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The Transformation of the International Political Economy

Robert Gilpin



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The Transformation of the International Political Economy*

The end of the 1980s was a time in human history when one age was receding and another was rapidly coming into existence. Whether or not one agrees with the American publisher Henry Luce that the twentieth century was the American century, the Pax Americana and American preeminence were waning. Contrary to the bold predictions of Nikita Krushchev and other earlier Soviet leaders, the future does *not* belong to communism, communism is not burying capitalism, but is itself on the defensive. The United States and the Soviet Union will continue to play crucial roles in the emergent global political and economic system. Other nations and new forces, however, will become more and more important in giving shape and substance to the international political economy.

The historical transformation of the early 1990s, which we are witnessing, involves much more than the ending of the reign of the superpowers and the primacy of their conflict in the agenda of world affairs. It is not merely, as many put it, that the Cold War is over, at least in the form that it has assumed in previous decades. What is occurring was characterized very effectively by the great British political geographer Halford MacKinder in an essay written in 1904. While MacKinder was premature in pronouncing the end of the Columbian epoch of the primacy of European over other civilizations, his words have become even more salient with the passage of time. Because of their prophetic nature I would like to paraphrase them:

“When historians in the remote future come to look back on the group of centuries through which we are now passing, and see them foreshortened, as we today see the Egyptian dynasties, it may well be that they will describe the last 400 years as the Columbian epoch, and will say that it ended soon after the year 1890. Of late it has been common-place to speak of geographical exploration as nearly over, and it is recognized that geography must be diverted to the purpose of intensive survey and philosophic synthesis. In 400 years the outline of the map of the world has been completed with approximate accuracy, and even in the polar regions the voy-

* The research for this paper was supported by a grant from the Pew Charitable Trusts to the Center of International Studies of Princeton University.

ages of Nansen and Scott have very narrowly reduced the last possibility of dramatic discoveries. But the opening of the twentieth century is appropriate as the end of a great historic epoch, not merely on account of this achievement, great though it be. The missionary, the conqueror, the farmer, the miner, and, of late, the engineer, have followed so closely in the traveller's footsteps that the world, in its remoter borders, has hardly been revealed before we must chronicle its virtually complete political appropriation. In Europe, North America, South America, Africa, and Australasia there is scarcely a region left for the pegging out of a claim of ownership, unless as the result of a war between civilized or half-civilized powers. Even in Asia we are probably witnessing the last moves of the game first played by the horsemen of Yermak the Cossack and the sailors of Vasco da Gama. Broadly speaking, we may contrast the Columbian epoch with the age which preceded it, by describing its essential characteristic as the expansion of Europe against almost negligible resistances, whereas medieval Christendom was pent into a narrow region and threatened by external barbarism. From the present time forth, in the post-Columbian age, we shall again have to deal with a closed political system, and one of world-wide scope. Every explosion of social sources, instead of being dissipated in a surrounding circuit of unknown space and barbaric chaos, will be sharply re-echoed from the far side of the globe, and weak elements in the political and economic organism of the world will be shattered in consequence. There is a vast difference of effect in the fall of a shell into an earthwork and its fall amid the closed spaces and rigid structures of a great building or ship. Probably some half-consciousness of this fact is at last diverting much of the attention of statesmen in all parts of the world from territorial expansion to *the struggle for relative efficiency*.¹

Several elements of MacKinder's statement are worth noting. The first, of course, is that at the very height of Western domination and imperialism, he foresaw the end of preeminence of Western civilization over the World's other civilizations; although the primacy of western civilization continued longer than he expected because of two offshoots of Western civilization, the United States and the Soviet Union, Western domination is now rapidly receding. Second, the globe is becoming a unified and closed system in which "the explosion of social forces", including, of course, that most destructive of social forces, war, reverberate around the world. The advent of weapons of mass destruction and the problem of environmental degradation have reinforced these destructive forces. And, third, the growing awareness of these social, political, and technological forces is causing a profound shift in the policies of states from the pursuit of territorial expansion to "the struggle for relative efficiency". To put it in the language of another prophetic thinker, Karl von Clausewitz, inter-

¹ Halford MacKinder. "The Geographic Pivot of History", 1904. Reprinted in *Democratic Ideals and Reality*, New York: W.W. Norton, 1962, p. 242. Italics added.

national economic competition has, at least to some extent, become the pursuit of foreign policy by other means. Three aspects of the world forecast by MacKinder — the end of Western preeminence, the uselessness of total war, and the increasing role of international economic competition — define better than anything else of which I am aware the predominant features of the emergent world economic and political system.

