic interactions.

At this time of the greatest instability in international economic relations since the depression of the 1930s, inter-state relations in the security realm, which had been the principal focus of the study of post-war international relations, appeared to be on the verge of entering a new era of collaboration. The United States was winding down its involvement in Indo-China; Henry Kissinger was negotiating détente with the Soviet Union; and President Nixon's visit to China in 1972 appeared to presage a new epoch in which China would be integrated peacefully into the international system. For many scholars of international relations, the traditional agenda of the discipline was incomplete, and the preoccupation of the dominant, realist approach with security issues and military power seemed increasingly irrelevant to the new international environment (Keohane and Nye 1972; Morse 1976).

The new turbulence in international economic relations prompted political scientists to take an interest in a subject matter that had previously been left largely to economists. It was not, as some commentators have suggested, that international economic relations had suddenly become politicized. Politics and asymmetries in power had always underlain the structure of global economic relations, seen, for example, in the content of the various financial regimes negotiated at Bretton Woods. Rather, what was novel was that the turbulence of the early 1970s suggested that the fundamental rules of the game were suddenly open for renegotiation.

Political scientists' new interest in international economic relations also coincided with the abandonment by the economics profession of what had previously been taught and researched as institutional economics: as the discipline of economics aspired to more 'scientific' approaches through the application of statistical and mathematical models, so it increasingly abandoned the study of international economic institutions. Political scientists discovered a vacuum that they quickly filled: the field of global political economy was born.

What is GPE?

Global political economy is a field of enquiry, a subject matter whose central focus is the interrelationship between public and private power in the allocation of scarce resources. It is not a specific approach or set of approaches to studying this subject matter (as we shall see, the full range of theoretical and methodological approaches from international and comparative politics has been applied to the study of international political economy).

Like other branches of the discipline, GPE seeks to answer the classic questions posed in Harold D. Lasswell's (1936) definition of politics: *who gets what, when, and how?* This definition explicitly identifies questions of *distribution* as being central to the study of politics. It also points implicitly to the importance of power—the concept that is at the heart of the study of political science—in determining outcomes. Power, of course, takes various forms: it is classically defined in terms of relationships—the capacity of one actor to change the behaviour of another (Dahl 1963). But power is also exercised in the capacity of actors to set agendas (Bachrach and Baratz 1970; Lukes 1974), and to structure the rules in various areas of international economic relations so as to privilege some actors and to disadvantage others (Strange 1988).

Consider, for example, the international financial regime. As the world's largest economy (and single most important market for many other countries in the global system), the United States has been able, over the years, to exercise relational power: to force changes in the behaviour of other countries—notably, to accept changes in their exchange rates (as, for example, in the Nixon administration's breaking of the fixed exchange rate between the dollar and gold, and the forced appreciation of the North-East Asian currencies against the dollar following the **Plaza Accord**). The rules of the international financial regime have also been structured so that they privilege the more economically developed states in the system: not only do the wealthy industrialized economies enjoy more votes within the IMF and the World Bank under the weighted voting system employed in the two major **international financial institutions (IFIs)** (Box 1.7), but the industrialized economies (in part because of arrangements they have negotiated among themselves) have also largely escaped the discipline imposed by the IMF on countries that run persistent balance of payments deficits. Until the recession of 2008–9, no industrialized country had sought assistance from the IMF since Britain and Italy did so in 1976. Despite running huge deficits in its balance of payments, the United States has not been subject to IMF discipline

BOX 1.7

Voting in the International Financial Institutions

When the allied powers decided at Bretton Woods to create two international financial institutions, they agreed on a formula for voting rights that represented a compromise between the principle of sovereign equality and the realities of markedly unequal economic power. Members' voting power has two components: 'basic votes', assigned equally to all members; and (a much larger number) of weighted votes that are linked directly to the money members subscribed to the two institutions. Quotas have been adjusted over the years as the membership of the institutions has expanded, but the G7 industrialized countries still control 43 per cent of the votes in the IMF, while more than forty African countries together have less than 5 per cent of the total votes.

Eight countries—China, France, Germany, Japan, Russia, Saudi Arabia, the United Kingdom, and the United States—have their own representative on the twenty-four-member IMF Executive Board, which is responsible for the day-to-day running of the institution. Others are arranged in various groups, with a single executive director casting their collective votes. Five executive directors represent individual countries on the seventeen-member World Bank Executive Board: the United States, Japan, Germany, France, and the United Kingdom; the remaining twelve directors represent the Bank's other 180 member states.

In the IMF, 'Ordinary' Decisions require a simple majority, whereas 'Special' Decisions require an 85 per cent 'supermajority'. The United States, with 16.74 per cent of the total votes at the IMF, can unilaterally block 'Special Decisions', such as changes in the IMF's Charter or use of its holdings of gold. Voting, however, is relatively rare, with most decisions being carried by consensus.

Criticisms of the failure of IMF quotas and voting rights to reflect the growing significance of developing economies were increasingly voiced after the East Asian financial crises of 1997–98. This criticism led to proposals to reform quotas and to increase the number of basic votes assigned to each country. The first stage was an 'ad hoc' increase in the quotas of China, Korea, Mexico, and Turkey (ranging from about a 20 per cent increase for Turkey to about 80 per cent for Korea), took effect in 2007. In the wake of the financial crisis and the G20's decision to double the resources available to the IMF, the Fund's Executive Board approved far-reaching reforms. The increase in quotas would be distributed in a manner such that the share of emerging market and developing economies would double. Voting power in the Fund would more closely reflect the relative size of countries in the global economy. The ten largest members of the Fund would be the United States, Japan, the four largest European economies (France, Germany, Italy, and the United Kingdom) and Brazil, China, India, and the Russian Federation. China would be the single largest beneficiary of the redistribution, with its voting rights increased by 50 per cent. The United States, whose weight in the global economy is actually under-represented in its IMF voting rights, would retain its veto power with slightly under 16.5 per cent of total votes (for details of the new quotas and voting rights see http://www.imf.org/external/np/sec/pr/2010/pdfs/pr10418_table.pdf). The Executive Board would also be restructured with all Executive Directors being elected; two European seats would disappear to be replaced by two Directors from emerging economies. The changes, which require approval of countries with 85 per cent of the Fund's voting rights were scheduled to be introduced by the end of 2012. By March 2013, the requisite number of votes had not been achieved: the US had not agreed to the proposed reforms.

By convention, since the foundation of the two IFIs, the United States has nominated the president of the World Bank, and (West) European countries the managing director of the IMF. In an unusual move in 2000, however, the Clinton administration in the US vetoed the German government's first-choice nominee for the post of managing director of the IMF. Although the appointment of the nominees is subject to a formal vote within the Fund and the Bank, other members have only the option of either voting for or against the nominated candidate rather than proposing alternative names. The dominance of the US and Europe in choosing the CEOs of the IFIs has increasingly been contested; in the process that led to the appointment of Christine Lagarde as Managing Director of the Fund in June 2011, however, developing economies were unable to reach agreement on an alternative candidate.

The Washington, DC location of the two IFIs facilitates US influence over their operations. For more detailed discussion of the representativeness and accountability of the IFIs, see Woods (2003).

Unlike the IFIs, the Geneva-based World Trade Organization operates on the principle of one member, one vote, but its members have never voted: decision-making is by consensus, see Winham, Chapter 5 in this volume.

because it can take advantage of the international acceptability of the dollar and print more money to finance its trade deficits.

Besides a focus on questions of distribution and of power, two of the fundamental concerns of political science, students of global political economy have also been preoccupied with one of the central issues in the study of international relations: which conditions are more favourable for the evolution of cooperation among states in an environment where no central enforcement agency is present? For many observers, this problem of 'cooperation under anarchy' is even more pertinent in the economic than in the security realm. This is because greater potential exists in the economic sphere, particularly under conditions of interdependence, for cooperation on a win-win basis, but states have a considerable temptation to 'cheat' by attempting to exploit concessions made by others while not fully responding in kind (see Aggarwal and Dupont, Chapter 3 in this volume).

Much of the early GPE work in the 1970s and early 1980s, particularly in North America, married two of these central concerns—the distribution of power within the global economy, and the potential for states to engage in collaboration. Conducted at a time when many perceived US economic power to be waning, this work focused on the link between hegemony and an open global economy (see Box 1.8).

Approaches to the study of global political economy

Following the publication of Robert Gilpin's (1987) magisterial overview of the then emerging field of global political economy, most introductions to the subject have identified three principal categories of theoretical approaches to GPE. In Gilpin's original terminology (he changed some of his labels in the updated version of his book: Gilpin 2001), these were liberalism, nationalism, and Marxism. Of these three labels, only liberalism has been used universally in other categorizations. Other writers have substituted **statism**, 'mercantilism', 'realism', or 'economic nationalism' for nationalism. The approaches that Gilpin subsumed under the label Marxism have variously been identified as 'radical', 'critical', 'structuralist', 'dependency', 'underdevelopment', and 'world systems'.

In itself, the use of a variety of labels points to one of the problems with the 'trichotomous' categorization of approaches to the study of GPE: the (sometimes misleading) lumping together of substantially different perspectives within a single category. Moreover, the trichotomous categorization does not capture the wealth of methodological and theoretical approaches used in the contemporary study of GPE, or provide an accurate signpost to the breadth of fascinating questions that currently preoccupies

BOX 1.8

Power and Collaboration

The theory of **hegemonic stability** suggests that international economic collaboration in pursuit of an open (or liberal) economic order is most likely to occur when the global economy is dominated by a single power (because this country, the hegemon, will have both the desire and the capacity to support an open economic system—the dominant economy is likely to benefit most from free trade; moreover, its relatively large size will give it leverage over other states in the system). Theorists pointed to the experience of the mid-nineteenth century, when Britain was the hegemonic power, and to the period of US dominance from 1945 to 1971, as demonstrating the relationship between hegemony and an open world economy. In contrast, the inter-war period, when no single country enjoyed equivalent preeminence, was characterized by a breakdown in international economic collaboration. The decline in the relative position of the US economy in the 1960s, following the rebuilding of the Western European and Japanese economies, appeared to coincide with renewed closure (a rise in protectionism in response to imports from Japan and the East Asian NIEs) and the general turbulence in global economic regimes noted above.

Subsequently, however, the hegemonic stability argument was undermined both by trends in the real world and by new theoretical work. In the 1990s, countries extended their collaboration on international economic matters, especially in trade, despite a relatively more even dispersion of economic power in the global system.

For statements of the hegemonic stability argument, see Kindleberger (1973) and Krasner (1976); for alternative theoretical perspectives see Keohane (1984, 1997), Snidal (1985*b*), and Pahre (1999). For further discussion, see Aggarwal and Dupont, Chapter 3 in this volume.

researchers in the field. For these reasons, we do not use such conventional categorization in this book. So common is the trichotomy in introductions to GPE, however, that it is worth investing a little time in understanding the underlying foundations of the categorization. Matthew Watson's chapter in this volume examines the historical origins and subsequent intellectual lineage of the principal theoretical perspectives on GPE.

Much of the best work in global political economy in recent years has been less concerned with prescription than with explanation—for example, how differences in political institutions shape policy decisions, and why some sectors of the economy are more successful than others in seeking protection (see Hiscox, Chapter 4 in this volume); why it is easier for states to collaborate on some issues rather than others (see Aggarwal and Dupont, Chapter 3 in this volume); why states have increasingly pursued trade agreements at the regional instead of the global level (Ravenhill, Chapter 6 in this volume); why states have been unable to agree on an effective regime for dealing with international debt (Pauly, Chapter 8 in this volume); and why some global environmental regimes are effective while others are not (Dauvergne, Chapter 14 in this volume). Of course, policy prescriptions often follow from such theoretically informed analysis, and they are far more specific than those of the 'get the state out of the market' variety.

Since the early 1980s, the study of global political economy has been enriched by the application of a diverse array of theoretical and methodological approaches, but neither their subject matter nor the methodologies employed allow easy categorization. Take, for example, the role of ideas in shaping policy agendas, in helping states to reach agreement in various international negotiations, and in legitimizing current economic, political, and social structures. Ideas have been the central focus of work firmly within the Marxist tradition, which builds on the arguments of the former Italian communist party leader, Antonio Gramsci, on how ideas help ruling classes to legitimate their domination (Cox 1987; Gill 1990). But ideas have also been pivotal to quite different approaches, drawing on the work of the German sociologist, Max Weber. Work from this perspective examines the role that ideas play in defining the range of policy options that governments consider, and in providing a focal point for agreement in international negotiations (Hall 1989; Goldstein and Keohane 1993; Garrett and Lange 1996). Also derived from Weberian analysis are constructivist approaches, which emphasize the significance of ideas in constituting actors' perceptions of their interests and identities, rather than taking these for granted—examples of the application of constructivist analysis to IPE include Colin Hay (Chapter 10 in this volume), Haas (1992), Hay and Rosamond (2002), Burch and Denemark (1997), Abdelal, Blyth, and Parsons (2010). And cross-fertilization has occurred across different approaches—for example, the Gramscian idea of hegemony has been used by writers from a non-Marxist perspective, such as Ikenberry and Kupchan (1990), and finds resonance in Joseph Nye's (1990) concept of 'soft' power.

Likewise, turning to **methodology**, we find similar methods employed by scholars from dramatically different theoretical traditions. Consider rational choice approaches, for example. Since the mid-1990s, rational choice has dominated many areas of the study of political science, particularly in universities in the United States. Its origins lie in economic theory; the focus is primarily on individuals, the factors that lead them to choose preferred courses of action, and how strategic interaction generates uncertainty. In GPE, rational choice analysis has been prominent in the recent study of why international institutions, including the European Union, take particular forms, what the effects of institutions are, and why some institutions survive longer than others (Frey 1984; Martin 1992; Garrett and Weingast 1993). Vaubel (1986, 1991) has applied rational choice analysis in an examination of the behaviour of the officials of the IMF. Such work is very much in the mainstream of contemporary political science. But rational choice methods have also been applied by theorists working within the Marxist tradition—for example, Roemer (1988), and Carver and Thomas (1995).

Although rational choice methods have become dominant in some circles within North American political science, a large number of scholars of GPE would find it difficult to accept the argument of one proponent of rational choice methods that GPE 'is today characterized by growing consensus on theories, methods, analytical frameworks, and important questions' (Martin 2002: 244). Diversity in **ontology**, **epistemology**, and methodology continues to characterize the international study of global political

BOX 1.9

Epistemology, Ontology, and Methodology

Epistemology addresses the issues of what knowledge is and how it is acquired. Ontology is the study of being, addressing the question of what is there, what are the essential features of an object. Methodology refers to a procedure or set of procedures used to study a subject matter.

economy (see Box 1.9). Many scholars find this rich mix of theories and methodologies a cause for celebration rather than concern. This is certainly the view of the contributors to this volume, which reflects much of the current lively debate in the study of GPE.

The first part of this volume looks at some of the approaches that have addressed the key concerns of theorists of GPE: what conditions are most conducive to the emergence of collaborative behaviour among states on economic issues, and what are the determinants of the foreign economic policies of states? It then examines the evolution of trade relations, first at the global and then at the regional level. Chapter 7 reviews the development of the global financial regime since 1944; the following chapter addresses the causes of financial crises and the reasons why international collaboration to date has been ineffective in devising strategies to combat them.

The chapters in the second half of the book examine various aspects of the debate about globalization: whether in fact the contemporary economy is global and whether it differs, qualitatively or quantitatively, from previous eras of economic interdependence; the role of production networks in driving globalization; the consequences of enhanced globalization for the policy options available to states; the impact of globalization on world poverty and inequality; how globalization has changed the relations between industrialized and less developed economies; and the impact of globalization on the environment.

KEY POINTS

- The field of global political economy emerged in the early 1970s in response to developments in the world economy, in international security, and in the study of economics and international relations.
- GPE is best defined by its subject matter rather than as a particular theory or methodology.
- Approaches to the study of GPE have conventionally been divided into the three categories of liberalism, nationalism, and Marxism.
- This trichotomous division is of questionable contemporary utility because of the variation in approaches included within each of the three categories.
- The contemporary study of GPE is characterized by the application of a wealth of theories and methodologies.
- Most of the contemporary work in GPE focuses on positive theory: that is, attempting to explain why things happen, rather than on policy prescription.

? QUESTIONS

1. What were the principal factors that determined the severity of the recession of 2008–09?
2. In what ways did the recession of 2008–09 change global economic governance?
3. What were the principal features of the classical period of mercantilism?
4. What were the reasons for rapid economic growth in the nineteenth century?
5. How did the gold standard operate automatically to bring the payments position of countries into equilibrium?
6. What were the principal reasons for the breakdown of international economic relations in the inter-war period?
7. What are the defining characteristics of the post-1945 world economy?
8. What factors led to the emergence of IPE as a significant field of study?
9. What is GPE?
10. What are the main weaknesses with the traditional threefold categorization of approaches to GPE?

FURTHER READING

Cohen, B. J. (1977), *Organizing the World's Money: The Political Economy of International Monetary Relations* (New York: Basic Books). The first major study from an IPE perspective of global financial relations.

Cohen, B. J. (2008), *International Political Economy: An Intellectual History* (Princeton, NJ: Princeton University Press). The most detailed examination of the development of contemporary international political economy.

Cooper, R. N. (1968), *The Economics of Interdependence* (New York: Columbia University Press). A pioneering work that laid the foundations for the emergence of GPE as a significant field of enquiry in the 1970s.

Crane, G. T., and Amawi, A. (eds) (1997), *The Theoretical Evolution of International Political Economy: A Reader*, 2nd edn (New York: Oxford University Press). An excellent compilation of selections from classical and contemporary writing on global political economy.

Gilpin, R. (1987), *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press). The most theoretically sophisticated of the early introductory books on IPE.

Hirschman, A. O. (1945), *National Power and the Structure of Foreign Trade* (Berkeley and Los Angeles, CA: University of California Press). A pioneering study of the relationship between power and the foreign economic relations of Nazi Germany.

Keohane, R. O. (1984), *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, NJ: Princeton University Press). The most thorough assessment of the relationship between the distribution of power and collaboration among states on international economic matters.

Maddison, A. (2001), *The World Economy: A Millennial Perspective* (Paris: Development Centre of the Organization for Economic Co-operation and Development). Excellent source of historical statistics on the development of the world economy.

Palan, R. (ed.) (2012), *Global Political Economy: Contemporary Theories*, 2nd edn (London: Routledge). The most comprehensive survey of contemporary theoretical approaches to global political economy.

Schwartz, H. M. (2010), *States versus Markets: The Emergence of a Global Economy*, 3rd edn (London: Macmillan). Provides an unusual historical perspective on the contemporary global economy by tracing its development since the 1500s, with emphasis placed on the links between the emergence of the modern state and the modern global economy.

Strange, S. (1971), *Sterling and British Policy: A Political Study of an International Currency in Decline* (London: Oxford University Press). A pioneering work on the relationship between politics and international financial policies.

Strange, S. (1988), *States and Markets* (London: Pinter). An idiosyncratic introduction to global political economy that is organized around the theme of structural power.

Wallerstein, I. (1974), *The Modern World-System* (New York: Academic Press). The first volume of a multi-part work examining the emergence of the modern world economy.

WEB LINKS

http://www.g7.utoronto.ca University of Toronto G8 Information Centre.

www.imf.org International Monetary Fund.

www.worldbank.org World Bank.

www.unctad.org United Nations Conference on Trade and Development (UNCTAD).

www.opec.org Organization of the Petroleum Exporting Countries.

www.eh.net/encyclopedia/article/officer.gold.standard Gold Standard—EH.Net Encyclopedia.

www.amosweb.com/gls Glossary of economic terms.

ONLINE RESOURCE CENTRE

For additional material and resources, please visit the Online Resource Centre at:
www.oxfordtextbooks.co.uk/ravenhill4e

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2

The Historical Roots of Theoretical Traditions in Global Political Economy

Matthew Watson

Chapter contents

Reader's guide

This chapter focuses on the historical origins and the subsequent intellectual lineage of what are generally considered to be the three core theoretical positions within contemporary global political economy (GPE). At the very least, these three positions—realism, liberalism, and Marxism—form students' standard introduction to the subject field via the textbooks. The search for such origins is important in general, because it reminds the student of any subject field that contemporary perspectives are part of a longer tradition of thought. It is even more important in GPE because its introductory textbooks tend not to rework its historical roots from scratch. Instead, they often rely on populist intellectual histories, where the politest thing that can be said about the ensuing image of where GPE came from is that it is overly simplified. The problem in this respect is that the modern-day variants of realism, liberalism, and Marxism are treated as the authoritative ones, with the original statements of those positions then being fitted to their closest modern-day equivalent. This, though, is to read the history of ideas the wrong way round. By taking the alternative option of trying to present students with a clear idea of exactly what divided the main theoretical positions in contemporary GPE at their point of origination, this chapter provides important contextual evidence about the way in which those positions have subsequently evolved into their modern form. The result is that it is possible to collapse a number of the rigid lines of demarcation that are drawn in introductory textbooks between competing theoretical positions in GPE, while also identifying the intellectual propositions that did most to divide the eighteenth- and nineteenth-century precursors so as to compare them with today's accounts of those positions. Through this process it will be shown that no straight lines exist linking Listian nationalist political economy to contemporary GPE realism, the Smithian system of natural liberty to contemporary GPE liberalism, or even necessarily Marxian political economy to contemporary GPE Marxism. Each of the classical positions contains formative intellectual assumptions that were unique to its own time, and the same is also true of each of the modern-day positions.

Introduction

The purpose of this chapter is to provide a broad overview of the subject field of GPE as a whole, but without simply repeating the introductions to the field that dominate other textbooks. Indeed, those introductions will often appear in the pages that follow as objects of criticism. I take issue with them primarily for their lack of attention to GPE's historical roots, and for allowing this to contribute to the reproduction of a number of important misreadings of the paths from foundational political economy debates to where GPE is located today. My aim is to question the account of the three main theoretical positions through which introductions to GPE are typically taught—realism, liberalism, and Marxism—and to urge students to go beyond these accounts and explore for themselves the specialist history of economic thought literature that offers alternative perspectives on those positions.

There is what might be called a 'textbook GPE', then, which usually provides a student's first exposure to the subject field. Yet there are also other ways of learning about theoretical traditions in Global Political Economy. I will reveal my hand straightaway by declaring my preference for these other ways, especially for the objective of uniting GPE with the study of the historical roots of its dominant theoretical traditions. GPE and the history of economic thought are generally treated as being two completely separate practices, but there is no good reason why this should necessarily be the case.

This chapter should therefore not be read as if it were a direct substitute for usual introductory textbook chapters on GPE theory, because I am attempting to do something quite distinct. It is, of course, very important that students become aware of the standard textbook account of how modern-day GPE realism, liberalism, and Marxism differ from one another, as this will be the type of scholarship that they will encounter more and more as their studies progress. It is also important, though, to understand how these modern-day positions may be somewhat less than faithful to the arguments from the history of political economy to which they purportedly express filiality. For instance, the analytical ends to which modern-day liberals put the eighteenth-century political economy concept of 'market' often look completely different to how the eighteenth-century scholars used it. It is also possible to identify a shared commitment across the centuries for liberals to talk about an abstract 'economic man', but the meaning of that abstraction differs markedly between the eighteenth century and today because different behavioural characteristics are imputed to it.