Behind the historic transformation from the Columbian epoch to the contemporary civilization lie the forces of economic growth, scientific discovery, and technological advance. These forces are the manifestations of a process of development and modernization that began in Western Europe and propelled that small promontory on the eastern edge of the Eurasian land mass to global superiority in the first centuries of the Columbian epoch. But the Western-centric view, shared by Americans and Russians alike, that the transformed world economy will be merely an extension and fulfillment of a process of economic growth and technological advance that originated in the west and diffused to the rest of the world, is a misleading one. To be sure, the Industrial Revolution of the 18th century, modern science, and the major technologies of the contemporary world originated in the West. However, western scholarship is beginning to recognize that this notion of a creative West and a passive East is incorrect.

The contemporary world is best described as the product of a dual process of economic growth and technological development. Although a number of civilizations throughout history have experienced periods of rapid economic growth, only two civilizations have enjoyed economic growth for a long period, and in the twentieth century these two independent and autonomous centers of economic growth have become increasingly interdependent. As the integration of these centers of economic growth takes place, a truly global economy is coming into existence for the first time in human history.

One of these centers arose in Western Europe. For most of the modern era, it has been the predominant center. Until quite recently, the history of the modern world can be understood as a process of historical change that began in the Mediterranean and subsequently diffused north to Atlantic seaboard states before spreading both westward across the Atlantic and eastward across the Eurasian continent. These forces of change swept across both the North American continent and what MacKinder called the "heartland of the Eurasian continent" in Eastern Europe and European Russia, but the core of this economic system lay in the North Atlantic seaboard economies of Western Europe and North America.

The other of these autonomous centers of economic growth arose in Japan. Much younger than the first, it can be said to have begun its period of rapid ascent in the early nineteenth century. With the Meiji Restoration (1868), this growth process accelerated within Japan itself and then began a slow process of diffusion throughout northeast Asia. Today, primarily through the instrumentalities of Japanese trade and investment, this

growth process has intensified in northeast Asia and is spreading southward along the east Asian seaboard, into southeast Asia, and across the pacific.

Throughout the history of international relations, economic, technological, and demographic developments have caused the center of economic and political activities to shift from one locus to another. In his massive multi-volume history of this historic movement of the global political economy, the French historian Fernand Braudel has told the Western half of this story graphically in terms of the rise and decline of great and dominant urban centers. As one national city has replaced another, the shifts in the international distribution of power and wealth "interrupt the calm flow of history ... [These shifts] always meant a massive historical shift of forces, revealing the precariousness of the previous equilibrium and the strengths of the one which was replacing it. The whole ... world economy was affected ... and the repercussions were never exclusively economic ..."²

Today, the "precarious equilibrium" of the international system is once again being upset as historic movements of economic, political, and technological forces converge on East Asia and Japan. The ongoing shift in the international distribution of economic power toward this new center of independent and autonomous growth has placed the older and formerly dominant centers in Western Europe and North America on the defensive. The "calm flow of history" is being disrupted once again, at least for most West Europeans and North Americans who have enjoyed in the postwar era both unprecedented prosperity and, with the exceptions of the Korean and Vietnam Wars, what the American historian John Lewis Gaddis has rightly called "the long peace".³

Beginning in the mid-1980's, the postwar international system began to change with a rapidity seldom known in human history. The spectacular rise of Japan and of other economic competitors in east Asia and elsewhere in the so-called Third World began to transform the world economy. The repercussions of the shift in the global division of labor are not exclusively economic, but spill over into the realms of political and cultural affairs. China, which only began to industrialize earlier in the 20th century, has become by 1990 a major regional military power armed with nuclear weapons; one day it could become a global rival to the superpowers. Because of its large economy, Japan's expenditure of only a little more than one percent of its gross national product on national defence has moved it to third place in funding of the military after the United States and the Soviet Union. The economic, technological, and demo-

² Fernand Braudel. *The Perspective of the World — Civilization and Capitalism. 15th-18th Century*, Vol. 3, New York: Harper and Row, 1979, p. 32.

³ John Lewis Gaddis. *The long Peace: Inquiries into the History of the Cold War*, New York: Oxford University Press, 1987.

graphic forces at work in East Asia and throughout the Pacific rim have unleashed a profound and far-reaching process of political change.

The emergent global economy will be primarily the product of the coming together and interaction of the Western and east Asian cultural traditions, and of their centers of economic growth. In time, other great civilizations such as those of China, India, and the Middle East will be integrated and will assume an increasingly important role as they equip themselves to join in "the struggle for relative efficiency". When they do, a truly multipolar world of diverse civilizations will further transform human affairs. But, for the immediate future and barring a great war, the shape and substance of the international political economy will be primarily a consequence of the interaction among the presently dominant world centers of economic growth and technological advance in Western Europe, North America, and Northeast Asia.

The task before us is to understand and prepare for the post-Columbian age of a truly global economy and political system. Many questions and issues confront us. What will be the nature of this international political order or, as some pessimists fear, international *disorder*? While one hopes that there will be a truly effective United Nations in which the several centers of world power cooperate to keep the peace and promote justice, the type of the inter-civilizational conflict that has characterized so much of human history cannot be ruled out. What will be the principal ideas or ideologies that guide human actions? While Marxism as an economic, political, and social system has failed disastrously, it is still too early to conclude that Western-style capitalism and democracy will provide the model for the future. How shall we organize and manage the truly global and transnational economy that is replacing an international economy hitherto fragmented by national and other boundaries? While the process of economic globalization and liberalization is rapidly integrating national economies into a highly interdependent world economy, opposing forces of economic protectionism and economic regionalism are also important in reshaping global economic affairs. Reformed institutions, new rules, and international cooperation are required to guide these economic transformations.

In the rest of this monograph, I want to focus on these economic issues. There is an immediate need for action in this area because the economic order put into place at the end of the Second World War is disappearing and we have thus far failed to put anything substantial in its place. It is in the interest of us all to work out the rules for what MacKinder called "the struggle for relative efficiency." We must begin this task by understanding the nature of the contemporary international economic order and the developments that are bringing it to an end.

The Postwar Bretton Woods System

As Susan Strange has wisely observed in her several critiques of what she calls the “American school of international political economy”, one should not idealize the postwar Bretton Woods System and the beneficial role of American leadership.⁴ This international economic system was flawed in numerous ways; it was not a Golden Age. American commercial and monetary policies, especially after 1970, frequently had a negative impact and greatly undermined the effectiveness of the system. Japan and Western Europe also pursued policies based on narrowly conceived notions of their economic and political interests. Yet, until the system began its steady demise in the mid-1970’s, it did provide a set of rules and institutions that tended to depoliticize and stabilize international economic affairs.

The so-called Bretton Woods system had several distinctive features. The first was the crucial role and position of the United States in the functioning of the system. Beginning at the 1944 Bretton Woods conference itself, the United States exercised leadership in the construction and management of the system. The United States, in cooperation with Great Britain, essentially laid down the rules that would govern international economic affairs. These rules, with several important exceptions, reflected the American commitment to a liberal economic order based on multilateralism, the Most Favored Nation Principle, and non-discrimination. These basic precepts were embodied in international institutions created to govern the system, such as the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT). Moreover, the American economy became the principal engine of economic growth and created a substantial fraction of the demand for the exports of the rest of the world. The United States was in fact rather indifferent to its own trade and payments balances; a complementary relationship was established in which foreign nations exported to the American market and American multinational firms reached foreign markets through overseas production by their subsidiaries.

Throughout most of this post-war era, the multinational corporation was essentially an American phenomenon. Through foreign direct investment, these firms in effect replicated abroad their domestic industrial structures. This so-called “horizontal” type of foreign investment created overseas subsidiaries that were not intimately linked to the home productive base of the firm. Despite their label as “multinational” or “transnational” corporations, these American firms did not greatly advance the integration and globalization of industrial production.