Critically-minded students therefore have much to gain from learning about the tendency for the three main theories of GPE to have become detached from their historical moorings. All is not necessarily as clean and as clear-cut in the intervening history as is so often suggested in the introductory textbooks to the field. The textbooks focus overwhelmingly on the character of the modern-day positions of realism, liberalism, and Marxism, as well as on what modern-day proponents of those positions say about their debts to classic interventions in the history of their field. My focus, in the first instance, is on those interventions themselves, the arguments that their authors made in their own words, and how they have subsequently been understood in the specialist history of economic thought literature. Combining the two might well bring GPE and the history of economic thought together in fruitful ways.

Teaching Global Political Economy through the Textbooks

Most GPE scholars were taught their trade having first studied international relations (IR) courses. Perhaps predictably, given this background, the question-asking framework associated with IR continues to loom large as a template for GPE (Phillips 2009). The same three-way distinction between realism, liberalism, and Marxism has been transposed in pretty much identical form from one to the other. Indeed, Robert Gilpin—author of the best-selling GPE textbook, *The Political Economy of International Relations* (1987), as well as being one of the first generation of IPE scholars who, according to Benjamin Cohen (2008), set the parameters within which the field continues to be located today—describes these positions as 'the three ideologies' of GPE (Gilpin 1987: 25; see also Gilpin 1975: 21).

The origin of the claim within the IR literature is significant, as is Gilpin's specific choice of descriptor. He could have called them three separate starting points for GPE. However, this would have implied that, at some stage, students would be required to branch out from those starting points in order to comprehend what is at stake by beginning there. Starting points, after all, are very rarely also the end points of academic endeavour. Equally, he could have called them three separate theoretical bases for understanding the world around us. However, the art of working within a theoretical perspective is always to question the limits that perspective imposes on original thought as a means of ultimately transcending it.

Gilpin is clear about why he instead uses the word 'ideology' to describe realist, liberal, and Marxist GPE. He does so in an attempt to capture a sense of self-contained, coherent world views, capable of imposing meaning on any experience of the world, and equally capable of encapsulating whole systems of thought and belief (Gilpin 1987: 25–6).

Students can turn to pretty much any introductory IPE textbook to find out how the subject field might be divided using this three-way split in Gilpin's specific sense. My intention in this chapter is rather different. The textbook introductions generally display very little focus on the historical roots of these three competing traditions of GPE's orthodox pedagogy. In specifying those roots rather more precisely, it becomes possible to show the limitations of conceiving of Gilpin's three ideologies of GPE as self-contained, coherent world views. As such, it also undermines the rationale for calling them 'ideologies' in the first place.

The reason why this way of thinking continues to hold such a spell over GPE textbooks has much to do with how the chronology of the field continues to be understood. Almost every appraisal of the subject field begins by commenting on GPE's youth relative to other fields (Gill and Law 1988; Onuf 1997; Pearson and Rochester 1998; Dash *et al.* 2003). It was forged amid attempts to explain events that were a particular feature of distinctively modern times. Specifically, GPE results from concerns to reflect on the future of world economic affairs following the collapse of the **Bretton Woods** system of international economic management in the early 1970s (Krasner 1976; Gilpin 1987; Frieden and Lake 1995; Grieco and Ikenberry 2003). That system had brought seemingly unparalleled stability to the economies of the Western alliance. **Marshall Aid** had allowed the US to recycle its massive post-war trading surpluses while also simultaneously allowing countries in Western Europe and East Asia to fast-forward the process of economic reconstruction through securing extremely high growth rates and employment rates. From the perspective of the disturbances of the 1970s, the immediate post-Second World War era looked like a 'golden age' of almost limitless economic possibilities (Kitschelt *et al.* 1999). Given such a context, the task that the early GPE scholars set themselves was how to envision the conditions of renewed systemic stability (Murphy and Tooze 1991: 17).

This intimate connection between the birth of GPE and the onset of what seemed to be qualitatively new economic conditions made it possible for the early GPE scholars to pay something less than full attention to the implications of the history of political economy for their new subject field. After all, developments within the most recent phase of the modern world economy could be said only to require the most up-to-date methods and approaches from the existing academic literature. 1970 represents an important birth date for GPE, then, in two distinct ways. It not only provided the early GPE scholars with a set of concrete historical facts for them to try to explain. It also provided them with some dominant theoretical constructions to organize the attempt to make sense of the surrounding world. Looking back from today, GPE's birth date provided the subject field with two very important originating biases. The contextual assumption of foregone stability continues to cast a large shadow over contemporary GPE, providing a means of distinguishing normatively between the work of those who are willing to suppress the possibility of a new social order in the interests of international economic stability and the work of those who are not. Equally, the approaches that were just coming to prominence in GPE's parent field of IR in the early 1970s—primarily **rational choice theory**—continue to provide the basis for methodological disputes in GPE today.

Such disputes have been given their most important airing in recent times in Benjamin Cohen's *International Political Economy: An Intellectual History*. It was not so much the contents of the book as the fact that he specifically put pen to paper to write it that made so many GPE scholars take notice of it. Had it been written by a lesser figure within the field it is unlikely that so many people would have felt the need to engage with it. Cohen is, it should go without saying, a doyen of GPE: he has been writing in the field almost since its 1970 birth date and is a highly respected figure for the insights that he has brought to bear on the subject. Under anyone else's authorship the book would almost certainly have included Cohen himself as the eighth of the all-important first generation of GPE scholars.

As it is, Cohen identifies competing American School and British School traditions within the field and places a 'follow-my-leader' interpretation on his explanation of how the influence of seven formative figures in GPE still shapes the division between the two schools (Cohen 2007). In a deferential act he refers to these figures as the **Magnificent Seven** (Cohen 2008: 10), intellectual entrepreneurs who laid the methodological foundations for GPE in its earliest years. As befits the subsequent distribution of GPE scholars to their respective schools, five of these first-generation trailblazers paved the way for the development of the American School (Robert Keohane, Robert Gilpin, Charles Kindleberger, Stephen Krasner, and Peter Katzenstein), and two for the British School (Susan Strange and Robert Cox). Cohen's underlying point is that, although all seven agreed that there was a need for a new field to close the existing gap between International Relations and International Economics, they disagreed quite significantly about the precise form that field should take (Cohen 2009). Keohane (2011: 37) has subsequently written of the eclectic intellectual interests that they used to bounce off each other, saying that the earliest pioneers in the field were 'neither expecting nor wanting general agreement'. However, while Cohen accepts that the disagreements were what gave GPE its early vitality, still there was enough agreement amongst the pioneers for two recognizable but distinct groupings to form. The five 'Americans' shared similar commitments about what constituted good research; the two 'Britons' did likewise, albeit along different lines.

Cohen's most controversial claim is that what has emerged over time is an American School that prides itself so much on its scientific method that this is willingly traded for the realistic nature of its underlying concepts and for its broader applicability to political debates about the content of world economic order; this coexists in his opinion with a British School that is so attentive to its normative method that it generally overlooks the need for empirical testing or the desire to generate replicable results (Cohen 2007). As in a similar account of what divides GPE written some years earlier by Craig Murphy and Douglas Nelson (2001), Cohen's American School has a much more restricted scope of study and a much narrower definition of what counts as political in GPE. Members of the British School, by contrast, tend to rule out nothing a priori as a feasible object of study if it can be shown that it relates to a site of human **agency** that has some demonstrable impact on economic life chances. The objective of such studies is to show how the underlying structure of society both nationally and globally produces **distributional consequences** worldwide. By contrast, the third generation of the American School is more likely to focus solely on issues of policy formation, studying the success that particular actors have had in embedding their interests in international economic agreements and how they have shaped market relationships accordingly. This applies equally to the achievement of national objectives by actors who work at the level of the state and to the maintenance of effective international institutions by actors who work at the level of global governance.

Much depends in this respect on the willingness to work within the restrictions of rational choice theory (a point made even more forcefully by Murphy and Nelson). The third generation of American School authors holds methodological preferences that appear to be ideally adapted to the embrace of rational choice theory. The abstract assumptions of **utility-maximizing behaviour** provide them with the degree of replicability and predictive capacity in their results that they treasure so highly. By remaining loyal to what Jonathan Kirshner (2011: 205) has called a 'hyper-rationalist' mode of explanation, a seemingly rigorous basis is provided on which to claim that a particular type of policy will always be selected in certain circumstances, either because it reflects the generic enactment of self-interest that will always be in play, or because this is the type of policy consistently produced in similar circumstances in the past.

British School scholars have generally been much less sympathetic to the encroachment of rational choice theory within GPE. Their concern is that the theory itself attempts to naturalize a specific conception of economic agency: one that is institutionally suited only to life lived within generally **free market economies**. To adopt that approach, they argue, is akin to turning GPE into an element of the free market

hegemony that the subject field's scholars might otherwise wish to critique. It is simply not possible from this perspective to gain sufficient autonomous theoretical space to comment on the political structures of world order if the theory being used itself both reflects and reinforces those structures (Cox 1981).

Cohen's self-confessed aim in describing the increasing divergence of three generations of American and British School scholarship is conciliatory. He sees himself very much as a bridge-builder, praising the American School for its commitment to scientific rigour but equally praising the British School for its focus on the bigger picture of why world economy dynamics impose themselves on life chances in the way they do. Mutual recognition of these competing strengths, he suggests, makes it much more feasible that GPE scholars might begin the profitable search for what exists in the intellectual space lying between the two schools.

However, Cohen's intervention itself creates impediments to adjudicating between these very different methodological claims on the basis of how well they correspond to the history of political economy. By writing the history of GPE specifically through the work of seven pioneering scholars of his own time, it becomes very difficult to bring back into the equation any preceding intellectual history. None of the Magnificent Seven was academically active to any obvious degree before 1970, which tends to position 1970 as the effective beginning of history as far as GPE is concerned: a Year Zero, if you like. Yet this was a time at which rational choice theory was already beginning to make serious inroads into GPE's parent discipline (Blyth and Varghese 1999). In other words, writing GPE's history in this way has the effect of locking it to the very modern predilection for viewing the world through the eyes of rational choice theory. This was not a theory that was in any way prominent when GPE's longer term roots were being laid down in alternative forms of political economy scholarship in the eighteenth and nineteenth centuries, but the subsequent emphasis on the modern does provide a means of reinterpreting the older political economy scholarship as if it spoke directly to the concerns of rational choice theory. The realism, liberalism, and Marxism of the GPE textbooks are cut off from their longer term historical roots precisely to the extent to which they are incorporated into an academic agenda already wholly permeated by the influence of rational choice theory.

The biggest problem with this, to my mind, is not the fact that these changes have occurred per se, because theoretical perspectives are always likely to evolve, if only under the influence of the changing concrete circumstances that they are trying to explain. Rather, it is the fact that these changes have occurred without significant reflection on their origins from either the advocates or the detractors of the distinctively modern approaches. Rational choice theory has not materialized out of thin air, fully formed and merely awaiting incorporation into GPE, but has its own specific intellectual history. Its prominence in the other social sciences mirrors the effects of the so-called **Formalist Revolution** in economics in the 1940s and 1950s, through which the logical form that was used to express explanatory arguments was first allowed to take precedence over their economic content (Blaug 1999). This was the time when the leading edge of economics initially began explicitly to be modelled as a mathematical science, with the **mathematical tractability** of the implied economic relationships considered to be more important than whether or not those relationships had genuine economic meaning. Deirdre McCloskey (1990: 223) has called this the rise of 'blackboard economics'. The hyper-rationalist individual who instinctively maximizes utility is perfect for such an exercise, because this individual is mathematically tractable rather than genuinely economic.

Terence Hutchison (1998) has argued that McCloskey's blackboard economics deserves the methodological label of 'ultra-deductivism'. This is to stipulate a number of first-principle behavioural characteristics and then to read off all actual economic behaviour from those characteristics by treating them as unchallengeable **axioms** of conduct. None of the founders of the positions that have evolved into modern-day GPE realism, liberalism, and Marxism adopted anything approaching ultra-deductivism as their leitmotif. This was a development most closely associated with the work of the English economist, Nassau Senior, in the 1820s. He first began to write about an abstract persona who has evolved into the 'economic man' that is today so familiar from rational choice theory. Senior was also the first to treat this abstract persona as the basis of economic enquiry, thus creating a competitor to the prior concern for understanding the individual relative to the concrete historical circumstances of his or her constitution. The emergence of neoclassical economics through the **Marginalist Revolution** of the 1870s

BOX 2.1

Neoclassical Economics and the Marginalist Revolution

Neoclassical economics focuses almost all of its attention on instances in which behaviour can have a rational calculus of costs and benefits imposed upon it. The aim is to use this calculus to offer an ostensibly detached, objective description of economic events that matches the standards of scientific rigour by being cleansed of the disruptive influence of philosophical debate (Schumpeter 1954/1994). The analyst is thus supposedly able to comment on economic affairs from beyond the boundaries of his/her own particular world view. Such concerns relegate the significance of clear normative position-taking, thus providing economic enquiry with a technical veneer. The methodologist of economics, John Neville Keynes, once distinguished between the 'science' and the 'art' of economics, in order to emphasize that economists' attempts to engage in methodologically rigorous enquiry (the science) must also be set within the context of explicit acknowledgement that all economic enquiry is always undertaken with specific purposes in mind (the art) (Keynes 1891/1970). David Colander has recently picked up on this distinction to suggest that the current dominance of neoclassical theory has led to the disappearance of the 'art' of economics (Colander 2001). Economic theory always proceeds according to preconceived social ends but, in trying to emphasize the purely technical prerequisites of modern theory, this is something that neoclassical economists typically attempt to disguise.

Historically speaking, neoclassical economics is itself a complex amalgam of positions that possess a familial resemblance but otherwise have different theoretical emphases (see Watson 2005: ch. 2). There are even three distinct starting points for neoclassical theory in the Marginalist Revolution of the 1870s, to be found in the contrasting work of William Stanley Jevons (1871/1970), Carl Menger (1871/1950), and Léon Walras (1874/1984). As these three worked out of Manchester, Vienna, and Lausanne, respectively, there were rival English-speaking, German-speaking, and French-speaking traditions of neoclassical economics right from the start. However, despite these differences, all three traditions have a similar core in a recognized way of thinking, all emphasizing what they took to be the distinctively economic behavioural characteristic of maximization. This was economizing behaviour in the literal sense of the word, seeking to make the most of whatever means were at hand.

The earliest neoclassical economists disagreed on what the individual would attempt to maximize. Jevons contrasted pleasure and pain to say that the maximization of **utility** mattered most; Walras emphasized the experience of scarcity constraints to suggest that the individual would focus on maximizing **'rareté'**; whereas Menger allowed his economic agents to maximize anything they set their minds on. The important point for current purposes, though, is not what each thought people maximized but the fact that they each used the technique of trying to isolate economic decisions taken at the margin. This allowed for the identification of optimal strategies within the context of equilibrium models, as well as for the later insertion of the rationality assumption to explain how the individual might come to know instinctively exactly what the optimal strategy is in any set of circumstances. These features of the early neoclassical economists' work remain visible today in the research of Cohen's third generation of American School GPE.

began to popularize such a shift, but it was not truly cemented until the culmination of the Formalist Revolution some four decades later (see Box 2.1).

KEY POINTS

- The presentation of realism, liberalism, and Marxism specifically as ideologies is itself evidence of the transformation of the original positions from how they were first formulated in the eighteenth and nineteenth centuries.
- The move towards rational choice theory-inspired variants of GPE realism, liberalism, and Marxism mirrors prior changes in economics orthodoxy.
- The recent spate of publishing on the American and British Schools of GPE has crystallized the debate about the extent to which rational choice theory should set the methodological parameters of the subject field.

GPE Realism and the Nineteenth-Century Nationalist Political Economy Tradition

The fact that scholars even consider it worthwhile to teach realism as one possible basis for GPE reveals something potentially interesting about the subject field's origins. Realism, of course, is a standard theoretical approach in IR, but a fair degree of creative licence is then required to transpose it into a readily recognizable political economy approach. In and of itself, realism has no political economy *content*, even if it can talk about matters of economic *policy*. The aim of realist GPE is simply to explain how one state seeks to impose its national interest at the expense of other states' national interests in bargaining situations that occur either bilaterally or multilaterally.

This might then be applied, for instance, to bargaining situations governing **international trade**, **foreign direct investment**, or **cross-border production**.

As there is every justification for tackling such questions with no regard whatsoever for theories of political economy—the subject matter of inter-state bargaining is not, after all, a political economy so much as a politics question—this raises the issue of whether realist GPE, strictly speaking, should qualify for being called GPE at all. At the very least, Susan Strange, another one of Cohen's Magnificent Seven, believes that it should not. She has argued (1998*a*) that realism reduces GPE to the economic branch of foreign policy studies and, for this reason, she was prepared to withhold the designation of GPE when describing work conducted in the realist tradition. Instead, she preferred to call it the PIER approach, which stands for the politics of international economic relations. This is a bold and for some, no doubt, a controversial move, as it draws fairly strict boundaries around the subject field, telling some people that their work counts as GPE proper but others that it does not. In other words, by insisting that GPE has to have political economy foundations of a recognizable lineage if it is to be deserving of the name, Strange forcibly excludes many realists from consideration within the subject field, even though this is the intellectual home that they would instinctively nominate for their own work. What allows them to nominate such a home is that they use a rational choice theory approach for investigating the dynamics of inter-state bargaining, which in turn has its origins in the increasing encroachment of economics methodology into GPE. Yet Strange (1996) was no fan of rational choice theory either.

Strange might well have been justified in being so unforgiving, certainly if a recognizable political economy heritage is considered a crucial element of successfully practising GPE. Perhaps in the search for some sort of political economy credibility—and almost certainly in an attempt to disarm the question of whether realism is genuinely GPE—significant efforts have been made to redescribe contemporary GPE realism as the logical heir of classical nineteenth-century political economy nationalism. This is a standard refrain of pretty much all introductory textbooks in the subject field. Yet, in its own terms, it is an unconvincing claim, as I will now try to demonstrate. To treat the two as synonymous styles of study separated only by distance in time systematically distorts the objectives of classical nineteenth-century political economy nationalism.

The overwhelming statism of modern-day realist GPE

The intellectual lineage of GPE realism can be traced to the founding texts of modern IR realism. It represents an attempt to synthesize two separate strands of thought, described by R. B. J. Walker (1993: 108–22) as structural realism and historical realism. Modern structural realists tend to follow Hans Morgenthau's lead (1948/1960) in anthropomorphizing the state and therefore treating state behaviour as epiphenomenal of essential human characteristics. By making the further assumption that it is human nature to be self-serving and to chase gains solely for oneself, combatively self-interested actions are consequently inscribed into the very logic of state behaviour. It might well be necessary to differentiate Walker's designation of structural realism from Kenneth Waltz's 'neo-realist' variant of the same, because Waltz (1979) explicitly rejects Morgenthau's **anthropomorphization** of the state. However, his account of the nature of state behaviour and of its essential logic is much the same as that of Morgenthau.

By contrast, modern historical realists work within a tradition that originates with E. H. Carr (1939/1946). Here, the emphasis is on developing historically contextualized explanations for how the instinct for combatively self-interested actions might be balanced in any given instance by the perceived need for a state to demonstrate to rival states that it is acting within the bounds of international political norms. The structural logic of state behaviour might therefore always be offset by historically conditioned concerns for turning away from exercising full-on aggression towards other states. But this in itself is further assumed to reflect the rational decision to try to store up more resources of political credibility now for use in self-interested ways in the future. Although the link is nowhere fully fleshed out by GPE scholars, all forms of GPE realism therefore rely on the methodological changes first enacted in economics as its orthodoxy cohered in iterative stages from Nassau Senior through the Marginalist and Formalist Revolutions.

That specific lineage will be entirely alien to a student who comes to this chapter familiar only with introductory textbook accounts of competing GPE approaches. However, that student will doubtless recognize what is being described here in substantive terms. The two IR realist traditions, one starting with Morgenthau (but with its Waltzian variant) and the other with Carr, translate readily into GPE realism as currently practised, with both emphasizing the statist assumptions of the modern-day scholars following in their footsteps. On the one hand, it is assumed that states are concerned solely with their own interests when calculating their preferred stance in international economic negotiations (that is, the realist tradition that begins with Morgenthau and is taken on by Waltz). On the other hand, it is also assumed that states will want to avoid triggering retaliatory actions from other states, as this is likely to harm domestic producers and consumers, and thus work against the national economic interest (that is, the realist tradition that begins with Carr). The easiest way to prevent the precipitation of openly aggressive behaviour from other states is to show that one is acting in accordance with prevailing international economic norms. These are the norms that are both inscribed into and defended by the actions of international institutions, thereby setting the context for global economic governance. In contemporary times, they include respect for the right of others to engage in **free trade** (as enshrined in the operating credo of the **World Trade Organization** (WTO)) and a commitment to liberalizing financial flows and open capital accounts (ditto the **International Monetary Fund** (IMF)).

In this sense, subject matters that link states economically can be talked about using exactly the same explanatory language of IR realism, referring as such to the essential struggle between states for power, prestige, and influence in 'high' political arenas. Even the core IR realism concepts of diplomacy and warfare are translated into GPE by using the adjectival prefix 'economic'. The **ontology** underpinning the theoretical claims that define the approach—that is, the common assumptions its adherents share about the fundamental nature of the world that deserves explanation—is very definitely based around the pre-eminence of the state. As is suggested by Stephen Krasner (1994: 17), one of the leading proponents of this style of GPE and another of Cohen's Magnificent Seven, it is assumed that 'states are the ontological givens in the system'. The *only* world that realist GPE can adequately describe is a world of states, and every other aspect of that world is merely subsidiary to the existence, activities, and decisions of states. Other influential actors, such as large corporate bodies or regulatory institutions, are either constituted directly by states or have their capabilities delegated to them by the decisions of states. From this perspective, to focus on world economic affairs is necessarily to prioritize the study of the actions of states. The statist approach provides no new methods of understanding of its own, theorizing actual state behaviour in exactly the same way as realism. Both are modelled more or less explicitly on the axiomatic assumptions of rational choice theory. In GPE, then, realism and **statism** usually serve as acceptable synonyms for one another.

The questions on which this style of GPE focuses are by no means insignificant ones. The state is evidently an important actor in shaping its citizens' experiences and expectations of the world economy, and to suggest otherwise solely in the search for intellectual space that transcends realist GPE would be unhelpful. It is clearly an issue of note for GPE scholars to understand how states position themselves against one another in international economic negotiations, as well as how they position themselves with respect to the balance of political forces within their respective societies so that they can decide on the character of their negotiating positions in the first place.

However, realist GPE with its statist ontology drawn from its rational choice theory method makes an even starker claim than this. The rational choice theory method dictates that it is unnecessary to ask how states will form their interests in any particular set of circumstances because those interests will be an existential given. States will always act in a way that enhances their immediate power resources within the world economy because those power resources are crucial to shaping further bilateral and multilateral economic negotiations to their advantage. This acts to reduce drastically the time period over which states can be assumed to be forward looking in managing their economic affairs: in effect, forward-looking behaviour is oriented merely to the shortest of short terms. On this point, though, modern-day GPE realism is directly at odds with classical nineteenth-century political economy nationalism. In fact, it might well be possible to push the differences between the two to their logical conclusions in order to depict classical nineteenth-century political economy nationalism as an anti-realist perspective. Yet, this is not a claim that can be found within introductory GPE textbooks.