⁴ Susan Strange. “Defending Benign Mercantilism”, *Journal of Peace Research*, 25 (1988): 273.

The dollar became the basis of the international monetary system of fixed exchange rates. The United States was the world's leading financial power and creditor nation, supplying the capital necessary for the revival and expansion of the world economy. The United States took the lead in successive trade negotiations within the framework of GATT. The Dillon, Kennedy, and Tokyo Rounds greatly reduced the level of formal barriers to international trade in commodities and manufactured goods. These negotiations, it should be noted, did not cover services, agriculture, foreign investment or a number of other subjects of increasing importance.

Underlying the functioning of this system and the expansion of trade was the assumption that comparative advantage and trading patterns were products of nature and natural endowments. The factors of production were assumed to be "given" and immobile. International competitiveness and the global division of labor, it was believed, could not be substantially altered by the policies of governments. The task of trade liberalization, therefore, was primarily a matter of removing external, formal barriers to trade and letting market forces determine who produces what and where it will be produced. The market reigned.

Another important feature of this system was that financial flows, with the exception of the Marshall Plan and of American Aid to Japan, were not especially important. Many nations, in fact, controlled capital flows and closely regulated their financial markets. Technological factors were also a deterrent to the international movement of money and investment capital. The system was free from the massive international flows of money and finance that had been a destabilizing factor in the 1930's. The major source of concern for economists and political leaders was that of recession. The capitalist world was determined to avoid a repetition of the Great Depression with its devastating effects on domestic and international affairs. At the conclusion of World War Two, almost every capitalist country committed itself to pursue policies of full employment, a commitment expressed in the triumph of Keynesian economics in the United States and elsewhere. With this new science of macroeconomics, economists, we were told, could now "fine tune" the economy. The business cycle, recession, and inflation were no longer problems of serious concern.

This post-war international economy was essentially an Atlantic-centered and governed economy. The major locus of economic growth lay in the North Atlantic basin and the principal economic ties were trans-Atlantic. American leaders even worried about how the over-populated and resource-poor Japanese archipelago could possibly survive. It is worth noting in this connection that the sub-title of Richard Cooper's very influential book, *The Economics of Interdependence*, published as recently as 1968, was "Economic Policy in the Atlantic Community".⁵ How rapidly and profoundly the world has changed over the past two decades!

Although Cooper spoke of the world economy as an interdependent one, it is important to appreciate that until the mid-1970s, the extent of interdependence among national economies was not really very great. As I mentioned earlier, for example, industrial production was hardly internationalized and international financial flows were modest. Economists, public officials, and business people could and did think of the world as a collection of relatively independent black boxes connected by fixed exchange rates, obeying a set of simple rules restricting or proscribing certain types of economic behavior, and of domestic economic policy isolated from the international economy. The rules governing this system were simple ones essentially stating what governments could or should not do, i.e., they should not erect formal trade barriers in violation of GATT rules. Domestic economic policy generally lay outside the scope of international rules.

The industries and technologies of the second industrial revolution of the late nineteenth and early twentieth centuries (such as steel and the internal combustion engine) provided the foundations of this international economy. These heavy industries were energy-intensive and based on mass production. The industrial system associated with these technologies and productive methods has been appropriately called Fordism after Henry Ford, the innovator of standardized mass production techniques. Throughout the early postwar years the United States was the leader in product innovation and production methods, and the Soviet Union under Stalin's ruthless leadership and drive was the second most powerful economy with its system of centralized planning and massive investments in heavy industry.

One final point needs to be made in surveying the main features of the postwar international economy. Despite the economic power of the Soviet Union, the international economy was essentially a western-based system composed of the United States and its European and Japanese political and military allies. In contrast to the world economy of the nineteenth century it was not an universal system because the Soviet Union and the rest of the socialist bloc were in effect outside the system and playing according to different rules. In fact, difficult economic issues dividing the three centers of world capitalism could frequently be resolved through appeals to the need for unity against the common Soviet enemy.