The political economy foundations of nineteenth-century economic nationalism

The most obvious and most famous account of classical nineteenth-century political economy nationalism

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is Friedrich List's *National System of Political Economy* (1841/2005*a*, *b*, *c*). For this reason, it is perhaps understandable that so many introductory GPE textbooks have sought pre-emptive forms of analysis in List's work to act as a link to modern-day GPE realism (e.g. Gilpin 1987; Gill and Law 1988; Frieden and Lake 1995; O'Brien and Williams 2004). However, such a link requires that a disservice be done to List by forcing him to talk to modern-day intellectual agendas rather than his own by superimposing modern-day academic language onto his work. This is nowhere more apparent than on the question of how states derive their economic interests. For modern-day GPE realists, this is simply a matter of devising strategies to enhance short-term economic bargaining power, but for List it always involved complex trade-offs between emphasizing short- and long-term economic goals. It also involved successfully managing the expectations of society if the long-term goals of overall national **economic development** were to be prioritized over the short-term goals of the immediate enrichment of society. There are clear elements of anti-realism contained within this position.

The first is that List was adamant (1841/2005*a*: 18–22; 1841/2005*b*: 34–5) that what counted as the national economic interest changed with respect to the stage of development exhibited by a country. Stated straightforwardly in this way, List's claim does not appear to be something to which most realists would today object, but there is a subtle yet important difference of approach between the two. Modern-day realists assume that the national economic interest will change over time as the country's level of development changes, but that in each individual time period the national economic interest will cohere internally as a singular entity. In List's work, by contrast, 'the' national economic interest was actually a series of competing national economic interests played out at a single moment in historical time but over markedly different timeframes. The question he asked was how might a state balance its broad overall societal objective of developing as quickly as possible with ensuring the compliance of its citizens at every stage of the development trajectory?

List's specific concern (1841/2005*b*: 191–2, 216–18; 2005*c*: 44–52) was to show why a newly politically unified but still only partially industrialized Germany should revoke its commitment to Britain's nineteenth-century **laissez-faire** policy, even if this temporarily restricted ordinary Germans' consumption possibilities by stopping them from accessing cheap British imports. List is often treated as if he were a critic of free trade *per se*, but this was not so. His argument was only that free trade was wrong for Germany in the particular historical conjuncture in which he was writing (List 1841/2005*a*: 107, 121; List 1841/2005*b*: 37–8, 65–6, 87–9). Germany, he wrote, should seek a better position to engage in free trade alongside Britain only once it had developed into Britain's industrial equal. Free trade was still the ultimate goal of List's nationalist political economy, then, only just not yet. His conclusion was that political attempts should be made to forge a nationalist economic identity by winning the German people over to the idea that their consumption of British goods in the short term was detrimental to German national economic self-determination in the long term (see Box 2.2).

The second big difference between List's work and that of modern-day GPE realists seeking to enlist him as their intellectual antecedent, is that he point-blank rejected their statist ontology. Instead, in clearly elaborated terms to introduce what is almost certainly the most important chapter of his most important book, List announced his commitment—both political and theoretical—to a nationalist ontology. He wrote that (1841/2005*b*: 70): 'Between each individual and entire humanity...stands THE NATION, with its special language and literature, with its peculiar origin and history, with its special manners and customs, laws and institutions'. He even placed the claim in capital letters in an attempt to make it impossible to miss, but still it *is* missed when introductory GPE textbooks claim an unproblematic lineage from List to modern-day state-centred GPE realism.

A new generation of List scholars in GPE has begun to highlight this neglect of the nation in its attempts to prise his *National System of Political Economy* from the clutches of modern-day realists and to ask what a nationalist economic ontology would look like today from a Listian perspective (e.g. Levi-Faur 1997; Crane 1998; Helleiner 2005). This work suggests that there is no simple one-to-one correspondence between List's nationalist economic ontology and the sorts of **protectionist policies** that he advocated for Germany in the specific circumstances it faced in the middle of the nineteenth century. While List definitely did favour the introduction of certain carefully specified barriers to trade because he believed such protection to be consistent with German national economic interests at that specific time (Shafaeddin

BOX 2.2

List and the Colonial Question

Much of the interest in List today results from attempts to use his work to make the case for allowing developing countries to enjoy enhanced autonomy to determine their own development course (e.g. Palan, Abbott and Deans 1999: 80; Balaam and Veseth 2008: 34). Critics of the current system of global governance are concerned that developing countries are not in charge of their own destiny because they are required to follow the policy script presented to them by international institutions. List's *National System* is appealed to as an example of how things might be different, as the whole of the book is a plea for German policy-makers in the middle of the nineteenth century to renege on their international commitments and to follow their own course instead. List was particularly critical of German politicians who had tied the country's economy to the free trade rules established by Britain, at that time clearly the leading industrial power (Payne and Phillips 2010). The policy allowed German consumers to benefit from cheap British goods, but List believed that the British were the main beneficiaries by using the relationship to dump its production surplus in Germany. He argued that this made his country nothing more than a trade captive of the leading industrial power (List 1841/2005c: 44–52). In effect, he said, Germany had become an economic colony of Britain (List 1841/2005*b*: 188–92; 216–7).

The parallels today are usually drawn with the WTO. The WTO has replaced Victorian Britain as the author of international commitments governing the flow of traded products, but the contents of the commitments remain the same. Both focus on rolling back the impediments to free trade. Equally, from a Listian perspective, both are inattentive to the process through which the advanced industrialized countries came to prominence in the sphere of international trade and insist instead that developing countries turn their back on such a process. List argued that, in his day, free trade was the policy of the strong, but that such strength had initially been built behind a structure of productive protection. He accused Britain of having 'kick[ed] away the ladder by which [it] has climbed up, in order to deprive others of the means of climbing up after [it]', thus disqualifying other countries from copying its first-mover advantage when engaged upon their own development (List 1841/2005c: 46). Advanced industrialized countries are accused today of using the WTO to enforce similar double standards by not allowing developing countries to protect their domestic industries until the time that they are able to join the free trade regime on equal terms. List's evocative phrase of 'kicking away the ladder' continues to be used to describe such effects (Chang 2003).

It would be somewhat one-sided, however, to try to depict List unequivocally as a friend of the developing world. It is certainly true that he objected vehemently to what he saw as deliberate British attempts to keep Germany underdeveloped and hence to treat it as some sort of imperial subordinate. Yet this merely reflected his fervent wish that, sometime in the not-too-distant future, Germany might be able to act on the world stage as Britain's equal (Shafaeddin 2005: 43). List still believed that there was a natural hierarchy of states, and his desire was purely to see Germany take its rightful place in that hierarchy. Given the time at which he was writing, this meant participating aggressively alongside other European powers in the struggle for overseas territorial acquisitions (List 1841/2005c: 71, 110). Part of the process of becoming Britain's equal was therefore to rival the scale and the significance of its empire. There is nothing in the *National System* that stands as a universal critique of imperial pretensions. The colonial instinct is fine, List seems to have been saying, as long as Germany is the colonizer and not the colonized (Harlen 1999: 739).

2005), the realm of national economic interests is much broader than the single case that he described (Wade 1996*a*). Because it is much broader, it can lead to many different types of policies today. Indeed, one of the major lessons to emerge from the work of a new generation of List scholars within GPE is that economically liberal policies can be the preference derived from adopting an economically nationalist ontology (Abdelal 2001). In other words, in an attempt to satisfy perceptions of the national interest today 'the nation' can be incorporated into liberal economic structures just as easily as into any other type of policy. The contextual factor of globalization leads many GPE scholars to assume that it is actually *easier* to construct liberal policies from a nationalist ontology today than it is the protectionist policies that List advocated for Germany in his day.

The continuing appeal of List's *National System*

The enduring appeal of List's work is that it provides a means of asserting the right to autonomy for developing countries seeking political shelter from the disruptive influence of international economic norms (Veseth 2005: 47). Just as List had argued that the imposition of the British policy choice of laissez-faire served to frustrate German development aspirations, so, too, do many people today suggest that development space is systematically squeezed by the neo-liberal agenda of global governance institutions (see Phillips, Chapter 13 in this volume). List's *National System* appears to be a valuable resource to appropriate in this respect, because introductory GPE textbooks draw a smooth line of descent from Adam Smith's *Wealth of Nations* to contemporary **neo-liberalism**, while List was a wholly uncompromising critic of Smithian liberalism. Once again, though, all is not what it seems on first appearance in constructing the historical roots of GPE in this way.

List's attack on Smith was deliberately provocative, all the time playing fast and loose with what Smith actually said if putting different words into his mouth served List's particular political purposes. The phrase 'laissez-faire' was not one that Smith used in his own work; moreover, at repeated points throughout *The Wealth of Nations* he presented his preferred policy solutions in terms that are anything but laissez-faire in orientation (Viner 1928/1989: 141). Yet, still, it was laissez-faire inclinations that List consistently attributed to Smith. There are many instances in which Smith's work forwarded clear anti-liberal arguments, perhaps most famously including praise of the clearly protectionist **Navigation Acts** for their far-sighted positive impacts on the wealth of the British nation (Smith 1776/1981: IV.ii.30; see also Elam 1997: 168). List ignored all such arguments, though, in his attempts to create clear blue water for his own version of nationalist political economy. He therefore turned his back on textual accuracy in the search for more convenient depictions of Smith's work.

In doing so, List invited upon himself a rather different legacy in the minds of historians of economic thought to that popularized within GPE. To the textbook authors and to many of the new generation of List specialists within GPE, he belongs amongst the very highest ranks of economic theorists (e.g. Winch 1998). To historians of economic thought, by contrast, he deserves no such elevated status. Indeed, they generally relegate him to the company of political pamphleteers in the third or even fourth rank of economic theorists (e.g. Tribe 1995). List opened up space for his crusade against Smithian political economy by deliberately caricaturing Smith's economics and turning his often ambivalent comments on the exposure of everyday life to market dynamics into undiluted and largely unthinking support for laissez-faire. Historians of economic thought tend to conclude as a consequence that List's distortion of Smith's work is a cause for lament.

Particularly in terms of its textbooks, however, GPE is dominated by accounts of Smith's work that very much mirror List's in focus. Although on many points he was a highly sympathetic critic of the market economy, Smith was a critic, nonetheless, because of the way in which it turned a person's intrinsic worth into a monetary price (Force 2003). As will be demonstrated later in the chapter, he understood this outcome to be a regrettably dehumanizing effect of the market economy and a clear impediment to the sustenance of functioning social organisms. Smith was not the gung-ho advocate of the marketization of everything that he was made to appear in List's characterization of his rampant individualism (1841/2005*b*: 70). Instead, the whole of his economic theory begins from the premise of how first to construct and then reproduce a functioning society. The contents of the textbooks suggest that GPE is taught today with very few of its scholars having noticed this fact or, if they have, treating it as unimportant. List consequently imposed upon Smith's work the type of hyper-rationalist assumption that Kirshner (2011) argues typifies third-generation American School GPE and which provides the basis for realist GPE understandings of inter-state negotiating practices. However, it was an assumption that Smith explicitly denounced in his rejection of utility theories of human nature (Griswold 1999). The historical relationship between realist GPE, List's *National System*, and Smith's *Wealth of Nations* is thus extremely complicated, and massively more complicated than the standard GPE textbook account.

KEY POINTS

- State power lies at the heart of the explanatory frameworks of all realist approaches to explaining international economic affairs, but they do not share a single conceptualization of what state power means, how it can be detected, or what is important about it.
- Despite the tendency to regard them as synonymous, the statist ontology of realist GPE bears no resemblance to List's nationalist ontology as outlined in his classic work, *National System of Political Economy*.
- List's work adds a level of complexity to the concept of national economic interest not apparent in realist GPE, but the distinctiveness he claimed for his own conception results in large part from deliberately caricaturing the work of his liberal predecessors on the same question.

GPE Liberalism and the Eighteenth-Century Smithian Political Economy Tradition

The integrity of Smith's original writing might well have suffered as List's exaggerated style of criticism eliminated all the subtleties and qualifications in his work and turned him into the defender of a clearly defined but equally clearly parodied liberal position. However, Smith was not wholly innocent of having done much the same to a previous generation of political economy writers. He created the space for his alternative to the dominant economic ideas of the day—an alternative he described as exemplifying a system of natural liberty rather than being liberal per se (Fitzgibbons 1995)—by reducing the complexities of other people's texts to a straightforward anti-liberal dogma (Rashid 1998). In an attempt to differentiate his *National System* from *The Wealth of Nations*, List heaped praise on seventeenth- and eighteenth-century writers of the British Mercantilist School for their advocacy of the system of tariffs and trade restrictions that supported their country's developmental aspirations (e.g. List 1841/2005*a*: 69–70; 1841/2005*b*: 87–9). Whenever he had an opportunity to talk about the British Mercantilist School he did so to contrast his appreciation of their arguments with Smith's ostensibly stubborn refusal to see them for what they really were. It is more than a little ironic, then, that no such self-conscious and self-organizing school existed in economic thought until Smith defined it in that way to his own ends. Nobody at the time could have purposely belonged to a school that had to wait until some time later to be defined into existence in post-hoc fashion. However, Smith's definition was an entirely negative one, based on fairly crude pigeonholing devices in order to say that pretty much the whole of economic theory had disappeared down the wrong path before he had been able to pinpoint the right one. Therefore, the historical roots of GPE liberalism do not necessarily have the most illustrious or pristine of origins, even if it is permissible to attribute those origins unequivocally to Smith.

There is an important element of the specialist Smith studies literature, though, that questions whether it is reasonable to view him as a liberal (Henderson 2006). Certainly his work contains many of the philosophical features of that which came to delineate the embryonic liberal tradition in the following century. His concern was with specifying the conditions of existence under which people can recognize themselves as autonomous individuals within a broader social structure. Yet the work that came to set the tone for what became known as liberalism took the European Enlightenment starting point of 'reason' to be the source of such autonomy. Smith, by contrast, followed in the Scottish Enlightenment footsteps of his teacher, Francis Hutcheson, by emphasizing 'sentimentality' instead (McLean 2006: 46–8). People learned appropriate expressions of sociability from this perspective not by being able to rationalize the best possible response to prevailing circumstances but through imaginative acts enabling them to experience vicariously the types of feeling currently affecting fellow members of society. This is a process that Smith (1759/1982: I.i.2) called 'sympathy' (see also Rizvi 2002), and it is only through successful sympathetic enactments that people become aware not only of their autonomous status within society but also of the need to act in socially acceptable ways so as to preserve that status.

These elements of Smith's work are almost entirely disregarded in GPE's introductory textbooks. It might be possible to find single sentences that say in addition to *The Wealth of Nations* he was also the author of *The Theory of Moral Sentiments*, but that tends to be about as far as it goes. The Smith that overwhelmingly is presented to GPE students is that of *The Wealth of Nations* and, moreover, it is usual for this Smith to be reduced to a single observation from that most heterogeneous of texts. The renowned Smith scholar, Jacob Viner (1928/1989: 126), has argued that a person must hold some pretty unusual economic ideas if they cannot read some pre-emption of their own theories back into *The Wealth of Nations*. However, the GPE textbooks tend to pick out just one comment to represent the supposedly authentic Smith, when in the middle of a much longer passage about the significance of choosing the right language if socially acceptable economic relations were to be reproduced he wrote the following: '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' (Smith 1776/1981: I.ii.2). This has typically been accepted in GPE—albeit incorrectly according to specialist Smith studies scholars—as evidence of his pre-emptive endorsement of the modern liberal justification of **economic self-interest**. His dismissal of mercantilist credos is read in this light, as a reaction against the infringements upon individual economic self-determination, but in truth it was much more complicated than that.

Smith on mercantilism

Smith devoted a significant proportion of the 950 pages of *The Wealth of Nations* to refuting the core propositions of **mercantilism**. Almost certainly the two most important anglophone contributions to what he took to be mercantilist thought are Thomas Mun's *England's Treasure by Forraign Trade* (1664/1928) and Bernard Mandeville's *Fable of the Bees* (1714/1755). At the very least, these were the two publications that drew so much of Smith's attention in his efforts to construct what he viewed as a credible counter-argument founded on philosophical principles of natural liberty. Mun's treatise was a celebration of England's eminent position in seventeenth-century international trade relations, which he attributed to a strong state capable of structuring the country's commercial activities so as to produce continual trade surpluses. Imports were discouraged by the use of tariffs, quotas, and subsidies. However, the English used their state strategically—through military means if necessary—to ensure that similarly restrictive practices were not imposed against their goods. As a consequence, exports were not discouraged to the same extent as imports. The result was a net inflow of precious metals as other countries serviced their trade deficits with England. For many of the people who Smith lumped together as a single Mercantilist School, the hoarding of precious metals made possible by trade surpluses was the measure of the nation's wealth, not the overall productive capacity of the economy as a whole.

Mandeville extended Mun's analysis to argue that, while hoarding of precious metals was the primary objective of the state's economic policy, the state should also ensure that its citizens did not follow its lead by attempting to hoard their wealth. He suggested that individual saving might well be seen as a private virtue, but that it was in fact a public vice. The impetus for export activity could only be maintained under the full utilization of domestic productive potential, and this, in turn, required the state to be on its guard against domestic under-consumption. Such situations were most likely to ensue when individuals chose to save rather than spend any new income they earned, so every effort had to be made to encourage spending, with the state acting coercively if necessary.

Mandeville's best-remembered text is most famous for its celebration of a host of individualistic and often anti-social character traits (Mandeville 1723/1997). He positively eulogized selfish behaviour aimed at rather tawdry acts of personal display, because he treated these as the lifeblood of the consumption mentalities that kept the growth rate of the economy high (Goldsmith 1990; Hundert 1994).

It is important to understand the historical context of why Mun and Mandeville were Smith's two principal targets in his critique of mercantilism. Such concern for appropriate contextualization is almost always absent from GPE, which shows how much work is to be done before the historical roots of liberal GPE can be specified adequately. Smith's system of natural liberty is not a simple ideological argument in favour of transferring economic authority from the state to the market, as it is made to appear in so much of the discussion to be found in introductory GPE (and IR) textbooks (e.g. Dunne 2001; Steans and Pettiford 2001). It is at once both much more historically specific and much more subtle than that. Even though Smith presented his attack on mercantilism in terms of economics, it is not in fact an economic critique that is most prominent in this part of his work. Instead, it is a combination of political and moral critiques that most notably stands out.

Smith's account of government

Starting with Smith's critique of Mun, the important historical fact to keep in mind here is that Mun was simultaneously a member of the Standing Commission on Trade established in Britain in 1622 and a member of the committee of the **British East India Company**. Smith's political critique of mercantilism focused on the obvious conflict of interests contained in situations such as this. Smith is often wrongly judged to have been against the whole process of modern government as an unnecessary distraction to the otherwise natural workings of the market economy. Testament to the popularity of this misunderstanding was the proliferation of Adam Smith neckties worn around Washington, DC, by political consultants complaining about the dynamics of 'Big Government' in the Reagan years. Yet Smith repeatedly used his own texts to highlight the indispensability of government to the way in which markets form and are reproduced in everyday economic life (McLean 2006). Markets can function only in the presence of an institutionalized system of private property rights, he said, and that system requires the law-making authority of the government to be credible (Fleischacker 2005). It was not government *per se* that drew Smith's ire, so much as clear corruption of the process of government when it was captured by particular vested interests.

The British East India Company was granted an English Royal Charter in 1600 to act on behalf of the sovereign in meeting the country's commercial objectives as laid down by the government (Robins 2006). However, it operated at a significant distance from the oversight that the government could apply to it. The British East India Company's sphere of activities was nearly two years' sailing time removed from its home country when allowing for the whole of the round trip. This provided it with a large degree of autonomy, which it used to seize for itself monopoly rights in the territories in which it was active. It generally treated those territories as colonial possessions, whenever the Company deemed fit stripping each colony of its resources and each colony's people of their ability to be economically self-sufficient. It imposed a form of martial law for this purpose, denying local people their social and economic rights in the interests of repatriating **balance of trade** surpluses to England. Smith made his feelings on this issue plain (1776/1981: IV.vii.b.44) by writing that to prohibit a people 'from making all that they can of every part of their own produce, or from employing their stock and industry in the way that they judge most advantageous to themselves, is a manifest violation of the most sacred rights of mankind'.

Always an opponent of colonization, Smith found the British East India Company's activities particularly objectionable for the abuse of trust it displayed in the enactment of martial law (Muthu 2008). He called it, as well as other exclusive stockholding corporations like it, 'nuisances in every respect' (Smith 1776/1981: IV.vii.c.108). Perhaps feeling himself unable to take on directly the Company's supporters and paid employees in government, Smith set his sights instead on the economic *means* that the British East India Company used to generate balance of trade surpluses: attacking the economic mechanisms through which it derived its political power also constituted an implicit attack on that power. He endeavoured to cast 'odious imputation' upon the specific system of government in operation in England at the height of the British East India Company's powers, whereby tariffs and other commercial restraints could be used to profit the Company at the expense of building the economic capabilities of the acquired territories, and so preventing them from enriching English consumers by trading lower-priced goods with them (Smith 1776/1981: IV.vii.c.107).

In one conceptual move, Smith was able to show that the political conflicts of interest sustaining the monopoly positions of exclusive stockholding corporations was bad both for the countries that were being colonized *and* for the ordinary citizens of the colonizing countries. He wrote that:

> “ Since the establishment of the English East India company, for example, the other inhabitants of England, over and above being excluded from the trade, must have paid in the price of the East India goods which they have consumed, not only for all the extraordinary profits which the company may have made upon those goods in consequence of their monopoly, but for all the extraordinary waste which the fraud and abuse, inseparable from the management of the affairs of so great a company, must necessarily have occasioned. ”
>
> (Smith 1776/1981: IV.vii.c.91)

He described the continuing toleration of such a situation as an 'absurdity' (Smith 1776/1981: IV.vii.c.91).

Smith's account of human behaviour

Smith's moral critique of mercantilism centred on what he saw as the unfortunate, even disreputable, behavioural characteristics being advocated in Mandeville's *Fable of the Bees*. In order to make his displeasure absolutely clear he described Mandeville as the purveyor of a 'licentious system' of philosophy, one that was 'wholly pernicious' (Smith 1759/1982: VII.ii.4.6). At the time of writing his *Theory of Moral Sentiments*, Smith found himself caught between two very different accounts of the moral basis of the newly emergent commercial society and its attendant market economy. On the one side, there was Mandeville, armed with a completely instrumental defence of commercial and market-based ethics. In Smith's reading, Mandeville paid no attention at all to respectable manners, validating all sorts of anti-social behaviour as long as it helped to advance economic interests and caused the economy to grow. Gratuitous displays of personal wealth invited no moral condemnation, even if they were paraded in the context of other people's poverty, because it meant that more money was circulating within the economy. Higher degrees of

BOX 2.3

Smith versus Ricardo on the Theory of International Trade

Smith's political critique of mercantilism paved the way for his advocacy of free trade: the monopolizing spirit against which he set himself was specifically a mercantile monopoly. The theoretical case for free trade was subsequently taken up even more forcefully by David Ricardo, and it is from Ricardo's rather than Smith's perspective that GPE scholars today typically teach the liberal arguments for free trade (see Ricardo 1817/2002). Ricardo assumed that different economies are differently endowed. Some countries have climates specifically suited to certain types of agricultural production; others have developed expertise in financial services and now have a solid banking structure; and others still concentrate the **capital accumulation** process in the production of manufactured goods. He further assumed that countries should specialize economically in what they already do best, thus increasing their existing lead over other countries in these areas.

This is the logic of **comparative advantage**, and Ricardo argued that modern economic production should be organized in each country on the basis of comparative advantage. To back this point, he showed—as a matter of logic, supported by elementary arithmetic—that welfare gains were available, both for the world as a whole and for every country in it, as long as a system of comparative advantage was supported by an institutionalized structure of free trade among nations. This was true even if one country had an **absolute advantage** over others in producing all categories of goods. The implication was that countries should specialize economically in what they do best, and reap the gains from this by trading the produce of their specialization in an unrestricted manner with other countries. Ricardo was writing only forty years after Smith, but the sheer scale of the difference between his position and previous governmental practice shows just how far opinion had shifted in the interim.

monetary expenditure were consistent, in turn, with enhanced growth potentials. Likewise, obsequiousness to the rich, praising and then aspiring to emulate their consumption for nothing other than its own sake, was also considered fine, because this, too, triggered new economic activity. Whenever Mandeville identified greater levels of economic activity, he was able to rationalize whatever behavioural traits underpinned it. To him, the creation of a civilized market order was not the priority; the creation of a dynamic market economy was. Smith disagreed. In his view, a dynamic market economy was not a reasonable objective in itself if it could only be bought at the cost of fundamentally anti-social behaviour.

However, Smith did not disagree with Mandeville to such an extent that he allied himself with the chief proponent of the other side of the debate, Jean-Jacques Rousseau. In his *Discourse on Inequality*, Rousseau implied that human life was increasingly not worth living if economic expediency was to be raised above the public ethics of the classical republican tradition (Rousseau 1755/2003). He was a strong supporter of the republican proposition that the virtue of the individual overshadows all other considerations, and certainly those of economic efficiency (Hörnqvist 2000). Rousseau went as far as to regret the entire move into the commercial stage of society, because for him this was associated with the unavoidable corruption of the individual as a moral entity (Baron 1988). The very possibility of luxury consumption within such a society, he said, was sufficient to turn everyone away from the path of virtue and to glorify instead in the possession of commodities for its own sake. He depicted a future of socially obstructive individuals permanently on the lookout for the commendation of their fellows purely on the basis of the wealth that they could display in their acquisitions. His conclusion was that life surrounded by commerce and markets necessarily forced people to live in each other's opinions and to lose their virtue in doing so.

The longer-term historical roots of liberal GPE date to Smith's attempts to construct a middle way between the ethics-free zone of Mandeville's economics and the economic restrictions of Rousseau's ethics (e.g. De Marchi 1999). However, the ethical basis of Smith's thought has been almost completely written out of the GPE account of liberalism. As Stephen Rosow (1997) has argued very persuasively, this is as narrow an understanding of liberalism as there has been in that approach's whole history. When GPE scholars talk about liberalism, it is almost always purely an economic liberalism of which they speak, even though Smith's work was built upon altogether different foundations. It is true that he sided with Mandeville against Rousseau on the latter's insistence that progress into the commercial stage of society was necessarily at odds with human happiness. Yet he shared many of Rousseau's concerns about the corrupting influence of luxury consumption and the need, contra Mandeville, to restate the value of virtue in the face of that corruption. He thus set out to construct a philosophical account of moral activity that would be specifically suited to the commercial stage of society. It is an account oriented to the articulation of what McCloskey (2006) has subsequently called the 'bourgeois virtues'.

The enactment of bourgeois virtues entails learning how to exhibit a politeness of manners, deliberately reining in the urge for self-display in anything other than the most restrained way. Smith called this learning the virtue of self-command (Smith 1759/1982: VI.iii.11). Tutoring oneself to self-command means being able to understand the effects of other people's hardship and to respond accordingly to one's success with only muted celebrations. Moderation of emotions all round is the order of the day in such a world (Smith 1759/1982: I.ii.intro.2). This eliminates at a stroke the gratuitous parade of possessions so beloved of Mandeville's consumers, as well as the obsequiousness to the rich that encourages the parade of possessions in the first place. Throughout *The Theory of Moral Sentiments*, Smith suggested that, whether or not society functions successfully under the influence of market-based economies depends on whether or not self-command is enacted successfully amongst the population as a whole.

Smith therefore praised deliberate acts of impartiality and insisted that all individuals should experience dutiful sensations to act conscionably with respect to other members of society. The purpose of government when understood from this perspective is to design social institutions to ensure that people live within the bounds of acceptable behaviour (Raphael and Macfie 1982). Partiality of the self is thereby juxtaposed with acting impartially through first having incorporated the image of the good society into one's most basic world view. When Smith's clear preference for a society populated by individuals who are capable of exercising self-command is taken into consideration, it becomes evident that it is very difficult to read his work as unequivocal endorsement of a market-based liberalism.

However, this is precisely how most GPE scholars and, to my knowledge, all introductory GPE textbooks *do* read his work (e.g. Strange 1994; Underhill 1994; Grieco and Ikenberry 2003; Brawley 2005; Oatley 2006). They typically take that reading from attempting to make his work speak to much more recent arguments about the '**invisible hand**', thus depriving Smith's own arguments to that effect of all their specific historical meaning and then turning them into unstinting praise of the automatic adjustment mechanisms inherent in all markets. Smith himself, in contrast, was unwilling to put his name to any such claim. It might therefore lead to convenient scholarship to appeal to Smith's notion of the invisible hand in order to draw a direct lineage from his foundational work on economic systems of natural liberty to global governance institutions' preference today for neo-liberalism. Yet convenience alone does not make it right to do so, just as it did not in the middle of the nineteenth century when List drew a direct lineage from Smith to the British preference for laissez-faire.

Maybe the reason why this elision is made so often nowadays is that the invisible hand reading fits neatly with the main claims of rational choice theory. If people are to act as instinctive utility maximizers they must have a context in which such instincts might be realized and a mechanism to trigger them in the first place. Somewhat fortuitously, perhaps, abstract accounts of 'the market' associated with modern-day GPE liberalism provide both the context and the mechanism. If the behavioural environment is shaped solely by a disembodied market logic then there can be no non-economic impediments to the activation of even the most extreme variants of 'economic man'. Moreover, that same logic also guides the individual to the equilibrium position associated with utility maximization. The unfortunate point, though, when trying to superimpose this purely modern-day reading back onto Smith is that he was as opposed to using the economic concept of equilibrium as he was to the philosophical proposition that people are governed by innate utility considerations.

KEY POINTS

- Smith was guilty of artificially homogenizing existing writings in the mercantilist tradition, doing so to support his political and moral critiques of mercantilism and to open up the space for his alternative system of natural liberty.
- The GPE textbook account of *The Wealth of Nations* offers only a very limited characterization of Smith's work as a whole, often ignoring completely all of his philosophical reflections.
- Associating Smith's insights solely with the populist rendition of the invisible hand concept is a complete red herring as far as specialist Smith scholarship is concerned.

GPE Marxism and the Nineteenth-Century Marxian Political Economy Tradition

The historical roots of Marxist GPE are much more frequently discussed within the subject field as a whole than are the historical roots of either nationalist or liberal GPE. Global political economists in general appear to be more comfortable constructing positions that are recognizably part of a lineage that appeals in some way to Marx than they are doing likewise for either List or Smith. Nonetheless, an important division is still visible on the question of which Marx to hark back to.

Some contributions in Marxist GPE are rooted in a normative Marx, who makes the avowedly political case for a new type of society. The lineage here is usually to *The Communist Manifesto* (Marx and Engels 1848/1948). Others, however, are rooted in an analytical Marx, who makes the intellectual case for breaking with the liberal traditions of post-Smithian classical economics. The lineage here is usually to the *Grundrisse* (Marx 1973) or to *Kapital* (Marx 1890/1930). Despite this difference, all are united in their refusal to take the social basis of capitalism for granted, as well as in their determination to ask searching questions about the likely effects of the capitalist system on those who have to live their lives within it. The broad church of GPE scholars who find their inspiration in Marx asks why members of society should be expected to consent to the reproduction of the capitalist system. This is to be contrasted with what Marx called the 'bourgeois economics' of Smith and the other classical economists, who he said were only interested in how the capitalist system might be organized to grow more effectively (Althusser 1996: 109–10).

As has already been shown, though, this is not really to take Smith's texts at face value, and once again we encounter a selective nineteenth-century rereading of eighteenth-century scholarship as a means of activating a new political economy tradition. Had he genuinely been interested solely in the capitalist accumulation imperative, Smith would have had no need to articulate his views quite so clearly in opposition to those of Mandeville. Marx was consequently partly right in his overall objection to Smith's work—after all, Smith exhibited no desire to leave behind the commercial stage of society in its entirety, only to civilize it—but not wholly so.

There is also something quite noteworthy in the language that Marx used to describe Smithian theory. He was often quite rude about Smith and dismissive of his talents as an economic theorist. The label 'bourgeois economist' when used by Marx is, of course, something to be accused of and not something to be celebrated for being. Yet behind this facade of outright rejection there are a number of crucial instances in his work when Marx borrowed his starting propositions directly from Smith. His rudeness was of the sort that is driven by exasperation that potentially important insights on the human condition of capitalism were not pushed to their logical political conclusion, rather than the suggestion that Smith's work was altogether devoid of insight. Understanding the historical roots of Marxist GPE consequently requires at least some appreciation of the relationship between the two men's work (Fay 1983).

The foundations of Marx's political economy

The whole of Marx's political economy is grounded in the opening premise that the capitalist system can only be a dynamic entity when the needs of that system are forcibly prioritized over the rights of individuals to live as autonomous human beings (Marx 1973). The reproduction of the capitalist system overrides that autonomy by turning individuals into a functional part of the system. People might believe that they work to satisfy basic existential needs, that they work to be able to finance leisure time, or that they work to provide themselves with the material possessions they associate with a life of comfort. Yet, for Marx, this in itself is an element of **false consciousness**: an inability to see things for what they really are and to form interests accordingly (Fromm 2004: 19). Within a capitalist system, he said, people in fact work solely in order to preserve the smooth running of the system itself through preserving the momentum towards capital accumulation. In effect, no individual is more than a tiny cog in a huge economic machine, and it is the well-being of the machine that takes precedence over the defence of truly human existence. In Marx's view, the incorporation of the individual as a commodified input into the capitalist system necessarily comes at the cost of dehumanizing effects (Marx 1930).

Interestingly, exactly the same conclusion shines through the later books of Smith's *Wealth of Nations*. In the earlier books, Smith outlined his model of the economy as it reached its commercial stage. He placed the concept of **division of labour** centre-stage in his model, showing that the growth of the economy and the consequent enrichment of the nation both depend on the degree to which work takes place within specialized units. The depth of the institutionalization of the market follows closely the incorporation of workers into ever-more finely detailed patterns of specialization (Smith 1776/1981: I.iii.1). This was socially beneficial, according to Smith, because the greater the scope of market relations the more chance there was of lifting people out of poverty. However, it was by no means an unequivocal social good, because there were palpable psychological costs involved when enforcing the division of labour onto people through the move towards routinized factory work. Smith went as far (1776/1981: V.i.f.60, 61) as to call the ensuing psychological effects 'mental mutilation', the division of labour forcing the mind into a 'drowsy stupidity' (1776/1981: V.i.f.51).

On this most fundamental of assumptions about everyday experiences under capitalism there is thus very little to choose between Marx and Smith. Marx developed from first principles a thoroughly thought-through and conceptually robust notion of **alienation** to replace Smith's simple observation about mental mutilation (see, for instance, Mészáros 2005), but it would be difficult to prove that they were doing anything other than talking about the same essential process. The only real difference—major though it is—relates to what they inferred from these shared foundations. Smith offered state-financed education as a palliative to the psychological drudgery of repeating the same basic work tasks day-in, day-out. In other words, he envisaged a solution in which workers could have the dehumanizing effects of their incorporation into a division of labour balanced by state-financed mental stimulation outside of work hours. For Marx, this was Smith at his most bourgeois. The education palliative was merely a means of imposing false consciousness, he said, and it was therefore part of the problem through which workers failed to see that the interests of the capitalist system did not coincide with their own interests (Rosen 1996: 10).

To ground this claim and to signal his break from Smith, Marx worked within the basic Hegelian position, which states that individual activities in the world change both the world on which the individual acts and the individual who does the acting. The novelty in his argument was in his insistence that it is the practical activities associated with the production process that matter most in this respect, thus rendering Smith's education palliative null and void. Individuals are socialized into the necessity of production before being coerced into a social structure that facilitates specifically capitalist production. Once there, the requirement is to live a regimented life, consisting primarily of the endless repetition of basic work tasks, so that standardized commodity production can take place. Obedience is paramount, and creativity in productive practices is discouraged for fear that it will corrupt the standardization of commodities.

Given this, it is easy to see why Marx thought that the act of labour was so important to life in a capitalist society. The subjugation of the needs of the individual to the reproduction of the capitalist system in effect reduces the essence of human life to mere labouring activities (Wolff 2002: 27). Even then, Marx was eager to show that labourers do not receive full recompense for the value of their labouring activities. He drew a politically charged distinction between labour and labour power, arguing that the average capitalist will always seek to reduce wages as far as possible and preferably to the point at which they become the equivalent of labour power, even though it is labour that is physically expended in the production process (Dussel 2008: 74). Labour power represents the costs of sustaining the workers who have been incorporated into the capitalist system. Yet it is labour that adds value to the commodities being produced, and thereby it is labour that creates the potential for the capitalist to take profits out of the system (see Box 2.4). The more that capitalists are able to enforce a structural difference between labour and labour power, the more assured are those capitalists of being able to reward themselves with handsome profits. Marx described this as the logic of **surplus value extraction**, and he believed it to be a fundamental logic inscribed into the very essence of the capitalist system. The basic idea here is that, in order to ensure the dynamism that guarantees its survival as a system, employers under capitalism must require employees to add more economic value in production than they are compensated for in terms of wages.

This, of course, is also a logic of exploitation. The contractual basis of the wage labour nexus defends a situation in which workers remain unpaid for part of the work they are obliged to do. A procedural injustice is clearly perpetrated in this instance and, given that this experience is fundamental to the reproduction of

BOX 2.4

Marx's Labour Theory of Value

Classical political economy developed historically as a relatively open field of scholarship. However, the labour theory of value—which in its purest form states that the one true price of a good reflects the quantity of labour expended in its production—provided a consistent point of departure for most classical political economists. The labour theory of value retained its basic intuitive appeal throughout the era of classical political economy because it presented a means of passing judgement on the intrinsic value of a commodity, which could then be compared with the distribution of the rewards from its actual selling price to determine how power had been exercized in the market relationship. The difference between the two, though, means that the underlying theory was specified in a variety of ways depending on the normative perspective adopted by the theorist. The main analytical divergences arise over the question of what, precisely, is counted as labour in the labour theory of value.

Perhaps unusually, the theory did not attain its purest form in its original articulation. It began life with a number of qualifications introduced by Smith, had further qualifications added by Ricardo, and was only latterly stripped back to its bare essentials by Marx. Smith began by saying that it was not only the physical labour provided by workers that gave products their underlying value. He believed that entrepreneurial labour could also legitimately be reflected in the price of a commodity (this is a feature of his concept of natural prices). Following from this, Ricardo argued that the organizational labour provided by the firm was also part of the value inscribed upon a product (this is a feature of his defence of profits). Today, in order to emphasize the significance of the so-called knowledge economy, some would say that intellectual labour should also be accounted for in the dynamics of price formation. Discussions have also recently begun about the concepts of emotional and affective labour, through which service sector workers impose perceptions of value onto the products they are selling by managing their ostensible feelings for the product in a way that secures the sale. There is thus no single labour theory of value, and hence no scientific unity in the approach.

The most famous articulation of the labour theory of value, though, came from Marx. He built on the work of the so-called **Ricardian Socialists** of the 1820s–1840s. They had forwarded a radical interpretation of the dynamics of price formation by arguing that the integrity of the labour theory of value rested on it meaning exactly what it said in its title. In other words, the intrinsic value of a commodity should be seen as having been determined by the inputs workers provide for the production process via their physical labour and by nothing else. Ronald Meek (1974) has latterly suggested that the political implications of such a view—i.e. that the social structure should be fundamentally reorganized to prevent anyone else benefiting from the efforts of workers in the production process—led directly to the development of neoclassical economics. From the perspective of the ruling elite, the break that neoclassical economics enacted from the labour theory of value meant that it was less politically threatening and more status quo oriented (De Vroey 1975). Marx, though, took the opposite path, fully embracing the radical implications of the work of the Ricardian Socialists. He treated social deference to organizational and entrepreneurial labour as further examples of the phenomenon of false consciousness. The returns that capitalists took from the economy were rewards for their privileged social position, he said, and not rewards for effort per se. They were therefore not legitimately earned. Marx's variant of the labour theory of value hence provided crucial underpinnings for his theory of surplus value extraction and to his account, more broadly, of the structure of exploitation in a capitalist economy.

capitalism as a functioning system, for Marx, capitalism could never be just (Buchanan 1982: 39). Indeed, from his perspective, the whole essence of capitalism is that it forcibly submits the vast majority of any given society—via the process of false consciousness—to implicit consent to the injustices that are committed against them. This is the point of departure for the normative Marx to build upon the insights of the analytical Marx in order to advocate the move to a brand new society capable of transcending the logic of exploitation on which capitalism depends. The organizational basis for prosecuting such a move arises from the fact that exploitation and injustice are not solitary experiences under capitalism. Rather, they are experiences that are shared to a greater or lesser degree by everyone within society who has to work to finance their own subsistence. Marx thus depicted society as riven into two classes relating to their respective positions in the production process. On the one hand, there are the capitalists—the bourgeoisie—who benefit from the surplus value extraction that permeates right to the heart of the capitalist system. On the other hand, there are the workers—the proletariat—who bear the indignity of having surplus value forcibly extracted from them.

Interestingly, there is very little by way of outright condemnation of the activities of individual business leaders in either the *Grundrisse* or *Kapital*. Certainly there is no evidence of the sustained hostility against the monopolizing spirit to be found in *The Wealth of Nations*, where Smith took every opportunity he could to decry business activities which led to 'a conspiracy against the publick' (Smith 1776/1981: I.x.c.ii.27). Whereas Smith took the concentration of capital through monopoly as a sign of diminished social propriety in the actions of business leaders, Marx treated it as the manifestation of a simple system requirement. One capitalist was necessarily in competition with all others, and if this meant forcing the destruction of rival capitals in a bid for survival then so be it. This was a system imperative, according to Marx, not the slapdash enactment of anti-social behaviour (Catephores 1989: 32). He focused his analysis at the level of the system imperative to such an extent that there was no need for him to comment on the rationality—flawed or otherwise—of any individual within the system. It was therefore always going to be something of a stretch to make his original insights compatible with the notion of a Marxist ideology of GPE suited to the age of rational choice theory.

Modern 'structuralist' and 'critical' extensions of Marx's political economy

Proponents of Marxist GPE have stayed loyal to the outlines of Marx's original analytical formulations in the 150+ years since they were initially devised. They generally seek to uncover exploitative dynamics in modern processes of international production, and they present such dynamics as infringements of global justice. Thus, one particularly prominent line of research involves attempts to investigate the way in which large companies with multinational operating facilities today make profits for themselves and their shareholders through globalizing the process of surplus value extraction. Such research focuses in particular on the potential for labour power to command different prices in different countries, as well as on how this creates opportunities for **multinational corporations** to enforce ever-greater discrepancies between the labour they command and the labour power they are obliged to recompense. The policy-making apparatus of the state might always be called upon to defend workers' rights and to meliorate the tendency towards proletarian exploitation. Yet Marxist GPE scholars have pointed increasingly to the development of a **transnational capitalist class** as a byproduct of the contemporary trend towards globalization (see e.g. van der Pijl 1998; Sklair 2001). Members of a transnational capitalist class have allegiance to no state and are therefore able increasingly to escape the impact of regulatory policies introduced by state managers in the interests of workers' rights. If this is true, then the fundamental antagonism between bourgeoisie and proletariat identified by Marx is likely to be experienced in its purest form today within specifically international production processes.

A 'structuralist' approach to Marxist GPE has developed in an attempt to capture this point, conceptualizing the world economy as a single, integrated capitalist system existing within a single, integrated political space of exploitation. Structuralists will often pay only limited attention to reconstructing Marx's explanatory framework in its own terms (Rosenberg 2002), because their real starting point is instead in Lenin's efforts to internationalize fundamental Marxian themes (Lenin 1917/1996). In a pamphlet of the same name, Lenin argued that imperialism had become the 'highest stage of capitalism' by the start of the twentieth century, as well as that, as such, the new dynamism within the capitalist system centred on the relationship between states. Marx's original class-based analysis was retained, but Lenin asked how class-based relationships had been transformed now that capitalism had become a world system.

He argued that domestic bourgeoisies in advanced European countries had increasingly become international bourgeoisies through their willingness to strike class compromises at home. Their acquiescence to the granting of workers' rights domestically was met by a need to increase the level of surplus value extraction overseas in the interests of maintaining underlying levels of profitability for the national economy as a whole. Colonial links provided the ideal political context in which this could be achieved. As a consequence, imperialism was seen to have important economic effects both at home and abroad. Given the willingness of many scholars to treat contemporary conditions of globalization as just the latest phase of economic imperialism (see e.g. Hoogvelt 1997; Hardt and Negri 2000; Petras and Veltmeyer 2001), the structuralist approach to GPE has retained many adherents. They are usually to be found today practising either World Systems Theory or Dependency Theory. In its most up-to-date guise, World Systems Theory is based on the assumption that the world divides into economic regions of core, periphery, and semi-periphery (see e.g. Wallerstein 1979), while Dependency Theory is based on the assumption that the continued distorted development of poorer countries results from the need to defend the conditions that have led to the development trajectory of more economically advanced countries (see e.g. dos Santos 1970). In both cases the efforts made by advanced industrialized countries to maintain their position of economic advantage is treated as a rational reflection of the existing global balance of power.

There are numerous variants of self-styled 'critical' GPE competing against modern structuralist Marxism for space in the radical GPE literature (see also Box 2.5). Some of these retain strong filial links with their Marxist heritage, whereas others have tried to place as much distance as possible between themselves and Marx's political economy. Yet, all seem to be linked to some degree to the turn towards post-Marxist Critical Theory in IR from the 1980s onwards. As a philosophical movement, Critical Theory dates from the 1930s and the Frankfurt School interventions focusing on the essentially political nature of all social scientific explanations. Despite some honourable exceptions, however, the origins of IR and hence GPE Critical Theory are more usually traced to Robert Cox—another of Cohen's Magnificent Seven—and his appropriation of only parts of Frankfurt School theory than to the foundations of that theory itself. In the early 1980s Cox attempted to create renewed space for radical approaches to IR by juxtaposing the transformative intentions of radical approaches with what he termed the 'problem solving' goals of non-radical approaches (Cox 1981). Cox had detected an ever-sharper concentration of research activities in IR on increasingly technical questions of system management: how best to organize the relationship between states in order to minimize the potential for violence between them, and how best to integrate states into an international system whose emergent properties emphasized liberal concerns for cooperation in the interests of meeting common goals. This reflected the increasing prominence of rational choice theory in the subject field's explanatory frameworks. In this

BOX 2.5

Feminist Global Political Economy

Feminists have every much the same entitlement to the labels 'radical GPE' and 'critical GPE' as have Marxists. Feminist approaches to the subject field are certainly radical in their assertions that the capitalist system is founded on the reproduction of patriarchal social relations and, as such, the system itself should be a focus for concerted political challenge. They are also certainly critical in their related concerns to show that the dual structures of a capitalist economy and a patriarchal society are anything but natural. Rather, the continued existence of these structures requires decisive political interventions on the part of those who have privileged access to public decision-making bodies. As such, they must both be seen as conscious political choices.