The Decline of the Bretton Woods System

Every one of these features of the post-war Bretton Woods system has changed or is changing dramatically. At the opening of the final decade of the 20th century, the world economy is being transformed at an astonish-

⁵ Richard Cooper. *The Economics of Interdependence: Economic Policy in the Atlantic Community*, New York: McGraw Hill, 1968.

ing pace. Whether this emerging global economy will ultimately survive continues to be problematic. Renovated international institutions, new rules, and increased cooperation among the United States, Western Europe, and Japan will be necessary if the challenges to the emerging global economy are to be surmounted. Our task at the moment, however, is to understand the changes taking place in the contemporary international economy and the challenges that these fundamental changes pose.

The first major change is the massive redistribution of world economic power away from the United States and the Atlantic economies toward Japan and the Pacific. The consequences of this redistribution of power are profound. It means, for example, that the United States is less and less able to perform the role of the engine of growth for other economies. It must be increasingly concerned about its trade and payments deficit; it must export if it is to arrest its relative decline and, I should add, repay its vast accumulated foreign debt. However, the challenge that I would like to stress the most is the need for greater international cooperation to exercise leadership in monetary, trade, and other economic policies. The United States is no longer able to provide this leadership, and international economic leadership, such as it is, has passed to the so-called G-7 nations. In international monetary affairs, a G-2 composed of Japan and the United States has emerged to play a vital role in governing the world monetary system. Japanese funding of the huge American government deficit and the cooperation of these two economies have become central features of the contemporary international economy. * Over the long term, however, all major powers in the world economy will have to work out a more systematic way to coordinate their economic policies and to lead the rest of the world.

While the dollar continues to be the basis of the international monetary and financial system, its role has been considerably lessened as the Yen and the Deutschmark have increased in importance. Japan has become the world's foremost creditor nation and thus far has chosen to use its surplus capital to support the weakened dollar. The West Europeans, concerned over the instabilities of the dollar and the fluctuations of American policy, have formed the European Monetary Union to protect themselves from the erratic American economy and are taking steps to create a tighter monetary and financial union. The breakdown of the system of fixed exchange rates has removed the discipline of the Bretton Woods system. As a consequence, the phenomenon of global inflation has become a novel feature of the world economy. The fear of uncontrolled inflation has placed a severe constraint on economic policy-making and undermined confidence in economists and Keynesian economics.

The task of continuing trade liberalization has become increasingly difficult. Formal tariff barriers have indeed fallen due to the succession of multilateral GATT negotiations, but they have been replaced by bilateral arrangements and informal barriers such as so-called Voluntary Export Restraints and local-content rules. Also, highly controversial issues such

as agriculture, services, and foreign direct investment (left out of earlier GATT negotiations) have now moved to center stage in the Uruguay Round of GATT negotiations. These factors along with the increase in the number of participants to over one hundred greatly complicate these negotiations.

The international financial system has also been revolutionized by recent developments: the deregulation of domestic financial systems, the increased velocity of international financial flows due to modern telecommunications, and a great expansion in the size of these financial flows. International financial flows now dwarf trade flows and have become the principal determinant of exchange rates, at least in the short run. The size and velocity of these financial and monetary flows also have reduced the autonomy of domestic economic policy and introduced a new element of instability into the system.

Yet another development is the globalization or internationalization of industrial production. The multinational corporation is no longer primarily an American phenomenon but is becoming a more truly transnational actor. While Americans firms continue to lead in foreign direct investment, they have been joined by Japanese and European corporations and even by corporations from the developing world. As observed by Kenichi Ohmae, these firms realize that they must invest in and establish productive facilities in all three cores of the world economy if they are to be competitive.⁶ However, in contrast to the earlier horizontal investment strategy of American firms, corporations today are increasingly following a transnational strategy of "vertical" investment in which production processes around the world are integrated and rationalized. Components produced in one location may be assembled in a second and sold in a third. This globalization of industrial production will gain in importance and momentum, especially as regional trading blocs in North America and Western Europe gain significance.

The technological environment is also undergoing a profound transformation. In fact, it would be no exaggeration to suggest that mankind has entered upon a new or third phase of the industrial revolution. Whereas the first phase in the eighteenth century was based on the technologies of iron and steam power and the second in the late nineteenth century on steel, chemicals, and electricity, this new phase represents a shift from chemical and mechanical based industries to knowledge-intensive industries. The assembly line and specialized, single purpose equipment of the mass production era are rapidly being displaced by flexible and radically new methods of manufacturing. Service industries based upon the production and processing of knowledge are becoming of increasing importance. Revolutionary technologies in bioengineering, electronics, and materials are creating new products and production tech-

⁶ Kenichi Ohmae, *Triad Power: The Coming Shape of Global Competition*, New York: The Free Press, 1985.

niques. Fordism and the technologies on which the advanced economies of East and West have been based are becoming less important as sources of economic growth and international competitiveness.

As comparative advantage in these industries shifts to the developing countries, the more advanced economies, with Japan taking the lead in one industry after another, are restructuring their economies around the computer and other high tech industries of the third industrial revolution. Fordism is giving way to the flexible production methods pioneered in Japan. And modern telecommunications are linking the service and the manufacturing industries of the world into a highly integrated global economy.

The most important innovation behind this technological innovation is, of course, the computer. Its capacity to store and manipulate vast quantities of data is changing the organisation of work. More importantly, the computer has opened up large new areas, previously inaccessible, for scientific research. This last development in turn has reduced the lead-time between scientific discoveries and their technological exploitation. The fundamental nature of the new knowledge and the rapidity with which it can be exploited have greatly intensified its impact on economic affairs, military weaponry, and all aspects of contemporary society.

The scope and novelty of many new areas of scientific and technological endeavor such as superconductivity, artificial intelligence, and bio-engineering are stimulating intense international competition. At stake is the determination of which nations or nations will be the dominant industrial and technological powers in the decades ahead. While the race has just begun and it is obviously much too soon to predict winners or losers, it is highly doubtful that there will be an overwhelmingly predominant technological leader as Great Britain was in the first and the United States was in the second industrial revolution.⁷ While Japan will surely be the leader in many, if not most, of these "information based" technologies, leadership in various scientific and technological fields will be shared and spread across a broad front. The scope and magnitude of this technological revolution are simply too immense to expect one civilization to predominate in all aspects of scientific and technological knowledge. The effect of this diffusion of technological entrepreneurship will be to encourage technological trading and corporate alliances within and across national boundaries. The losers in this game will be those corporations and nations that have little technology to share and decide to withdraw from the competition.

The advent of the information economy and the increasing importance of high-tech industries have undermined the basic assumption of the Bretton Woods trading system that comparative advantage was a "given" of nature and could not be altered by the policies of corporations and/or

⁷ This is the argument of Angus Maddison in his *Phases of Capitalist Development*, New York: Oxford University Press, 1982.

governments. Exemplified by Japan's spectacular rise as a trading nation, comparative advantage, at least in manufacturing and services, is now recognized as most frequently a product of deliberate policy choices and such factors as learning by doing, investment in education, research and development, and economies of scale. The fact that comparative advantage can, at least to some extent, be created, has encouraged governments to intervene in the market and to pursue industrial policies. Recent developments in the theory of international trade, in fact, give intellectual support to the argument that nations should not leave trading patterns and the location of global industry to the market alone.⁸ It should be emphasized, however, that industrial policies are often wasteful and poorly conceived. In addition, while comparative advantage has become more arbitrary and mutable, this fact does not lead to the conclusion that it does not exist. The case for a territorial division of labor based on comparative costs is still a strong one. Consequently, nations will participate in the world economy at the same time that they attempt to influence economic forces to their own national advantage. This paradoxical situation accounts in part for certain contradictory developments within the international political economy.

These several developments in economics, politics, and technology are transforming profoundly the nature of the international economy and therefore the problems posed for governments. A truly global and transnational economy is replacing the postwar international economy composed of isolated black box economies, connected mainly by the exchange rates and governed by a simple set of rules. The extent of interdependence in trade, finance, and production has deepened more than most societies and political leaders appear to appreciate. National economies have become so intertwined since the mid-1970s that domestic economic policies are losing their effectiveness and governments have much less capacity to pursue autonomous and independent policies. Also, in a more integrated world economy, seemingly domestic actions and policies of one nation will necessarily impinge upon the interests and policies of other countries. In a highly interdependent world, what in the past was considered to be a domestic matter can become an international one. For example, some of the more serious obstacles to international commerce today are domestic policies and economic institutions such as the West European agricultural program and the American banking system. Yet, the rules and institutions governing this highly integrated transnational economy continue to be essentially the ones laid down at the 1944 Bretton Woods conference.