Many feminists accept the basic Marxist proposition that the capitalist economy is rooted inextricably in the exploitation of those whose labours are functional to its reproduction. Indeed, for those feminists who seek to emphasize the economic basis of everyday life in their explanations of the subordinate social position of women, there is much to commend in an integrated Marxist-feminist perspective. Almost all feminists, however, wish to push beyond the Marxist conception of society, which overlooks the issue of gender in order to focus solely on the interaction of economic classes. In Marx's original analysis of the dynamics of capitalist reproduction, it is the male industrial working-class that is the main agent of historical change, and the majority of modern-day Marxists has retained this focus. The aim is to show how systems of ostensibly free exchange have been established on the back of the forced extraction of surplus value from the working class. The focus of feminist GPE is different. Here, the aim is to show how systems of ostensibly free exchange have been established on the back of social norms that involve deeply gendered assumptions about women's role within the world.

The ability of women to participate fully in the economy—whether as consumers or as producers—is constrained by the tasks they are required to undertake in support of basic family structures. Whereas the Marxist conception of labour refers only to paid work in the formal economy, feminists' extended conception of labour also includes unpaid work undertaken in the home, without which the maintenance of the workforce in the formal economy could not be guaranteed. Economy and society are therefore not distinct entities but rather interdependent spheres of human existence. As a consequence, any attempt to reproduce economic relations in their distinctively capitalist form is also likely to involve reproducing social relations in their distinctively patriarchal form. According to feminists, to engage truly with either radical or critical GPE requires explicit and simultaneous theorization of both dimensions of reproduction—that is, economic and social—within the context of everyday life.

way, however, IR had become increasingly focused on finding solutions to systemic problems that served to defend the most basic structure of world economic affairs. That is, it took the world increasingly as it found it, and stopped asking more profound questions concerning the political and moral legitimacy of the economic foundations of that world. Cox's appeal to a critical theoretical tradition should therefore be seen as an effort to refocus IR on these existential issues. Similar accusations of a failure to think about 'big picture' questions has dogged the American School's third generation scholarship in the recent debate about GPE methodology, but perhaps this is all that its rational choice approach allows (McNamara 2009).

Cox's own brand of Marxist-inspired critical GPE has focused on how the basic structure of world affairs is predicated upon the forced institutionalization of social relations of production consistent with capitalist accumulation (see e.g. Cox with Sinclair 1996). As such, it is an attempt to get IR scholars to ask questions more usually associated with GPE. His aim has been to show that the dominant problem-solving tradition in IR was inattentive to issues of economic organization, either nationally or internationally. It was consequently closed to political or moral critiques of capitalism and it had no basis to engage with radical perspectives on the social relations of capitalist production (Shapcott 2001: 81). In Cox's terms, it simply had to take the continued reproduction of capitalist accumulation for granted. It could ask how to manage the relationship between states so that possible tensions embedded within the very nature of accumulation might be alleviated. However, it had no basis from which to understand the social implications of those tensions as a need to argue for the move to an alternative type of society (Cox 1981: 131). Critical Theory's attraction was precisely that it was able to offer grounding for such an argument.

Returning the discussion again to historical roots, twentieth-century extensions of Marxism are notable for the way in which they involve at least a partial break with Marx's own intellectual trajectory. This is not a complete break, because the aspiration for a better world free of the logic of economic exploitation remains visible in modern-day GPE literatures that trace their origins either to Lenin or to the Frankfurt School. In this respect, the normative Marx remains alive and well, thereby justifying the retention of the label 'Marxist' in order to describe it. However, the analytical Marx is not necessarily as prominent. As befits the continued presence of the normative Marx, modern-day Marxist GPE seeks its essence in a fundamental challenge to prevailing neo-liberal conditions of world order. Yet it does not always reveal its historical roots in the analytical Marx's efforts to undermine the way in which Smith's system of natural liberty came to colonize the concepts of orthodox economic discourse. It certainly does little to show the struggle in which Marx had to engage in order to break free of Smithian thinking, given that he so often took Smith's conceptual starting points as his own. Smith's theory of the capitalist economy as an engine for the creation of economic value reappears, albeit in admittedly revised form, in Marx's work. Exactly the same is also true of his account of the way in which the focus on creating value has negative psychological effects on the capitalist workforce.

KEY POINTS

- Marx insisted that all economic experiences should be placed in their correct historical context and understood in relation to the evolution of the capitalist system from one time period to the next.
- Marxist GPE is an all-encompassing critique of capitalist society, from the exploitation it enforces upon its members to the false consciousness that masks the real dynamics of this exploitation within the normal workings of everyday life.
- In order to keep pace with changes to the economy, twentieth-century extensions of Marxism increasingly came to place more emphasis on the international dimension of economic affairs, but they have done so through partial divorce from their political economy origins in Marx's own work.

Conclusion

So, what can be distilled from this whistle-stop tour around the historical roots of contemporary GPE? The objective has been to caution against many of the introductory textbook accounts of those roots in an effort to signal to students what might easily be overlooked if the textbooks' rather simplistic characterizations are accepted at face value. Great care should be taken whenever one is confronted with a straight line drawn between the political economy tradition of an earlier time and the political economy tradition of a later time. Even if the traditions seem to share the same name, whether partly or wholly, things tend not to stay the same for long. This is because theories are dynamic entities constantly under pressure to change from two distinct sources. One is internal to the theory itself, as scholars attempt to further its development by improving upon its weaknesses and hence resetting its outer limits of applicability. The other is external to the theory, as scholars realize that changes in the real-world relationships that the theory purports to explain require different emphases within the theory.

While it would be unrealistic to expect anything other than the outline of a theory to remain in place over a protracted period of time, much of genuine value can be learned if the time is taken to compare the modern-day version of a theory with its original articulation. This is what I have attempted to do in this chapter for GPE realism, liberalism, and Marxism. The strategy of comparison allows for the embedded assumptions of the modern-day versions to be brought clearly to the surface, shining the spotlight on assumptions that were not originally present but now are. It also invites students to try to forward plausible reconstructions about what it was in the intervening environment that caused the new assumptions to be added, especially if they were originally consciously rejected.

It is a potentially infinite process to specify such factors in fully comprehensive fashion. I need to be clear that I have only been able to scratch the surface of the original contributions of List, Smith, and Marx in my attempt to demonstrate just how far GPE realism, liberalism, and Marxism typically depart from their work while still claiming that it is in their intellectual DNA. Much more can be done to set each author's work within the context of its time to isolate the ways in which the prevailing historical conditions influenced the content of the original theory. Historical contextualization of this nature allows further errors of analogy between newer and older theories to be brought to light. In addition, it makes it possible to identify a number of claims made in the introductory textbooks about eighteenth- and nineteenth-century political economy that simply do not stand up to scrutiny.

This brings the chapter full circle by way of conclusion. I have hopefully demonstrated that theoretical traditions within GPE are not self-contained, coherent ideologies at all. In fact, there is—or at the very least there is the possibility of there being—serious competition over ownership of any of GPE's main theoretical labels. Yet this possibility might only be unlocked through increasing awareness of the historical roots of contemporary GPE. Such awareness is important because, without it, it is impossible to trace the intellectual lineage of contemporary positions and, in the absence of the ability to do that, contemporary positions are stripped of reflexive interactions with their own origins. The multiplicity of potential GPE realisms, liberalisms, and Marxisms is likely to be reduced to just one variant of each if positions are forwarded without adequate historical moorings. History matters, then, and a historical turn to situate GPE more assuredly within the context of its political economy origins is very much to be advocated.

? QUESTIONS

1. What can be gained in our understanding of contemporary GPE by attempting to uncover the historical roots of the political economy traditions in which modern positions are located? In other words, why should we read classic texts?
2. To what extent does the trichotomous structure of liberalism versus realism versus Marxism obscure the significance of societal cleavages such as gender, race, and religion?
3. To what extent do GPE theories take the development profile of Western market capitalism and treat it as a generic feature of economic life, thus implying that all other countries will also have the same experience?
4. What are the main features of nationalist political economy in both its original and reworked Listian forms? Is it possible to point to examples in the modern world of nationalist insights continuing to inform the management of international economic affairs?
5. What emphasis should be placed on Smith's sympathy principle? How different might liberal GPE look if this aspect of his work were to be prioritized more?
6. Is Marxism still relevant in contemporary GPE? What features of the world that Marx described are still recognizably with us today?

7. Would it be appropriate to describe the economics of globalization simply as the operation of a global 'invisible hand'? If not, what does this do to the usual characterization of globalization as a liberal project?
8. Is it advisable to agree with Susan Strange, and argue that the study of foreign economic policy is not GPE proper, because it has no historical lineage to a recognizable tradition in political economy?
9. How convincing is the characterization of a 'transatlantic divide' within contemporary GPE?
10. To what extent do many GPE theorists incorporate the key insights of neoclassical economics without acknowledging explicitly that this is what they are doing?

FURTHER READING

General

Watson, M. (2005), *Foundations of International Political Economy* (Basingstoke: Palgrave Macmillan). This is for students who find my account of the practice of GPE convincing, as the themes of the current chapter are surveyed in much greater depth in this book.

History of economic ideas

Backhouse, R. (2002), *The Penguin History of Economics* (London: Penguin). This book is written with the beginning student in mind, and, as such, it is a more accessible introduction to the history of economic thought than those that address the student who already has some training in economics.

Barber, W. (2001), *A History of Economic Thought*, repr. edn (London: Penguin). This book attempts similar things to Backhouse, also assuming no prior economics training from its readership in presenting an accessible history of economic thought.

Blaug, M. (1996), *Economic Theory in Retrospect*, 5th edn (Cambridge: Cambridge University Press). This is almost certainly the most comprehensive account of the different ways in which the economy has been studied in the history of economic thought. However, it is written from a perspective that assumes the student has some prior background in economics debates, but this will not necessarily be the case for beginning GPE students.

Heilbroner, R. (2000), *The Worldly Philosophers: The Lives, Times, and Ideas of the Great Economic Thinkers*, 7th edn (London: Penguin). This is an accessible text where the author's aim is not to dazzle his readers with the technicalities of the argument, but to bring the basic ideas he is discussing to life. It performs the same sort of function as Backhouse and Barber, as it is aimed at the same sort of readership.

Landreth, H., and Colander, D. (1994), *History of Economic Thought*, 3rd edn (Boston, MA: Houghton Mifflin). This book covers much of the same territory as Blaug, and would serve as a more than acceptable substitute for it. Again, though, it is written assuming that the reader has some background training in the theories, methods, and language of economics.

Robinson, J. (1964), *Economic Philosophy*, revd edn (Harmondsworth: Penguin). This is written less as an introduction to the history of economic thought and more as an attempt by the author to carve out her own view of how economic analysis should proceed. Nonetheless, it is a very good read and students will learn much from it.

Samuels, W., Biddle, J., and Davis, J. (eds) (2007), *A Companion to the History of Economic Thought*, 2nd edn (Oxford: Blackwell). This book offers extensive commentary and criticism on existing attempts to provide a plausible historiography of economic ideas. Thirty-nine chapters cover nearly 700 pages of scholars writing on their research specialisms. However, as with Blaug and with Landreth and Colander, this is probably not for students who possess no prior knowledge of rudimentary economic debates.

Introductions to the classical political economists

Heilbroner, R. (1986), *The Essential Adam Smith* (New York: W. W. Norton). This is a very good introduction to the work of Adam Smith. Heilbroner provides excerpts from all of Smith's published work, each of which is preceded by a useful introduction.

Hollander, S. (1987), *Classical Economics* (Oxford: Basil Blackwell). This is a very good introduction to the field of classical political economy as a whole. However, there is a chance that beginning GPE students might find it a little bit daunting, as it is written by a respected economist for an audience that has some familiarity with the rudiments of economics.

Wheen, F. (1999), *Karl Marx* (London: Fourth Estate). This is perhaps the most readable of all biographies of Marx, and it tries to draw out the intellectual inspiration underpinning his work from a broader assessment of his life.

Wolff, J. (2002), *Why Read Marx Today?* (New York: Oxford University Press). This is an introductory book about Marx's ideas, and it will not present the non-economist with similar problems to those they might experience when reading Hollander. The content of the book follows directly from the self-explanatory title.

Classic texts

Despite all the above advice on further reading, nothing beats the rewards that come from going back to a classic text and discovering what is in it for oneself. I would very much advocate, then, that students attempt to familiarize themselves with at least some of the classic texts mentioned by name in this chapter.

WEB LINKS

www.unc.edu/depts/econ/byrns_web/EC434/HET/biographies.htm This is an electronic encyclopaedia, allowing students easy access to thumbnail sketches of the most important figures in the history of economic thought. Further searching of the site reveals an extensive glossary of economic terms and theories.

www.blupete.com/Literature/Biographies/Philosophy/BiosEcon.htm Students can work their way around the alphabetical listings on this site to find the bibliographies of most of the great economists in history, plus excerpts from the work of all those mentioned by name in this chapter.

http://oll.libertyfund.org/ This is the link to the online library of the Liberty Fund, which holds fully searchable electronic versions of many of the most important texts in the history of liberal political economy. The Complete Works of Adam Smith, for instance, is amongst the deposits in the online library.

www.marxists.org/subject/economy/index.htm This is a comprehensive site that allows students to explore both Marx's work and his reflections on the context in which his work was written. Importantly, it also contains links to a detailed glossary of terms to be found in the writings of Marxist political economists.

http://pandora.simons-rock.edu/~eatonak/LTV-FAQ.html This is a site that allows students to get to the heart of what made the labour theory of value so attractive to the classical political economists. It is organized very helpfully around a series of 'frequently asked questions'. Students seeking to contextualize what can be found here with what superseded the labour theory of value should then begin searching for content surrounding the 'subjective theory of value'.

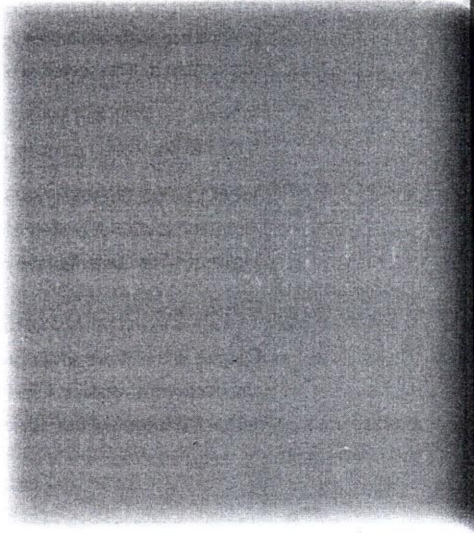
ONLINE RESOURCE CENTRE

For additional material and resources, please visit the Online Resource Centre at:
www.oxfordtextbooks.co.uk/ravenhill4e

3

Cooperation and Conflict in the Global Political Economy

Vinod K. Aggarwal and Cédric Dupont



Chapter contents

Reader's guide

How can one understand the problems of collaboration and coordination in the global political economy? In situations of global **interdependence**, individual action by states often does not yield the desired result. Many argue that the solution to the problem of interdependence is to create international institutions, but this approach itself raises the issue of how states might go about creating such institutions in the first place. This chapter examines the conditions under which states might wish to take joint action and provides an introduction to game theory as an approach to understanding interdependent decision-making. It then discusses the conditions under which international institutions are likely to be developed and how they may facilitate international cooperation. We then examine dimensions of institutional variation, with a discussion of factors that shape the design of international institutions.

Introduction

It is now commonplace to hear about the phenomenon of globalization. Much of the current analytical debate on globalization has its roots in the international political economy literature on interdependence of the early 1970s (Cooper 1972; Keohane and Nye 1977). At that time, political scientists began to identify the characteristics of the changing global economy, including the increased flows of goods and money across national boundaries as well as the rise of non-state actors as a challenge to traditional conceptions of international politics.

Although increasing interdependence among states was a relatively new phenomenon when considered against the baseline of the 1950s, high levels of interdependence had existed in earlier historical periods, including the period prior to the First World War (Bordo, Eichengreen, and Irwin 1999; McGrew, Chapter 9 in this volume). This interdependence, however, was not matched by high levels of institutionalization, in stark contrast to the post-Second World War Bretton Woods organizations of the International Monetary Fund (IMF), the World Bank, and the General Agreement on Tariffs and Trade (GATT, and now its successor, the World Trade Organization). The problems that institutions such as the IMF faced with the breakdown of the Bretton Woods dollar-based standard in 1971, the movement towards trade protectionism that appeared to undermine the GATT, and instability in the oil market with the 1973–4 oil crisis also drove the debate on interdependence in the early 1970s.

A key issue in considering the implications of interdependence revolves around the question of how to achieve collaboration and coordination among states. In particular, scholars have focused on how states respond to perceived problems in the global economy that they cannot deal with solely on their own. An important starting point is to distinguish interdependence from interconnectedness based on the costs of interaction. 'Where interactions do not have significant costly effects, there is simply interconnectedness' (Keohane and Nye 1977: 9). With costly effects (or high benefits), however, we can consider countries as mutually dependent on each other, or interdependent. In attempting to cope with interdependence, then, countries will be faced with making decisions that will affect their direct well-being, and thus the sharing of costs and benefits can be potentially controversial.

This chapter considers the problem of collaboration by first characterizing situations that might require states to work with each other to achieve a desired outcome. It then turns to a focus on basic game theory as an analytical tool to tackle the nature of collaboration and coordination efforts. Finally, we consider how institutions might play a role in enhancing the prospects for cooperative behaviour.

Globalization and the Need for International Cooperation

According to international economics textbooks, worldwide economic openness has clear benefits. Integrated world markets help to ensure an optimal allocation of factors of production and therefore help to maximize both aggregate world welfare and individual national welfare. By contrast, sealing off national borders fosters economic inefficiency and has negative consequences for poverty alleviation and development prospects. Yet, in practice, the benefits of globalization cannot always be realized by states pursuing independent policies; cooperative action is required.

The process of global integration forces significant adjustments in production patterns across states. In particular, the changing distribution of costs and benefits from trade liberalization can result in strong political opposition, both for and against further liberalization. Adjustment has been all the more difficult in that it leads to unpredictable outcomes and instability in the prices of traded goods. This has proven particularly problematical for many developing countries because they strongly rely on a few primary commodities for the bulk of their exports (UNDP 2011). Not only have the prices of most non-fuel commodities tended to decline over the long-term, but also they have been increasingly volatile (UNDP 2011; UNCTAD 2012*b*). From this perspective, the price surges from 2003 to mid-2008 and in 2009–10 may not be indicative of a long-term reversal and the abrupt drop of prices in the second half of 2008 is an acute reminder of the long-term boom and bust long-term pattern in commodity terms of trade (IMF 2012*b*; Spatafora and Tytell 2009). Ultra specialization by some countries in specific commodities has therefore, on the one hand, brought severe adjustment costs and, on the other hand, failed to provide stable and increasing revenues and significantly hurt their growth prospects (Cavalcanti, Mohaddes, and Raissi 2012). Developing countries that rely on the export of manufactures have also faced significant adjustment challenges. For example, many Latin American countries have increasingly faced a loss of market share in the United States and Europe with the rapid rise of the Chinese export juggernaut.

Liberal analysts often argue that countries will be able to manage the process of adjusting to a rapidly shifting division of labour. From their perspective, the prospect of growth in a large number of newly competitive sectors, combined with state capacity to provide social and fiscal transfers, should serve as means to address the challenges of world competition. Yet developing countries, in particular the poorest among them, often have a pre-industrial economic structure. As a consequence, economic openness has brought about a radical transformation of their socio-economic structures, particularly in rural areas, leading to massive migration flows to urban areas. The state structures of developing states are often simply unable to cope with such a rapid and radical transformation. This has led to chaos and, in many instances, to famine and violence as well as to further political instability and insecurity. For their part, rich countries often face strong domestic lobbies in agriculture, textiles, steel, and other older sectors of the economy, creating pressure for trade distorting restrictions of various kinds including subsidies, tariffs, quotas, **voluntary export restraints**, and the like (see Hiscox, Chapter 4 in this volume).

Given these political constraints, countries may either be unwilling or unable by themselves to sustain processes of economic liberalization. We need to distinguish between two situations. Facing political difficulties, some countries may no longer view international economic cooperation as beneficial and will adopt a national mercantilist approach, relying on selective domestic economic closure while pushing for market access abroad. For most countries, however, such a choice would be politically too costly given previous international commitments but also because they still consider cooperation to be valuable in the medium to long run. Reneging on economic liberalization mostly comes from the difficulty of resisting domestic demands for some protectionism or from the hope of levelling or tilting the international playing field in their favour. In the latter case, the temptation by some countries to slow or halt liberalization may induce others to reconsider their commitments, leading to an action–reaction cycle that slows global integration and decreases economic welfare.

International cooperative action may therefore be required to avoid the unfortunate effects of this **temptation to free ride**. This temptation varies according to the socio-political organization of countries and to their degree of economic flexibility. On the socio-political dimension, the political insulation of governments from lobbying by those who are affected by adjustment costs can ease the process of economic liberalization, as was the case in the first wave of globalization in the second half of the nineteenth century when few countries had democratic systems of government. But with the spread of democracy, such political insulation has drastically diminished, forcing governments to at best 'talk' protectionist or worse, adopting protectionist policies during economic recessions. Another way to make liberalization politically palatable has been the development in some countries of corporatist deals between the government, unions, and business to share the costs of adjustment. The temptation to free ride also depends on the economy of countries and on its flexibility, particularly regarding labour markets, as well as labour skill levels. More generally, countries with deregulated markets, and few and lean state-owned companies should be less tempted to free ride on the globalization process because adjustment would be less costly.

International cooperation may also be required to remedy what we call the **inhibiting fear** that countries may feel when facing a decision to either engage in economic liberalization or to continue it. Although countries may be convinced that liberalization will yield benefits, they may be hesitant to risk the instability that might come from the ebb and flows of the international market. This fear is particularly problematical in the domain of financial liberalization. In contrast to trade integration, financial integration has produced sudden and violent shocks to national economies (see Pauly, Chapter 8 in this volume). The massive increase in capital flows in the last fifteen years has been accompanied by extreme volatility, particularly for developing countries that have been experiencing sharp fluctuations in the flow of short-term capital (Edwards 2005; Calvo and Talvi 2005; Reinhardt and Rogoff 2009). As John Ravenhill discusses in Chapter 1, the series of crises that hit East Asia in the period 1997–8 led to drastic economic contractions. South Korea's growth rate dropped seven percentage points below its pre-crisis, five-year-average growth rate, Indonesia's performance was similar, and Thailand's was even worse (Eichengreen and Bordo 2002). Recent work on the Asian financial crises and the Argentinean crisis in 2001, both at the aggregate and case-specific levels, has shown that governments are highly vulnerable to such profound economic contractions. On average, the chances of losing office in the six months immediately following a currency crash seem to be twice as likely as at other times (Frankel 2005). Economic globalization has created profound and far-reaching policy challenges to states that, in turn, have an impact on key pillars of their economic and political organization.