⁸ Paul Krugman, ed. *Strategic Trade Policy and the New International Economic Order*, Cambridge: MIT Press, 1986.

The Transformation of the International Political Economy

As a consequence of the many changes that I have discussed, the international economy is undergoing an historic transformation. I use the term "international political economy" rather than "international economy" because the transformation taking place is as much political as it is economic. The shift from the Bretton Woods international economy to a global transnational and highly interdependent economy signifies a major development in the evolution of international economic and political relations. It is, however, still an ambiguous development permitting different interpretations and presenting difficult problems to be resolved.

The integration of national economies into a transnational economy is taking place at an astonishing rate in the areas of trade, finance, and production. Replacing a world economy composed of relatively isolated national markets, today there is a world market serviced by international as well as by domestic corporations in many economics sectors. Deregulation and technological developments have integrated financial markets into a truly global system. The multinational corporation is becoming the principal mechanism for the allocation of investment capital and determination of the location of production throughout much of the world. Western Europe has re-initiated the process of the unification and, with the crumbling of the Soviet empire, the postwar division between Eastern and Western Europe is rapidly disappearing. The North Atlantic-centered world economy of recent centuries is rapidly being displaced by a truly global economy in which dynamic non-European economies in East Asia and elsewhere have also become independent and self-generating sources of economic growth and technological innovation.

At the same time that this process of globalization and transnational integration is taking place, economic protectionism and economic alliances among states and corporations are also rapidly expanding. These alliances are being used to influence and, in some cases, to determine, market relations and economic outcomes. As tariffs and formal trade barriers have come down, non-tariff barriers and informal arrangements restricting free trade have proliferated, a development that the French euphemistically call "organized free trade". In the area of international finance, resistance to the further integration of capital markets is surfacing and such barriers to market entry as Voluntary Export Restrictions and local-content rules are spreading, especially in the United States and Western Europe. Although the multinational corporation is internationalizing production, alliances among individual states and national corporations, and especially among corporations themselves, have become increasingly significant for the organization and functioning of the international political economy.

These contradictory developments can be given two quite different interpretations. One interpretation, shared by many business leaders, pro-

fessional economists, and national leaders, is that a unified world economy is rapidly coming into existence where political boundaries will be of decreasing significance. This position is strongly represented in the United States where it has influenced and continues to influence American foreign economic policy more generally.

However, a different interpretation, based on an analysis of certain on-going trends, is possible. The 1988 U.S. Omnibus Trade and Competitive Act, the rapid overseas expansion of Japanese foreign direct investment, and the program of the European Community for the Completion of the Internal Market by 1992, support a new and rival assessment of contemporary developments, a viewpoint gaining proponents in the United States, Japan, and especially in Western Europe.

The first interpretation focuses upon the process of global integration and argues that in the postwar era we have witnessed and are continuing to observe a linear movement toward global independence of national economies. Inexorable economic and technological forces are believed to drive the economies of the world to ever higher levels of economic integration and productive efficiency. While this process of economic integration and globalization is uneven, characterized by frequent backsliding, many believe that it is nevertheless inevitable. Although it may be momentarily held back by irrational forces and by threatened interests that respond to the forces of economic integration with appeals to economic nationalism and demands for economic protectionism, in time the inherent logic of economic efficiency is expected to prevail as people understand that their true interests lie with a well-functioning world market, eliminating protectionist restraints, and moving in the direction of increased globalization. As the American economist C. Fred Bergsten has put it, although "virtually all countries on occasion attempt to resist these external pressures... efforts to resist the forces of market globalization can succeed only partially and for limited periods of time."⁹ Try as they might, the nations of the world cannot ultimately escape these irresistible forces of economic unification.