International cooperative action in the financial realm may reassure countries by promises of assistance either by individual states or international institutions before or during difficult times. This may facilitate states' adjustment efforts in responding to shocks and prevent them from taking the wrong action at the wrong time, which could lead to massive negative contagion effects. As with trade, the need for international support varies across countries depending on the socio-political and economic characteristics that we have discussed. The inadequate response of rich states and financial institutions to the problems faced by countries affected by the financial crises of the late 1990s led many countries to rapidly build up their holdings of foreign reserves to counter speculative attacks on their currency. Reserves now amount to more than 30 per cent of developing countries' GDP, enough to finance almost one year of imports. But this individual response has come at a significant price. Most central banks hold foreign exchange reserves in the form of low-yielding, short-term US Treasury (and other) securities; the accumulation of reserves by developing countries created an important opportunity cost (the difference between what governments might have earned by investing these assets elsewhere versus keeping them in low-yielding securities). In most cases, for instance, investing the same amount in the domestic economy would have yielded a significantly higher return. According to a recent study, the income loss due to this difference in yields amounts to close to one per cent of GDP (Rodrik 2006*b*). Leaving aside the question of whether this insurance against the vagaries of financial integration comes at an acceptable price, such a solution is only available to a small number of countries, and therefore is not a viable alternative to international action to provide liquidity to countries facing financial crises.

Finally, when countries address the issues of 'temptation to free ride' and 'inhibiting fear', they may encounter a third problem—how to negotiate the distribution of gains and losses from a possible agreement. This **where to meet** problem can be seen in cases of international cooperation such as a decision on how much to contribute to common support funds, how and to what extent to intervene in currency markets, and in the tradeoff between quotas, tariffs, and subsidies in trade negotiations (see Box 3.1). For example, as part of the bargaining over the creation of a **common pool of resources** to support financial stability, there is likely to be considerable debate about the criteria for which country should contribute how much. This burden sharing decision has often been a problem historically.

BOX 3.1

Goods and the Problems of Cooperation

In examining the problem of collaboration, we can use the concept of' 'type of goods' to examine more rigorously the problem of incentives to free ride, fear that one's counterparts will fail to follow good policies, and the distributive conflicts that might ensue over where to meet. In a capitalist economy, private firms produce goods such as wheat, clothing, computers, and services such as financial products, insurance, and the like. Such goods are generally referred to as **private goods**, based on two characteristics: the goods are generally excludable and are not joint in consumption. The concept of *excludable* means that goods can be withheld from those who do not pay for them; *not joint in consumption* means that when a consumer utilizes the good, it is exhausted and cannot be used by others without additional production. In addition to private goods, other goods may be desired, such as national defence or parks. These goods are characterized by the lack of ability to create exclusion and the jointness of their consumption, and they are known as **public goods**. Because anyone can have access to these goods once they are produced, consumers will misrepresent their demand for such goods as they can obtain them once they are produced and 'free ride'. In such cases, the private sector will not produce public goods, and governments will coerce citizens to pay for such goods through mechanisms such as taxation. If a good is characterized by lack of exclusion and lack of jointness, then such a good is referred to as a **common pool resource**. Examples of such goods include fish in the oceans, or even, as a limiting case, a public park. Thus, if the ocean is overfished, fish will cease to reproduce and die out. Similarly, while parks are often seen as public goods, too many users of a park create crowding, which impairs the enjoyment of the good for others. Private actors will be particularly reluctant to produce such goods, and even governments will be concerned about the problem of too many users. Finally, **inclusive club goods**

BOX 3.1 (continued)

refer to goods that may be excludable and yet be joint in consumption. These include goods such as software, music, and literature, which the private sector has a great incentive to produce. Once a unit of the good is produced, it can be distributed at either little or no cost. Indeed, firms may quickly develop a monopoly in the production of such goods if they are the first movers who make the good, and thus face regulation. For example, if a firm launches a satellite to beam television programmes to consumers, while the initial cost of securing a rocket to put the satellite in orbit will be great, once the satellite is in operation, the programmes can be disseminated to large numbers of consumers. Private firms will generally attempt to regulate consumption by encoding the transmission to prevent free riding. Alternatively, governments may simply regulate the industry and consumer behaviour to prevent consumption without paying (for example, penalties for copyright infringement). Figure 3.1 summarizes the four types of goods.

How do the problems of creating various types of goods play out in the international arena, and what obstacles do states face in achieving cooperation? Consider the case of cooperation with respect to global warming. It is now well documented that emissions of greenhouse gases, in particular CO_2, due to human activity (in particular the burning of fossil fuels) have reached levels that lead to an important warming of average temperatures on earth with potentially dramatic impact on populations in the medium to long term. Yet, because reducing the emissions of greenhouse gases is a costly process that may require deep restructuring of energy production and use, the negotiations over how much or how quickly to limit those gases has been an internationally contentious issue. The public good nature of the problem can be seen in the incentives to free ride by various countries who wish to benefit from the reduction in emissions of greenhouse gases but do not want to bear the costs of reducing their emissions. There is a severe distributive conflict ('where to meet') as actors debate the levels of reduction for developed and developing countries. The latter

Figure 3.1 Types of goods

		Jointness in Consumption? YES	Jointness in Consumption? NO
Exclusion Possible?	NO	Public	Common Pool Resources
Exclusion Possible?	YES	Inclusive Club Goods	Private

fear to derail economic development to fight a phenomenon largely associated with the economic development since the mid-1800s of current developed economies. With respect to crowding, at the extreme, limiting global warming has common pool resource properties, because jointness may be impaired if one country (or a small number of countries) produces a huge amount of emissions that then spread evenly in the atmosphere.

In 1992, States recognized the need to take action to limit global warming with the adoption of United Nations Framework Convention on Climate Change (UNFCCC) that established the Conference of the Parties (COP) as its highest authority to develop an international climate change regime. So far the most important pillar of this regime has been the Kyoto protocol adopted in 1997 by the COP and entered into force in 2006. The protocol set binding targets for the reduction of greenhouse gases by thirty-seven industrialized countries (the so-called Annex I countries) as well as a general commitment for all groups of countries. The originality of the protocol is that it defines 'flexible mechanisms' to help industrialized economies meet their targets, including the trading of emission 'rights', the transfer of 'clean energy' technology to developing nations (the so-called Clean Development Mechanism) as well as the possibility of joint implementation. But whereas the flexibility of implementation for industrialized economies and the lack of binding commitments for developing countries were essential for the adoption of the Kyoto protocol, they have severely limited its impact on the limitation of global warming. There is a clear need to do more, including by developing countries, and within a stronger monitoring framework. Yet discussions have been impeded by severe distributive conflicts (on financial commitments in particular) both within industrialized countries and between industrialized and developing countries.

With respect to inclusive club goods, the debate over standards also illustrates the problem of 'where to meet'. If a firm convinces its government to advocate the choice of its standard in international negotiations, the firm may be able to gain a significant advantage over its competitors. Even less firm-driven choices may influence costs and benefits, and lead to possible conflict. For example, the implementation of international financial reporting standards (IFRS) developed under the auspices of the International Accounting Standards Board (IASB) led to fierce debates and discussions within the European Union before its final implementation in January 2005. The IFRS cornerstone is the notion of fair value accounting (FVA) that aims at assigning market values to assets. Whereas this had been the standard adopted in the Anglo-Saxon world, continental European firms had relied on a more 'prudent' way with a valuation based on the balance sheet and a low valuation of assets. The move towards a new standard significantly increased the risk of hostile take-over of companies that would become suddenly more attractive due to 'hidden' reserves.

Intervention in currency markets is also controversial. Although some national intervention to maintain stable currencies may be warranted in that it helps governments to obtain various national economic objectives such as controlling the rate of inflation, the US has often accused Japan and China (and other East Asian states) of manipulating their exchange rate to gain a competitive advantage in trade.

Burden sharing problems may also be part of the problem of trade liberalization. A good example has been the ongoing conflict with respect to the reduction of agricultural support schemes used by developed countries (and often by developing countries as well) to protect their farmers. Addressing the free riding temptation has been hampered by the difficulty to find an agreement at a lower level of support.

KEY POINTS

- International cooperation can help to address three typical problems associated with the process of global integration: a temptation to free ride, an inhibiting fear, and a need to find meeting points in situations where collaboration will produce differing costs and benefits to governments.
- A country's need for international cooperation depends on its socio-political structure as well as on the structure and flexibility of its economy.
- Different types of problems associated with the process of global integration call for different solutions to address the three typical problems, ranging from the provision of binding rules to facilitating mechanisms.

International Cooperation: A Strategic Interdependence Approach

Our discussion so far has highlighted the potentially important role of international cooperation in enhancing the prospects for global economic integration. Yet, as the 'where to meet problem' shows, such cooperation may itself entail varying costs and benefits for participating states and its successful negotiation is therefore not a foregone conclusion. To further explore the challenges of international cooperation, we can utilize a game theoretic approach to examine interdependent decision-making. A country's choice depends both on its cost/benefit evaluation of the various outcomes and on its expectations regarding the choices of other actors. Game theory provides useful tools to analyse actors' behaviour in such a context. Key features of actors' interactions are captured through 'games' that describe the choices available to actors (players in the game), their evaluations of potential outcomes, as well as the information they have when they make their choices.

To keep this chapter's discussion of game theory as parsimonious as possible, we focus on simple games with two persons and two strategies per person (see Box 3.2). We further assume that actors have extensive knowledge of the other actor's preferences but that they cannot observe his or her actual choices. Obviously, in real-life situations, actors may have less information about preferences and/or may be able to observe the other's behaviour. Our modelling choices may appear to oversimplify real-life examples but, as several authors have already shown, simple models can clearly reveal the decisions that governments face in attempting to deal with fundamental aspects of interdependence (Cooper 1975; Snidal 1985; Martin 1992; Zürn 1992; Aggarwal and Dupont 1999; Drezner 2007).

Each of the three typical problems discussed in the previous discussion can be depicted with a specific game. We address them in turn and then focus on situations that represent mixed situations.

'Free riding temptation': The Prisoners' Dilemma

As we have seen, global economic integration remains fragile due to countries' political difficulties in implementing potentially costly economic changes—albeit ones that are economically positive. They may be tempted to free ride on others' policy changes to take advantage of their gains from their trading partners opening their markets, which may in turn affect others' policy choices, and possibly bring an end to global economic liberalization. This situation is aptly captured with the game called the Prisoners' Dilemma.

The Prisoners' Dilemma models a situation in which two individuals are involved in a robbery and are caught near the scene of the crime. The District Attorney (the DA or prosecutor) does not have sufficient evidence to convict either of the suspects of robbery unless at least one of them reveals additional information to him, but he has some evidence to convict both of them of a lesser crime (for instance, reckless driving or carrying a firearm). The DA wants more information to convict both suspects for a long period.

BOX 3.2

Game Theory and its Critics

Game theory has become a standard tool for analysis of situations of interdependence in social sciences. Aside from its predictive aim, game theory has a strong appeal for anyone engaged in explanation, investigation, or prescription. It often makes ostensibly puzzling processes intelligible, without attributing causality to factors such as the incompetence, irresponsibility, or lack of concern of decision-makers.

Whatever its value, however, the use of game theory poses severe methodological problems that have prompted intense debates in the literature. Critics have traditionally emphasized (1) the overstretching of the concept of rationality and (2) the gap between abstract theoretical concepts and real phenomena. Regarding the notion of rationality, most applications of game theory assume that players, interacting under conditions of imperfect information, possess a very high computational ability. To make their decisions, players must evaluate a host of possible worlds on the basis of the knowledge commonly shared with others or privately known. This kind of situation often implies that players engage in comparative reasoning about a large set of possible worlds. Leeway in their interpretation often leads to a myriad of possible equilibria, which significantly decreases the predictive power of game theory. To avoid this indeterminacy, most game theorists have refined the concept of 'rationality' to allow the selection of one or very few equilibria among the vast initial array. For example, one might assume that people always choose to buy the cheapest product available (even though we know that many people buy based on brand name, reputation, or other factors) because it makes the choices of actors easier to map. Most of these refinements to the concept of rationality thus lack empirical grounding.

A more recent controversy has focused on the empirical contribution of rational choice approaches to politics, including game-theoretic work. A variety of pathologies have prevented rational choice theory from improving our understanding of politics. In particular, rational choice theorists are, according to these critics, method-driven rather than problem-driven. In other words, instead of focusing on building models that accurately reflect decision-making in the real world, game theorists (according to critics) are more concerned with constructing elegant models. As a consequence, game theorists tend to neglect issues of empirical testing and therefore to undermine the scientific value of rational choice theory.

Although there clearly remain weaknesses in most game theoretic analyses of international relations, the link between theory and empirics has clearly improved over the last decade. Users of game theory have used different techniques to check the validity of their models based on a comparison with reality. The dominant approach has been indirect testing through statistical analysis using either large-N data sets or a series of case studies. Another approach has been to use case studies to trace the behavioural attitude of actors and check them with specific predictions of models.

The two prisoners are placed in separate interrogation rooms. The DA tells each prisoner that if they confess and reveal the truth, they will get a much lighter sentence. If both prisoners confess (Strategy S2 in the game depicted in Figure 3.2 below) however, they get a heavier sentence than they would have received if they had both remained silent (Strategy S1 in Figure 3.2) where they would have been charged with the lesser crime (when both confess, the DA has the evidence to convict both on the more serious offences). Confessing to the DA could bring the minimal sentence if the other one does not confess but could also lead to a lengthier sentence if the other also confesses. Remaining silent, on the other hand, may lead to either a moderate sanction if the other prisoner remains silent, or the maximum penalty if the other one speaks to the attorney. Facing this situation, and unable to communicate, the logical strategy for both prisoners is to choose to confess. They do so because confessing to the DA is individually always a safer strategy than remaining silent. The key point of the Prisoners' Dilemma game is that actors may face a structure of interaction that prevents them from reaching a cooperative solution even though such a solution would be optimal for both of them.

Figure 3.2 Prisoners' Dilemma Game (ordinal form)

		Player Beta	
		S1	S2
Player Alpha	S1	3, 3	1, 4
	S2	4, 1	**2, 2**

This story can be generalized using the game depicted in Figure 3.2. The numbers in the various cells indicate the preferences of players on an ordinal ranking scale, with four being the most preferred situation and one the least preferred. In the following figures, the first number in each box refers to Player Alpha's preference, while the second number refers to Player Beta's preference (thus '4,1' is Alpha's most preferred outcome and Beta's least preferred outcome).

As Figure 3.2 shows, both players have a dominant strategy (confess, Strategy 2) that leads to what is called the **Nash Equilibrium** outcome, which is in the lower-right cell of the matrix. A Nash Equilibrium is an outcome in which none of the players can improve his (her) situation by changing his (her) individual strategy. But if both players switch to Strategy 1 (remain silent) in the matrix in Figure 3.2, each of them gets a better outcome (upper left cell). Yet ironically, this collectively optimal situation, also known as a **Pareto-optimal outcome** (Pareto-efficient outcomes are defined as outcomes from which no actor could become better off without worsening the pay-offs to another actor), is unstable because each actor can improve his or her own welfare by individually switching strategy to the cells in the upper-right or lower-left corners of the matrix.

Within international political economy, the Prisoners' Dilemma has been widely used to illustrate the problem of reciprocal trade liberalization (Grossman and Helpman 1995; Hoekman and Kosteki 1995; Maggi 1999). The difficulties in monitoring partners' trade policies, and the potential political benefits to governments from open export markets and closed domestic markets often push states to back out of their commitments to reciprocate trade liberalization measures. As Conybeare shows (1984), this argument particularly applies to countries with large domestic markets, as these countries are less dependent on the success of trade liberalization (this makes the utilities of the lower-right cell in Figure 3.2 relatively acceptable) and such countries can also positively affect world prices through their tariff policy (imposing a tariff on imports lowers the price that other countries will receive for their exports). For smaller countries, though, the Prisoners' Dilemma is not an adequate depiction of their trade situations. Rather, smaller countries tend to have preferences that reflect the game of chicken, a situation that we discuss later.

Another typical application of the Prisoners' Dilemma in international political economy has been in examining the collective management of resources. Whereas countries producing particular commodities traded on world markets would prefer a situation where they all manage production so as to keep prices sufficiently high—by forming a cartel such as OPEC (Organization of Petroleum Exporting Countries),—individual countries face the temptation to 'cheat' by increasing extraction or production of those commodities so as to maximize their individual income. As a result, acting collectively to keep commodity prices stable—in commodities such as coffee, tin, and even oil—has been a daunting task, particularly for developing countries.

'Inhibiting fear': assurance games

The second typical problem that a country seeking to enter international cooperation faces comes from the uncertainty of benefits and costs linked to integration in the world economy. Global economic integration brings its full benefits when most countries are part of it and adopt appropriate policies. When some countries make mistakes, or if liberalization policies lose momentum, international markets may react abruptly. If states become paralysed by this likelihood, the whole world may revert to a much lower level of integration. This situation is best modelled through another category of game—assurance games.

One specific example of an assurance game is 'Stag Hunt', depicted in Figure 3.3. The name of the game comes from the story of two hunters chasing a stag. They go out before dawn and take positions on different sides of an area where they think a stag is hiding. They have a mutual understanding to shoot only at the stag (Strategy S1 in the game depicted in Figure 3.3). Shooting at any other wild animal, say a hare (Strategy S2), would lead them to miss shooting the stag because the stag would be frightened by

Figure 3.3 Assurance game (Stag Hunt) (ordinal form)

		Player Beta	
		S1	S2
Player Alpha	S1	**4, 4**	1, 3
	S2	3, 1	**2, 2**

Figure 3.4 Coordination game (Battle of the Sexes) (ordinal form)

		Player Beta S1	Player Beta S2
Player Alpha	S1	**4, 3**	1, 1
	S2	1, 1	**3, 4**

the noise and stay put in its hiding place. As time goes by and as dawn arrives, however, both hunters start thinking that going back home with a hare might be better than continuing to wait for the stag to come out of hiding. If each of them thinks that the other one will eventually yield to the temptation to shoot at a hare, they will both end up killing a hare—a better outcome than not catching anything but clearly much less attractive than sharing a stag.

In Stag Hunt, players share a single most preferred outcome—i.e. a Pareto-optimal Nash Equilibrium—but they do not have dominant strategies. As a result, there is a second, Pareto-deficient, equilibrium outcome. In such a game, reaching the Pareto-optimal equilibrium is not a foregone conclusion. Doubts about the willingness of one's counterpart to choose strategy S1 (shoot the stag) might push a player to choose strategy S2 (shoot a hare), which guarantees for that individual the highest minimal gain. Yet, such an outcome is rather unlikely because of the attraction of the upper-left cell. In contrast to the Prisoners' Dilemma game, it is not the temptation to reap additional gains that may prevent actors to be in the upper-left cell of the game but their anticipation of a possible mistake or unintentional move by the other one.

Financial globalization has features of a stag hunt game. With increasing capital flows among countries, global capital markets become deeper and provide greater opportunities for individual countries. Yet, policy mistakes by some countries may quickly destabilize markets. Fear of the potential negative impact of such a destabilization may lead countries to implement measures to slow down or restrict capital movements. Such a move may lead to changes in other actors' expectations and quickly drive the world, or at least a region of the world, to a much lower level of integration. This new situation could have the advantage of being less risky for countries but is unlikely to bring as many opportunities for investment and therefore reduce growth prospects.

'Where to meet': coordination games

Whereas market liberalization is essential for global economic integration and increased prosperity, sustainable global integration requires some market supervision. This supervision in turn requires cooperative action by countries. The difficulty, however, is that there are often many ways to supervise markets and countries may differ on their preferred coordination point because potential solutions vary in their costs and benefits. This strategic context corresponds to a game of coordination. In the specific game depicted in Figure 3.4, actors have to choose *among* Pareto-optimal outcomes. Its name, 'Battle of the Sexes', comes from the story of a husband and wife who have to decide where to spend their evening after work. They either can go to the opera or watch a football match. Neither spouse derives much pleasure by being without the other one but they differ on the best choice. The husband would prefer to watch football (strategy S1 in Figure 3.4) whereas the wife would prefer the opera (strategy S2 in Figure 3.4). In the story, both are getting off of work and have to rush to either the stadium or opera. They cannot communicate with each other (say the batteries of their cell phones are dead!), and have to meet at one of the locations. If each of them follows their preferred solution, they end up at different locations, which both regard as a bad outcome. Perversely, if both of them want to please the other one by choosing the location that they know that their partner prefers, they also end up being separated. Thus, they have to somehow implicitly coordinate, with one making a concession and the other getting his / her first choice. Figure 3.4 provides a generalization of that story.

In the Battle of the Sexes, none of the players has a dominant strategy. Player Alpha prefers to play Strategy 1 when Player Beta chooses Strategy 1 and prefers Strategy 2 when Player Alpha chooses Strategy 2. With Player Beta having the same preferences as Alpha, the game has two equilibrium outcomes—the upper-left and lower-right cells in Figure 3.4.

These two outcomes are clearly Pareto-superior to the two other possible outcomes, but actors will disagree on which one to choose. Player Alpha prefers the upper-left cell whereas Player Beta prefers to end up in the lower-right cell. Both players want to avoid being separated but each player prefers a different outcome.

In international political economy, efforts by developed countries to choose mutually compatible macroeconomic policies typically reflect games of coordination (Putnam and Bayne 1987). For instance, when there is high volatility in financial and exchange rate markets, coordinated responses by leading countries would often be best but each country would like to choose the policy mix that best fits its own domestic constraints. Coordination was a key challenge in efforts to address the 2008-9 global financial crisis and the global recession that has followed since then. Whereas major central banks were able to coordinate their actions to contain the stress in financial markets to a reasonable extent, governments have had more difficulty in implementing concerted fiscal responses. Some countries, such as the United States, engaged in large fiscal stimulus, while others were more reluctant to use fiscal policy out of concern for the health of public finances. This asymmetry fuelled a concern for free riding where a country would benefit from the efforts of its neighbours, as their stimulus plans boost its exports without affecting its fiscal stance. As a result, countries resorting to large stimulus tended to adopt 'nationalist' or protectionist policies to channel government funding to national firms. To offset this sub-optimal dynamic, major economies have promoted the use of a new informal grouping—the G20—as a forum in which heads of states have repeatedly committed to concerted plans of action and pledged to refrain from protectionist measures. Yet, despite high hopes following the meetings held in London and Pittsburgh in 2009 (Cooper 2010), the new forum gradually lost momentum.

Another prominent example is the choice of international monetary system (Cooper 1975). Discussions between the USA and Great Britain during the Second World War regarding the architecture of the future international economic order revealed that, although both countries agreed on the absolute need for coordination, they fought over the details of the new order, with each trying to impose its own plan. A more recent example was the debate within the European Union over the design of monetary union, which saw Britain, France, and Germany proposing different solutions for some economic and monetary convergence between member states as well as for rules of fiscal behaviour within the monetary union (Wolf and Zangl 1996). At the global level, in the aftermath of the recent global financial crisis, Russia and China have aired the idea of finding an alternative to the current dollar-dominated system. They have not however been able to push this onto the financial agenda of the G20 whose performance on matters of monetary and financial governance has fallen short of expectations (Helleiner 2012; Vestergaard and Wade 2012).

Mixed situations: Chicken, Called Bluff, and Suasion

We now turn to games that capture situations in which more than one typical problem of cooperation may be present or in which the actors may view the structure of the problem differently. We begin with the game of Chicken that combines the features of the temptation to free ride as well as distributive tensions between the actors. This game, depicted in Figure 3.5, builds on the story of two cars, travelling in opposite directions, speeding down the middle of the road toward one another. Inside each car sits a driver who wants to impress his respective passenger that he is a tough person (i.e. demonstrate resolve). The best way to do so is to continue driving straight down the middle of the road (strategy S2 in the game depicted in Figure 3.5)—even when the car coming in the opposite direction comes dangerously close. Yet, if at least one driver does not swerve, the outcome will be disastrous and both cars will crash, killing everyone. To avoid this unfortunate outcome, at least one driver will have to yield and swerve (strategy S1

Figure 3.5 Chicken Game (ordinal form)

		Player Beta S1	Player Beta S2
Player Alpha	S1	3, 3	**2, 4**
Player Alpha	S2	**4, 2**	1, 1

in Figure 3.5), but both would like the other one to be the 'Chicken' who swerves.

The distributive tension between two equilibrium outcomes is a typical feature of the coordination games discussed earlier. But in contrast to those games, the game of Chicken has a third outcome that is collectively optimal—the compromise solution in the upper-left cell. As in the Prisoners' Dilemma, however, this outcome is not stable and actors have a strong temptation to revert to one of the two equilibriums represented in boldface in Figure 3.5. As such, the Chicken game helps to capture more complex situations faced by countries attempting to engage in international cooperation (Stein 1982).

In the context of the global political economy, Chicken games are useful depictions of the complex structure of burden sharing that occurs within a group of powerful players. For instance, when there is monetary and financial stability in the global economy, the US and the EU may tend to resist making public commitments to international cooperation unless there is a clear sign that the other party will act similarly. Getting out of a trade negotiation stalemate or dispute can also be a Chicken-like situation in which each actor is unwilling to agree on any asymmetric solutions.

To this point, we have only considered cases where actors have symmetrical preferences. We now examine two interesting *asymmetric* games, the first of which has one player whose preferences are those of the Prisoners' Dilemma game, and a second player with a structure of preferences of the Chicken game. The resulting asymmetric game, known as the game of 'Called Bluff', is depicted in Figure 3.6.

Player Alpha has Prisoners' Dilemma preferences with a dominant strategy to play S2, whereas Player Beta has Chicken preferences with a preferred choice of S2 if Alpha chooses S1 and a choice of S1 if Alpha chooses S2. Yet in this game, owing to the asymmetry in pay-offs, Beta knows that Alpha has a dominant strategy of S2, Beta therefore should choose S1, leading to the equilibrium outcome in the lower-left cell in Figure 3.6. Here, Player Alpha gets his most preferred outcome, whereas Player Beta gets her second worse outcome. This scenario can be used to analyse situations where stronger countries or actors can take advantage of the other's weakness and shift the burden of cost of cooperative action onto the weaker party. This outcome is caused by the difference in actors' sensitivity (vulnerability) to the need for cooperation itself. The player with the less dependence on the need for cooperation (Beta in Figure 3.6) is able to free ride on the other player (Alpha in Figure 3.6). Given the lack of capacity of the weaker actor to sustain cooperation alone, this often leads to a breakdown of international action.

A good illustration of this situation is the monetary policy of Germany and Japan in the 1960s, in the context of the Bretton Woods fixed exchange rate system. The stronger player, the United States, asked these countries to revalue their currencies to help boost the competitiveness of US exports and relieve the pressure on the dollar. These countries refused to undertake significant revaluations, which thus had increasingly costly implications for the US economy and, ultimately under the Nixon administration, the US simply forced the burden of adjustment on the weaker countries by breaking the link between the dollar and gold and imposing a 10 per cent across-the-board tariff. This action led to the end of the Bretton Woods system (see Helleiner, Chapter 7 in this volume).

A second case of asymmetry is a game with one player having preferences oriented toward cooperation and the other one having Chicken preferences. In the game of 'Suasion', Player Beta has preferences similar to a player in the Chicken game but Player Alpha has preferences that are typical of another game, the game of Harmony. The basic feature of Harmony games (see Figure 3.7) is

Figure 3.6 Called Bluff (ordinal form)

		Player Beta S1	Player Beta S2
Player Alpha	S1	3, 3	1, 4
	S2	**4, 2**	2, 1

Figure 3.7 Harmony (ordinal form)

		Player Beta S1	Player Beta S2
Player Alpha	S1	**4, 4**	3, 2
	S2	2, 3	1, 1

Figure 3.8 Suasion (ordinal form)

		Player Beta	
		S1	S2
Player Alpha	S1	4, 3	**3, 4**
	S2	2, 2	1, 1

that both players not only dislike acting separately (as in the case of coordination games) but they also do not differ on the best outcome. They both therefore have a dominant strategy to do the same thing. Cooperation is, so to speak, naturally guaranteed (as, for instance, in nineteenth-century liberal assumptions about international economic relations, which argued that everyone would generally be made better off with free trade and open markets more generally).

Combining a player with Chicken preferences and a player with Harmony preferences yields the game depicted in Figure 3.8, known as the game of 'Suasion' (Martin 1992).

The predicted outcome of the Suasion game shares some similarity with that of the game of Called Bluff illustrated in Figure 3.6. Both games feature a situation in which one player gets its most preferred outcome. However, the difference between these two games is that in Suasion, the 'stronger' player (Alpha in Figure 3.8) gets his second best outcome, which results from the choice of his dominant strategy (S1 in Figure 3.8). Put into the context of international cooperation, this clearly reflects a situation in which an actor perceives the benefits of international action to be much more than its associated costs. Because this actor (Alpha) absolutely wants to carry through action at the international level and is assumed to have the capability to do so, other actors (Beta) are in a situation whereby they will let him (Alpha) undertake the bulk of the effort, and will enjoy the benefits at low or no costs to themselves.

One can view this as a situation as one of the tyranny of the weak, which is in sharp contrast to the game of Called Bluff. Note, however, that the stronger player is not forced into an asymmetric outcome by the behaviour of the weak, but by his own preferences. From this perspective, the Suasion game features an opportunistic attitude by the weak rather than a deliberately tyrannical outlook. Martin (1992) argues that this game illustrates the Western world's restriction of technology exports to the Soviet Union during the Cold War. Control of technology sales to the Soviet bloc was done through the Coordinating Committee on Export Controls (COCOM). Within it, however, the United States had a dominant strategy to control technology whereas European states were more opportunistic. They could benefit from sales to the Soviet bloc without jeopardizing the overall balance of power between the two blocs. The US was dissatisfied with this situation and had to persuade Europeans to participate fully with COCOM.

More generally, this type of game relates to situations where one actor (or group of actors) can undertake actions that are immune (up to some degree) to the free riding behaviour of other countries. For example, tax havens in small countries were 'tolerated' by bigger countries as long as the latter could use capital movement restrictions to secure financial stability. When capital restrictions were dismantled, there were significant increases in the efforts to circumvent the free riding behaviour of tax havens. Such free riding became politically intolerable with the advent of the global financial crisis, which required global coordination efforts. The G20 countries put significant pressure on 'renegade' countries with the preparation of a black list by the Organization for Economic Co-operation and Development (OECD).

KEY POINTS

- Each of the typical problems of international cooperation can be viewed through the lens of strategic decision-making.
- Game theory can help us analyse interdependent decision-making.
- Cooperation can be expected to fail either due to actors' incentives to cheat, to actors' sensitivities to distribution issues, or to lack of confidence in the other actor's behaviour.
- Problems of distribution and free riding may be combined in real-world situations; some games are able to model these combinations.
- Differences in resources or in the perceived need for cooperation result in situations of asymmetric burden sharing.

International Cooperation: A Variety of Solutions

The discussion of cooperation problems in the global political economy highlights the varied nature of the challenges facing actors. We now turn to the question of how to address these challenges. In particular, we focus on the role that international institutions can play in addressing cooperation problems. Our analysis begins with situations where the problems can be addressed without institutions and then turns to cases where institutions help the process of cooperation.

International action without international institutions

In most of the games that we have examined, individual actions by both players lead, or may lead, to an outcome that we can characterize as collectively optimal because there is no welfare loss. Yet, this notion of optimality tends to be short sighted because the asymmetric outcomes of the Called Bluff, Suasion, Chicken, and even coordination games are optimal only in terms of a narrow view of *collective welfare*. Such a conception of welfare does not obviate the problems of the distribution of gains that may either make the road to an agreement difficult or plague the likelihood of collaboration. As we discuss later, institutions may play useful roles in addressing these problems, but collaboration may also occur through individual actions.

Individual, decentralized, action can also be optimal in the thorny case of the Prisoners' Dilemma. Yet, for this to happen, we must relax the Baseline assumption that players play the game only once and allow them to have repeated interactions through time (Axelrod and Keohane 1986; Taylor 1987; Sandler 1992; Cornes and Sandler 1996). When players expect to meet again in the future, they may be more willing to cooperate. Yet even under such conditions of iteration, however, cooperation is not a foregone conclusion. For example, if the expected net value of cooperation is too low (for example, actors may overly discount the importance of future iterations owing to a dire economic or political situation at home for governments), the temptation to free ride cannot be overcome. The Prisoners' Dilemma (PD) demonstrates that, if defection by one actor would generate high costs for the other actor (resulting in a lengthy prison sentence in PD), or if actors cannot gather information easily, actors may not reach a Pareto-optimal outcome.

Applied to the case of trade liberalization, repeated interaction is not sufficient to ensure cooperative behaviour for governments that are under heavy domestic pressure, as the temptation to reap immediate political gains through defection may simply be too great. Domestic pressure may be particularly high in democratic countries where economic groups or citizens have easy access to the political sphere, in countries with a political system that tends to favour coalition governments, or in countries without strongly embedded social consultation mechanisms. Conversely, the cost of defection may be too high when actors invest heavily in cooperative efforts and value the outcome produced by cooperation. In such cases, they are significantly more reluctant to jeopardize cooperation, even if others have undertaken free riding behaviour.

A world without international institutions is also not universally effective in securing the exchange of goods. As long as trading partners have access to other markets for their products, an institution-free world can work in the context of global trade, because countries can simply turn to another market if a breach in the trading relationship occurs. Yet if there is only one partner that is interested in the goods produced, or if it would be more costly to trade with other partners, such an option does not exist. If a country cannot threaten to sell its goods elsewhere, another country may take advantage of it. Another important qualification for successful institution-free contexts is if one (or both) of the parties has made relation-specific investments. In such a case, these investments will discourage defection and may encourage cooperative behaviour.

What other factors might impede cooperation when actors cannot rely on international institutions? Monitoring will be much more difficult if states only have limited information gathering capability. If an actor has so little information that, for example, it is unsure whether the other actor 'defected' on the last round, then the prospect of repeated interactions does not increase the chances of cooperation. Similarly, an expanding number of states, with an expanding range of trade products that use increasingly sophisticated policies to intervene in markets, makes monitoring trade policies increasingly difficult. It is therefore more difficult to detect non-compliance without the help of a third party.

The role of institutions

As our discussion earlier suggests, actors may need help to sustain collectively optimal outcomes. One way that individuals might be able to coordinate their choices to achieve desired goals might be through the creation or use of international institutions or regimes. International regimes have been defined broadly as 'sets of principle, norms, rules and decision-making procedures upon which actors' expectations converge' (Krasner 1983). To refine this definition, we can distinguish between the principles and norms, or 'meta-regime', and the regime itself, defined as the rules and procedures to allow us to distinguish between two very different types of constraints on the behaviour of states (Aggarwal 1985). In this case, we can use the term institution to refer to the combination of a meta-regime and a regime—rather than Krasner's definition. Note that an institution is not the same thing as an international organization: one can find areas of international collaboration where there are well-defined principles, norms, rules, and procedures for actors' behaviour in the absence of an organization such as the IMF. We structure our discussion below around three major functions of institutions (see Table 3.1).

First, institutions can act as channels for the third-party enforcement of agreements. To successfully overcome players' temptation to free ride, international institutions should be strong, meaning that member countries should have specific and binding obligations. In particular, agreements that credibly restrain actors' temptation to free ride in trade and monetary policy, for instance, need to rely on some sort of enforcement mechanism delegated to an international institution. At its strongest expression, in the European Union or in the WTO, such a mechanism relies on an organization—the EU has two such entities, the Commission and the Court of Justice—with supranational power to monitor, evaluate, and sanction (if needed) the behaviour of its members.

The chances of a cooperative agreement can also be enhanced through a different kind of centralization—one that ensures a prompt and undistorted dissemination of information. This type of facility helps identify the requirements of multilateral action and protects against possible defections. Enforcement can also be achieved through either positive incentives, as when the IMF provides funds to countries that are following its policy recommendations, or through punitive action as when the World Trade Organization rules against a particular state policy.

Table 3.1 Problems, Games, and Institutional Roles

	From problems to institutional solutions		
	'Free riding temptation'	**'Inhibiting Fear'**	**'Where to meet'**
Strategic game	Prisoners' Dilemma	Stag Hunt (Assurance games)	Battle of the Sexes
Illustrations	Trade liberalization Debt rescheduling	Financial integration Trade specialization	Managing adjustments Multilateral negotiations
Role(s) of institutions	Channel to enforce contracts – monitoring/surveillance – sanctioning mechanisms – policy transfer	Enhancers of cooperation – pools of resources – suppliers of knowledge and capacity	Providers of solutions to distributive conflicts – negotiation fora – agenda setting – linkages
Examples of institutional solutions	*Monitoring/Surveillance*: Articles IV and VIII of IMF; Trade Policy Review mechanism WTO; *'Sanction'*: Conditionality IMF; DSB's authorization of sanctions WTO *Policy transfer*: Common Trade policy and Economic and Monetary Union in the European union	*Pools of resources*: quota system in IMF *Suppliers of knowledge and capacity*: WTO (technical cooperation), World Bank, IMF, UNCTAD	*Negotiation fora*: WTO General Council; Executive Boards IMF and World Bank; UNCTAD *Agenda setting*: IMF and World Bank staff

Second, international institutions can help craft responses to situations characterized by distributive tensions among states. They can help states choose one among several collective outcomes and eliminate some sharply asymmetric outcomes. Institutions may also be useful for gathering information about the preferences of actors, and through appropriate use of agenda setting, may help find focal point solutions for both cost sharing and benefit splitting. Institutions with a firmly and widely established meta-regime tend to perform these tasks extremely well. In contrast, institutions lacking a strong meta-regime may have difficulty generating possible solutions that are attractive to all members. This has often been considered as the source of difficulties for the GATT, and its successor the WTO. Deep disagreements among GATT members led to the creation of another forum, the United Nations Conference on Trade and Development (UNCTAD), in the 1960s, and to serious hurdles in the negotiations of the extension of the scope of GATT/WTO, as recently revealed during the Doha round of negotiations. The members of UNCTAD had shared principles and norms that they felt were not importantly addressed in GATT/WTO.

Third, international institutions can do a lot to allay actors' fear or reluctance to engage in cooperative behaviour. Rather than enforcing a particular outcome, institutions should enable actors to reach it (by pooling resources, for example). To help the integration of developing countries into the global financial system, the IMF provides cheap credit opportunities through the contributions subscribed by all members. The World Bank finances the development of basic infrastructure in developing countries to help them reduce poverty. At the European regional level, the European Monetary System (EMS) has relied on a decentralized system of very short lending facilities among members to help them defend the parity grid that served as an anchor to the set of national currencies.

To address enforcement and distribution problems, institutions can establish rights for members that either define mechanisms of exclusion or determine compensation schemes. In relation to our previous discussion of games and cooperation, careful institutional design can sometimes 'privatize' the benefits of cooperation, reducing the temptation to free ride. The reduction of trade barriers almost always applies to countries that belong to particular clubs, be they regional (see Ravenhill, Chapter 6 in this volume) or global. Assigning rights and obligations can also produce decentralized cooperation when institutions also provide information about the preferences of actors and reduce the costs of their discussions to their minimum. When actors are more certain about who owns and is responsible for what (a result of the assignment of rights and obligations), cooperation may result.

Under these conditions, as Coase (1960) suggests, actors do not need any centralized power to remedy the problem of negative **externalities** (situations where an individual's action negatively affects the well-being of another individual in ways that need not be paid for according to the existing definition of **property rights**) (Conybeare 1980; Keohane 1984) but should find a mutually satisfactory solution through financial compensation. The crucial aspect, in the Coasian framework, is establishing liabilities for externalities. The history of international monetary agreements provides several examples of the difficulties associated with determining satisfactory schemes assigning responsibilities to the involved parties. For instance, the collapse of the fixed exchange rate systems was largely due to the inability of IMF members to redistribute the burden of adjustment from the USA to Germany and Japan. Difficulties in the so-called European Snake in the early 1970s induced member states to design the EMS in such a way as to put the responsibility on strong currency members (in particular Germany) to intervene as much as weak currency members in defending existing parities.

Our brief discussion of the roles of institutions reveals the value associated with information gathering and dissemination. Long-term enforcement requires identifying prospects for defection, finding a focal point based on the constellation of positions, and informing actors of the overall global context. Therefore, a major activity of international institutions is to collect information about actors' behaviour, preferences, and the state of the international environment.

KEY POINTS

- Institutions are key instruments for resolving enforcement, distribution, and assurance problems.
- Institutions help assign rights and obligations to benefactors of cooperation as well as in defining those benefactors.
- Institutions help make the international scene an information-rich environment.

The Formation and Evolution of Institutions

We have seen that institutions can help cooperation in several ways. But how might institutions be formed in the first place? And what factors may impact the design of institutions? We begin with a broad discussion from the literature on international relations and then turn to more specific issues. In examining institutions, five different approaches in international relations have been brought to bear on this problem: Neorealism, Neorealist institutionalism, Neo-liberal Institutionalism, Cognitivism, and Radical Constructivism (Aggarwal 1998).[1]

Neorealists assume that in an anarchic international system, states must rely primarily on their own resources to ensure their security. For neorealist scholars, thus, regimes and international institutions have no significant role in international relations because power considerations are predominant in an anarchic world (Waltz 1979; Mearsheimer 1990). In this view, as we have discussed earlier, collaboration will only be sustainable if states highly value future interactions, have symmetric resources, and are highly interdependent.

Still within a power-based tradition, though, some scholars have examined changes in and the effects of international institutions. In this literature, labelled Neorealist Institutionalism, the central concern is on how regimes affect the distribution of costs and benefits of state interaction. For analysts in this school (Krasner 1983; Aggarwal 1985; Krasner 1991; Knight 1992), institutions have distributional consequences (in other words, the benefits of cooperation may be unequal) and can be used as devices to seek and maintain asymmetric gains. They can more broadly help control other actors' behaviour, both at home and abroad (Aggarwal 1985). For example, within the domestic context, state elites can argue that their hands are tied and thus attempt to circumvent pressure for particular actions from domestic actors. Examples of this include the Mexican government signing onto the North American Free Trade Agreement (NAFTA) (tying the hands of the Mexican government to a more open market posture in the face of domestic protectionist groups) or the American use of the Multi-Fiber Arrangement (MFA) to prevent textile and apparel interests from pressing for excessive protection.

A central theme in this literature has been the role of hegemonic powers in fostering the development of institutions through both positive and negative incentives (Kindleberger 1973; Gilpin 1975; Krasner 1976). Benevolent hegemons, for example, may provide **public goods** (a special type of good, e.g. national defence, that cannot practically be withheld from an individual without withholding them from all—the 'nonexcludability criterion'—and for which the marginal cost of an additional person consuming them, once they have been produced, is zero; the 'nonrival consumption' criterion) because their large size makes it worthwhile for them to take action on their own to overcome collective action problems. But while suggesting that regimes may form when powerful states desire them, this approach does not tell us much about the nature of regimes. Moreover, scholars in this school overemphasize tensions arising from the differences in the distribution of benefits between actors and downplay the possibility that actors may not necessarily and as acutely think in comparative terms but focus on the positive impact of institutions on their situations. Finally, this approach has little to say about actors' desire to pursue multilateral versus bilateral solutions to accomplish their ends.

Building on these criticisms of the Neorealist approach, Neo-liberal institutionalists have examined the specific incentives for states to create institutions—as opposed to simply engaging in *ad hoc* bargaining. This body of work, taking off from seminal research by Oliver Williamson, examines the role of institutions in lowering the costs involved in choosing, organizing, negotiating and entering into an agreement (what he calls transaction costs), and has garnered a considerable following in the field of international relations (Keohane 1984). As we have seen, institutions provide many useful functions in helping actors to coordinate their actions or achieve collaboration. This theoretical approach assumes that collaborative action is primarily demand driven—that is, actors will create institutions because they are useful—but does not really specify a mechanism for how they would go about actually creating them.

An important theme of this work has been how existing institutions may constrain future institutional developments (Keohane and Nye 1977; Keohane 1984). One aspect of this constraint is the possibility that

[1] The term Radical Constructivism was first used by Haas (1992); for a recent synthesis see Duffield (2007).

existing institutions with a broad mandate will affect the negotiation of more specific institutions, leading to the 'nesting' of regimes within one another (Aggarwal 1985). Thus, while the notion of transaction costs and sunk costs (the investments that actors have made in specific institutions) are central elements in this thinking, the role of regimes in providing states with information and reducing organizational costs can be distinguished from the role of existing institutions in constraining future actions.

A fourth approach to examining institutional innovation and change places emphasis on the role of expert consensus and the interplay of experts and politicians (Haas 1980; Haas 1992). New knowledge and cognitive understandings may lead decision-makers to calculate their interests differently. For example, work by Ernst Haas focused on the efforts of politicians to use linkages across various issues (sometimes from quite distinct areas) to create new issue packages in international negotiations. The objective is to provide benefits to all, in an effort to facilitate the formation of international regimes (Haas 1980).

Lastly, 'Radical Constructivists', while focusing on the role of ideas, argue that reality is in fact constructed in the minds of decision-makers. These scholars, drawing from Ernst Haas's work, go much further than Haas in suggesting, 'power and interest do not have effects apart from the shared knowledge that constitutes them as such' (Wendt 1995). Analysts in this school see norms and values as being dominant causal forces and ascribe considerable power to institutions in not only constraining actors, but in fundamentally altering how they conceive of their basic interests. In summarizing their view, Peter Haas notes that this school argues that 'there is no 'objective' basis for identifying material reality and all claims for objectivity are therefore suspect' (Haas 1992). The subjective element in states' decision-making makes it more difficult to objectively evaluate the role that institutions might play or how they might be constructed.

The characteristics of international institutions

The five general approaches discussed above are a useful starting point for the understanding of how institutions are created and of the key drivers of their subsequent evolution, but they clearly are of limited help to understand specific variations in the forms of institutions. Based on the existing literature and on our own work, we characterize institutions in terms of their membership, the stringency of their rules (the degree to which they constrain state behaviour), their scope, their membership, the extent of delegation of power from member states to institutional bodies, and the centralization of tasks within the institution (see Box 3.3).

The Bretton Woods institutions, the WTO, and UNCTAD have quasi-universal *membership*. By contrast, the Group of Seven most industrialized countries only welcomed one new member in the last thirty years (Russia formally joined the Group in 1997, transforming it into the G8). Moreover, it is interesting to underline that the G7/8 remains autonomous from the larger G20, with the latter becoming the most visible global economic steering forum. Similarly, most regional integration arrangements have remained selected clubs with limited membership (see Ravenhill, Chapter 6 in this volume). Membership also varies in terms of the type of actors who can participate. While most institutions remain state-centric, some have started to include private actors. For instance, the Financial Stability Forum (FSF) was created in 1999 and upgraded to the Financial Stability Board by the G20 in 2009 (Helleiner 2010) to promote international financial stability groups representatives from national ministries, international financial institutions, and sector-specific groups (insurance, accounting standards, securities commissions). Controversy continues at the WTO over whether non-state actors should be permitted to participate in deliberations. (For other efforts paying particular attention to membership issues see Sandler (1992), Koremenos, Lipson, and Snidal (2001) and Aggarwal and Dupont (2002)).

The second dimension, *stringency of rules*, covers both the precision and the obligation of rules in the literature on legalization of world politics (see Aggarwal 1985 on regime strength, and Abbott and Snidal 2000 on legalization). From this perspective, authors have often contrasted the so-called European and Asian models of regional economic integration. The first one is built upon a wide set of specific and binding rules (called the *acquis communautaire* in the jargon of European integration) whereas the second is built upon declarations, intentions, and voluntary commitments (Ravenhill 1995, 2001). The lack of any precise and concise definition of a balance of payments problem in the IMF severely affected the constraining power of this institution in preventing its members from running imbalances.

BOX 3.3

IMF and WTO: Selected Organizational Characteristics

Set up in order to promote international monetary cooperation, the International Monetary Fund exerts a surveillance function over member states' financial and economic policies and provides financial and technical assistance to member states. Day-to-day business is conducted by the Executive Board, a restrictive body with twenty-four Executive Directors representing directly or indirectly all members. The IMF's five largest shareholders—the USA, Japan, Germany, France, and the United Kingdom—along with China, Russia, and Saudi Arabia have their own seats whereas the other sixteen Executive Directors are elected by groups of countries. The Executive Board gets its powers from the Board of Governors, the highest authority of the IMF in which each member has a seat. To assist it in the conduct of IMF affairs, the Executive Board in turn selects a Managing Director who is the chief of the operating staff of the Fund of 2,800 employees, with half of them being economists.

Within the Executive Board, the normal *de jure* decision-making mode is simple majority, but important issues are decided by qualified majority, either 70% (suspension of one member's rights in case of non-respect of obligations) or by 85% (e.g. modification of quotas, change in the seats of the Executive Board, provisions for general exchange arrangements). Qualified majority voting increases the power of the biggest contributors, in particular the USA, which has a veto power over issues requiring 85% majority decisions. *De facto*, however, voting rarely occurs in the Executive Board. Instead, Executive Directors use consensus to adopt decisions.

The institutional structure of the WTO differs significantly from the IMF model. It reflects very clearly what the organization considers to be its primary role, that is, a forum for the negotiation of liberalization agreements. In the WTO, the principal institutional structures are a ministerial Conference meeting every two years; the General Council, and three councils in the area of goods, services, and intellectual property. All members have a seat in these councils. The default decision-making mode is consensus but decisions may also be made at unanimity (suspension of MFN treatment), at 75% majority (interpretation of an existing multilateral agreement, or a waiver of an obligation for a particular country), or with two-thirds majority (for admission of new members for instance).

The WTO General Council also serves as the Trade Policy Review Body that adopts reviews of member states' trade policies. Reviews are conducted on the basis of a policy statement by the Member under review and a report prepared by economists in the WTO Secretariat. That Secretariat, headed by a director-general, has around 630 staff and its main function is one of administrative and technical support to WTO councils, committees, and working groups.

Delegation of authority in the WTO is therefore restricted to the mechanism for solving trade disputes between members. Delegation is conferred first to small groups of experts (three or five) who are established when members fail to settle disputes in a conciliatory way. Panel members are independent individuals under instruction from no government. Their role is to make an objective assessment of the dispute and issue a report with findings and recommendations (establishing the legality of member states' policies in the case under dispute). This report has then to be adopted by the General Council serving as the Dispute Settlement Body. The latter, however, can only reject the panel report by consensus.

The second body with delegated authority from the member state is the Appellate Body, which reviews appeals made by member states on panel reports. The seven members of the Appellate Body serve for four-year terms and are legal experts with international standing. The appeal can uphold, modify or reverse the panel's legal findings and conclusions. As for the case of panel reports, the Dispute Settlement Body must endorse the appeal report. Rejection is only possible by consensus.

For more information, http://www.wto.org; and http://www.imf.org.

Third, we consider the *scope* of agreements defined as issue coverage (Aggarwal 1985; Koremenos Lipson and Snidal 2001). The evolution of the GATT from its origins in 1947 to the creation of WTO in 1995 reveals an important increase in the scope of the agreements. Whereas GATT initially focused on the liberalization of trade in goods, the WTO covers services, agriculture, as well as trade-related aspects of intellectual property rights and investment (see Winham, Chapter 5 in this volume). Similarly, the G7/8 agenda has drastically expanded from a focus on macroeconomic management at its creation in the mid-1970s to a broad range of international security and economic issues, including terrorism, energy, environment, and arms control in the 1990s and early 2000s. At the other end of the range, one finds sector-specific institutions such as the International Organization of Securities Commissions (IOSCO), the International Associations of Insurance Supervisors (IAIS), and International Accounting Standards Board (IASB), as well as product-specific organizations such as the International Coffee Organization (ICO), the International Cocoa Organization (ICCO), the International Copper Study Group (ICSG), and the International Sugar Organization (ISO).

The fourth dimension is the extent of *institutional delegation*, the authority ceded by members to an institution, a dimension central to several existing studies (Abbott and Snidal 2000; McCall Smith 2000; Dupont and Hefeker 2001; Hawkins, Lake, Nielson, and Tierney 2006). International agreements may or may not include the creation of institutional organs, and these organs may or may not be given some autonomy from members for making new rules or monitoring and enforcing existing ones.

The extent of delegation may vary significantly across organs of the same institution. For instance, while the dispute settlement process in the WTO features an independent Appellate Body, the governing body of the organization—the General Council—relies upon consensus decision-making and the members have kept the size and the prerogatives of the secretariat down to a minimum. At the regional level, the extent of delegation strongly distinguishes the European Union from the small secretariats found in other regional institutions. Whereas the EU includes organs with supranational power, governments remain in full control of negotiation and implementation processes in most other regional agreements, including the NAFTA, the Association of Southeast Asian Nations (ASEAN), and the Asia-Pacific Economic Cooperation (APEC) grouping.

A fifth dimension is *institutional centralization* (Koremenos, Lipson, and Snidal 2001). Is there a concentration of tasks performed by a single institutional entity? Centralization may refer to such tasks as the diffusion of information, monitoring of members' behaviour, or the imposition of sanctions, as well as the adoption of new rules or modification of existing ones. Strong administrative bodies are natural candidates for the centralization of many tasks, as exemplified by the case of the European Commission in the European Union, or the administration of the IMF or the World Bank. Yet, in the latter two, key decisions and tasks go through the Executive Board with a limited membership of twenty-four countries or groups of countries represented by Executive Directors chosen by member states (see Helleiner, Chapter 7 in this volume).

It is often difficult to understand these five dimensions as being separate but they are conceptually distinct. As an example, although it is hard to imagine an agreement with lax rules and high delegation, strict rules do not necessarily imply high delegation (good instances are the numerous bilateral treaties on investment and to a lesser extent bilateral free trade treaties). Similarly, centralization and delegation may reinforce each other but none of them requires the other one. Conferences or councils of head of governments and states centralize most of the activities of several regional economic organizations (including monitoring, and dispute settlement). Yet, decision-making remains either consensual (where no state publicly dissents from the agreement) or based on unanimity.

Explaining institutional design

How can one account for institutional variation on these five dimensions? Consistent with a functionalist approach to the study of international institutions, we should expect the five dimensions to be affected by the type of problems that institutions should address (Stein 1982; Snidal 1985; Aggarwal and Dupont 1999; Koremenos, Lipson, and Snidal 2001; Ostrom 2003). In Table 3.1 in the previous section, we linked our three typical problems with specific roles for international institutions. Keeping these in mind, the 'temptation to free ride' problem is the one that clearly calls for strong rules, with delegation and centralization to international bodies. Cooperation is difficult and thus requires relatively strong institutions. In such cases, membership tends to be restricted to well 'socialized' governments. An inclusive membership makes monitoring more difficult and costly, and thus creates many opportunities for members to free ride.

As for scope, on the one hand, enforcement of the agreements is more likely to occur when institutions have a broad scope and are able to connect different issues ('issue linkage'). Linkages across issues help in deterring defection on a single issue when actors have broad interests (McGinnis 1986; Lohmann 1997). For example, members of the WTO cannot subscribe to the agreement on goods (GATT) without also accepting the agreement on services (GATS) as well as the agreements on intellectual property rights (TRIPS) and investment (TRIMs), and the dispute settlement mechanism. On the other hand, adding issues to an institution's agenda requires strong capacity to monitor behaviour, which may often not be present. In the context of the ongoing Doha Round of talks within the WTO, there has been an increasing concern about the negative impact of the willingness to support an all or nothing approach—to make the WTO a single undertaking as a means to achieve a negotiation breakthrough (Elsig and Dupont 2012).

The 'inhibiting fear' and 'where to meet' problems call for quite different institutional features. For these cases, there is a positive link with centralization for the pooling of resources, knowledge, and information provision, or the reduction of costs of negotiations. Addressing the 'inhibiting fear' may require some clear and binding rules on access to resources and knowledge. Yet in these cases, restricting the size of membership may not be a strong prerequisite for success. Solving distribution problems may require a softening of rules to allow some room for different interpretations of the agreements. Delegation of power is not essential in both situations, except for a potential benefit of agenda setting power to find mutually acceptable solutions.

As for scope, there is no clear link between 'inhibiting fear' and issue coverage. But a diverse set of issues can provide greater ground for compromise when players have different preferences and when they do not assign equal value to all of the issues. For instance, trade liberalization and monetary cooperation in the European Community has often been facilitated by the development of social or regional policies or packages to 'compensate' countries that might not immediately be major beneficiaries of the other policies. But, as the case of agriculture in the GATT/WTO shows, having different issues on the agenda is not helpful when countries categorically exclude certain issues from consideration in making trade-offs. Finally, with respect to membership, selected, restrictive groupings tend to reinforce the fear of being left out and thus should be avoided to address the 'inhibiting fear' problem. As for problems of distribution, more members may on the one hand help in the quest for new solutions. Yet, new members may also add as many new conflicts as complementarities among players.

As we have seen, then, different types of problems call for appropriate institutional design. Although focusing on general tendencies in institutional design in view of the problems they need to address provides a useful first step, we are still faced with some anomalies. For instance, given that trade liberalization is widely portrayed as embodying a 'temptation to free ride', how can one explain that some institutions (for instance European Free Trade Association) that focus on trade liberalization have remained informal and thus lack organs with delegated power? Why is it that some institutions do not have clear rules and preconditions for membership (for instance GATT/WTO or the EU until the early 1990s)? And lastly, why do some countries prefer very loose rules in designing institutions (such as ASEAN and APEC)?

To increase our ability to understand such choices, we can consider three other key influences. First, an important issue is what we call *potential participants* in the institution. In particular, the number of these actors and their relative power—two factors considered by Koremenos, Lipson, and Snidal (2001)—as well as their overall financial and 'social' capital (Ostrom 2000) influence the design of institutions. Relatively little concern about membership rules in GATT 1947 can be accounted for by the fact that the international system was much smaller and more homogeneous than the one that emerged in the 1960s as a result of decolonization. Similarly, the need to define strict criteria for entering the EU only became salient when the iron curtain fell and former communist countries with still very different political systems expressed an interest in joining the EU. Turning to the financial and social capital among potential actors, the disparities in size of financial reserves held by East Asian economies surely explains the very decentralized form of the regional financing arrangement known as the Chiang Mai Initiative (an East Asian institution that is intended to provide emergency finance to member economies facing a run on their currencies). In turn, the fact that there has been little formalization of relationships between central banks in the developed, democratic world builds upon a joint understanding and on a high level of expertise on how to address problems.

Second, the *information and knowledge available to actors* affects institutional design. Institutions comprised of actors with rich and reliable information usually require less centralization or less delegation (Coase 1960; Williamson 1975; Koremenos, Lipson, and Snidal 2001), as illustrated with the loose structure of the European Free Trade Association from its creation in 1960 to its upgrading in 1993. The founding members of that association—the United Kingdom, Denmark, Norway, Sweden, Austria, Switzerland, and Portugal—did not have the mutual distrust that characterized French–German relationships in the EC and information from partner countries was thus considered by all members to be rich and reliable. Existing knowledge about the issue area(s) covered by the agreement may affect the stringency of rules, the delegation of power, issue scope, and membership. Poor knowledge about the issues at stake tends to make actors wary of making hard commitments (rules and delegation)—a tendency particularly present in the discussions in the domain of the environment (see Dauvergne, Chapter 14 in this volume). Better knowledge may affect issue scope and the contours of membership. Whereas the politics of trade liberalization may call for careful selection of members for inclusion in the WTO, the widespread belief in the veracity of international trade theory (which argues that global membership yields the greatest efficiency in the allocation of resources) helps to account for the pressure to universalize increasingly membership in this institution.

Third, and finally, we can focus on the *outside institutional setting*. When actors create new institutions, they generally do not do so in a vacuum. Thus, when new institutions are developed, they often must be reconciled with existing ones. One approach to achieving such reconciliation is by nesting broader and narrower institutions in hierarchical fashion. Another means of achieving harmony among institutions is through an institutional division of labour, or 'horizontal' linkages (Aggarwal 1998). The challenge of institutional reconciliation is not, however, unique to the creation of new ones. In lieu of creating new institutions, policy-makers might also modify existing institutions for new purposes. For instance, faced by seemingly intractable balance of payments problems in Africa in the 1990s, the IMF developed new **structural adjustment** facilities that overlapped substantially with those of the World Bank. When modifying institutions, members therefore must also focus on issues of institutional compatibility. Moreover, bargaining over institutional modification is likely to be strongly influenced by existing institutions.

A few examples will illustrate these ideas. One can think about the problem of reconciling institutions from both an issue area and a regional perspective (Oye 1992; Gamble and Payne 1996; Lawrence 1996*a*). Nested institutions in an issue area are nicely illustrated by the relationship between the international regime for textile and apparel trade (the Long Term Arrangement on Cotton Textiles and its successor arrangement, the Multifiber Arrangement that was phased out completely in 2005) with respect to the broader regime in which it was nested, the GATT. When the Executive Branch in the US faced pressure from domestic protectionist interests simultaneously with international pressures to keep its market open, the American administration promoted the formation of a sector-specific international regime under GATT auspices. This nesting effort ensured a high degree of conformity with both the GATT's principles and norms as well as with its rules and procedures (Aggarwal 1985, 1994). Although the textile regime deviated from some of the GATT's norms in permitting discriminatory treatment of developing countries' exports, it did follow the **most-favoured nation** (MFN) norm, which called for developed countries to treat all developing countries alike.

The Asia-Pacific Economic Cooperation grouping (APEC), created in 1989, illustrates the concept of regional nesting. APEC's founding members were extremely worried about undermining the GATT, and sought to reconcile these two institutions by focusing on the notion of 'open regionalism'—that is, the creation of APEC would not bar others from benefiting from any ensuing liberalization in the region. APEC members saw this non-discriminatory liberalization as a better alternative to using Article 24 of the GATT, which permits the formation of discriminatory **free trade areas** and **customs unions**, to justify this accord (see Ravenhill Chapter 6 in this volume). Rather than forming an institution that could conflict with the promotion of GATT initiatives, therefore, APEC founding members attempted to construct an institution that would complement the GATT. Furthermore, APEC members wanted to avoid undermining existing sub-regional organizations, in particular ASEAN. This clearly restricted the level of obligation and delegation that could have been transferred to the newly created pan-regional organization (Dupont 1998).

An alternative mode of reconciling institutions would be to simply create 'horizontal' institutions to deal with separate but related activities, as exemplified by the division of labour between the GATT and the Bretton Woods monetary system (IMF and World Bank). In creating institutions for the post-Second World War era, policy-makers were concerned about a return to the 1930s era of competitive devaluations, marked by an inward turn among states and the use of protectionist measures. These 'beggar-thy-neighbour' policies were found across economic issue areas, and individual action by each state worked to the detriment of all. As a consequence, the founders of the Bretton Woods monetary system also turned their focus to creating institutions that would help to encourage trade liberalization. By promoting fixed exchange rates through the IMF and liberalization of trade through the GATT, policy-makers hoped that this horizontal institutional division of labour between complementary institutions would lead to freer trade.

Finally, on a regional basis, one can see the development of the European Economic Coal and Steel Community and the Western European Union (WEU) as horizontal organizations. The first was oriented towards strengthening European cooperation in economic matters (with, of course, important security implications), while the WEU sought to develop a coordinated European defence effort.

Conclusion

This chapter has sought to provide a systematic analysis of the problem of collaboration in global political economy through the lenses of types of problems, games, and institutions. We have seen that states may need to collaborate or to coordinate their actions to keep economic globalization on track because they may face problems of free riding, an inhibiting fear that their efforts will lead to instability for their economy, and the need to find coordination points that have varying costs and benefits to the participants.

The problem of free riding or the difficulty of finding a coordination equilibrium is a common one on a number of issues, including trade, monetary cooperation, the environment, human rights, and the like. Despite some limitations, game theory provides useful insight into the diverse set of problems that states may face in collaborating or in coordinating their actions. One of the most commonly used games, the Prisoners' Dilemma, has been utilized to show that in many issue areas, actors have a strong incentive to defect despite the potential joint gains that they may receive. Yet as we have shown, many problems in international political economy are not PD games, but instead may be better characterized as Chicken, Assurance, Suasion, or even Harmony games. By carefully examining the types of problems that actors face in a particular issue area and the structure of payoffs, game theory provides insight into the constraints on joint action.

It is worth keeping in mind that the preferences that go into creating games are often assumed by many analysts—particularly those in the neorealist institutionalist and neo-liberal institutionalist camps. Where do preferences come from and are such preferences amenable to change? It is on this dimension that constructivist arguments focusing on the role of experts, changing knowledge, and possible shifts in preferences through learning may provide significant insight that can help us to create more logically compelling games.

Once we can establish the basic game structure that actors face, we can better examine what role institutions might play in ensuring more favourable outcomes. In some cases, contrary to the perspective often taken by neo-institutionalists, institutions may not really be necessary for ensuring cooperative state action. Hence, we examined the types of situations in which self-help might lead to a positive outcome versus those in which institutions might play a genuinely useful role in overcoming collective action problems.

The role of institutions in fostering collaboration itself raises two puzzles. First, how might states collaborate in the first place to create institutions? This in itself raises an analytical problem that various theories have attempted to address. As we have seen, hegemons may have strong incentives to create institutions to constrain the behaviour of other actors and possibly their own domestic lobbies. Other approaches such as neo-liberal institutionalism focus on the strong incentives that major states may have in creating institutions and suggest that small numbers of actors may be able to overcome the usual collective action problems that may lead to free riding behaviour. To better understand the process of institutional design, we focused on five dimensions to characterize institutions: membership, the stringency of their rules, their scope, the extent of delegation of power from member states to institutional bodies, and the centralization of tasks within the institution. The types of problems which actors face can partially account for specific institutional characteristics. Yet other factors also influence the design of institutions. These include the potential participants in the specific issue area, the knowledge and information available to actors, and the pre-existing institutional context. In particular, with respect to the last factor, the Asian financial crisis of 1997–8 and the ongoing proliferation of trade agreements raises an important issue about reconciling new and old institutions. The Asian financial crisis generated considerable conflict when some Asian countries sought to create an Asian Monetary Fund. In the end, this effort faltered in the face of IMF and US opposition, but East Asian countries have since aggressively sought to create regional institutions. In trade, the problems of the Doha Round have been accompanied by a renewed push to shift away from broad multilateral institutions to bilateral free trade agreements and regional accords. The extent to which such arrangements will further undermine the WTO remains a crucial question that will have important implications for prospects of continued economic liberalization in the global economy.

QUESTIONS

1. Why does globalization increase the pressure for international collaboration?
2. What is the most frequent problem of collaboration in global political economy?
3. What is the thorniest situation of collaboration in global political economy?
4. How can game theory help us understand problems of collaboration?
5. Can enforcement really be carried out in international political economy?
6. How can institutions help overcome obstacles to collaboration?
7. What is the link between the types of problems that countries face in the global economy and their choice of an institution?
8. What are some key characteristics that can be used to describe international institutions?
9. What theories or variables help to account for the choice of specific international institutional characteristics?

FURTHER READING

Aggarwal, V. K. (ed.) (1998), *Institutional Designs for a Complex World: Bargaining, Linkages and Nesting* (Ithaca, NY: Cornell University Press). A collective volume that focuses on the relationships between institutions and the stability of dense institutional settings.

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Cooper, R. N. (ed.) (1989), *Can Nations Agree?* (Washington, DC: Brookings Institution). An insightful collection of work on coordination attempts of economic policies among nations outside of institutional settings.

Hasenclever, A., Mayer, P., and Rittberger, V. (eds) (1997), *Theories of International Regimes* (Cambridge: Cambridge University Press). A collective volume on recent developments on theories of international regimes with application to all domains of international politics.

Kaul, I., Grunberg, I., and Stern, M. A. (eds) (1999), *Global Public Goods* (New York: Oxford University Press). A collective volume with a range of examples of global public goods in economics, politics, and environment with interesting lessons for the future provision of such goods.

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Krasner, S. D. (ed.) (1983), *International Regimes* (Ithaca, NY: Cornell University Press). The seminal collective volume on international regimes that includes the classic definition of regimes as well as a range of examples in various domains of international politics.

Olson, M. (1965), *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, MA: Harvard University Press). Classic work on collective action and the conditions under which groups of actors may produce public goods.

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Taylor, M. (1987), *The Possibility of Cooperation* (Cambridge: Cambridge University Press). An advanced treatment of the problem of cooperation using repeated games.

Yarbrough, B. V. and Yarbrough R.M. (1992), *Cooperation and Governance in International Trade*. Princeton: (Princeton University Press). An elegant analysis of the problem of governance in trade approached through the lens of transaction costs.

WEB LINKS

www.gametheory.net Game theory.

http://www.globalpublicgoods.org Global public goods.

ONLINE RESOURCE CENTRE

For additional material and resources, please visit the Online Resource Centre at:
www.oxfordtextbooks.co.uk/ravenhill4e