On the other hand, the second interpretation is that what is taking place in the international economy is a dialectical process. Both the globalization of world markets and state intervention in domestic as well as international markets to achieve political, security, and economic goals, are taking place simultaneously. We are not witnessing a linear process in which the forces of economic integration will eventually triumph over economic nationalism and result in a completely open world economy. Instead, complementary developments of increasing globalization and increasing mercantilism are interacting and reshaping the international political economy. As has happened in the past, the nation-state is adapting

⁹ C. Fred Bergsten. *America in the World Economy; A Strategy for the 1990s*, Washington, D.C.: Institute for International Economics, 1988, p. 60.

to the changing global economic, technological, and political environment.

As tariffs have come down, quantitative restrictions (QRs) on imports have gone up. For example, in 1980, just 5 percent of American imports were affected by quantitative restrictions; by 1986, 18 percent were so affected. Western Europe and many developing countries have also increased the usage of non-tariff restrictions on their imports.¹⁰ Important sectors of the Japanese economy are and no doubt will continue to be similarly protected. Bilateral arrangements such as the United States-Canadian Free Trade Agreement and the United States-Japanese microchip agreement are spreading. By one estimate, more than forty percent of world trade is "managed trade" of some kind. The rules of the GATT, which are not applicable to important subjects such as agriculture, services, and direct investment, may now cover 5-7 percent the global economic activities.¹¹ The international monetary system has been greatly weakened by the shift in the 1970s to flexible rates and the creation of the European Monetary System. While international macroeconomic policy cooperation by the G-7 governments have made impressive strides, it has been sporadic and its long-term success is dependent upon achievement of a solution to a number of political, theoretical, and technical issues.

The dual process of expanding economic interdependence and of simultaneous global protectionism is transforming the contemporary world economy and, one might add, political system. As economic and political leaders respond to this dual process, states and economic actors are making changes in their policies and behaviors, changes that will accelerate in the future.

Former Chancellor Helmut Schmidt of West Germany has characterized these seemingly contradictory trends in a phrase reminiscent of MacKinder. The nations of the world, he has written, are engaged in a "struggle for the global product."¹² This stark and perhaps overly dramatic depiction of contemporary developments is based on a growing realization in Western Europe and elsewhere that the postwar era of economic and political relations is rapidly coming to an end. The potential reintegration of the Soviet Union and other East European countries into the world economy, the relative decline of American economic and political leadership, and the shifting locus of the world economy to Japan and the Pacific Basin are rapidly transforming the structure and the functioning of international relations.

¹⁰ *Ibid.*, p. 72.

¹¹ *Ibid.*

¹² Helmut Schmidt, "Struggle for the World Product", *Foreign Affairs*, 52 (April 1974): 437-51.

At stake in this dual process of economic integration and mercantilistic struggle is nothing less than global economic, technological, and, by implication, political leadership. Which nation or nations will be the leading economic power/s and which ones risk falling by the wayside as the world moves into the 21st century? The resolution of this issue will have major political and security implications.

There are two prerequisites for a nation to participate in this global economic competition. In the first place, it must become involved with and open to the world economy. The autarkic and command economies of the socialist bloc as well as the import substitution strategies (ISS) of Latin American and other Third World economies have proved to be disastrous economic strategies. The demands of the less developed economies for a New International Economic Order (NIEO) and other anti-market strategies have failed. The lesson, which these nations have learned the hard way, is that participation in the larger world economy is vital for economic development. In addition, important changes in the nature of international trade, in the economic role of multinational corporations, and in the significance of scientific and technological developments for international competitiveness point out a second lesson. Exemplified by the remarkable economic success of Japan and the newly industrializing countries (NICs) of east Asia, governments must take appropriate measures to improve, in MacKinder's words, the "relative efficiency" of their economies.

Those nations or regions best equipped or adapted to take advantage of the remarkable changes in the world economy will succeed not only economically but also politically. If one is to achieve economies of scale in production to be competitive at home and abroad or to acquire foreign capital and technology, then it is necessary to participate in the world market. Yet, these goals cannot be achieved in the contemporary world solely by the traditional philosophy of "leaving it up to the market". Those nations or alliances of nations that will do well are the ones with institutions and policies enabling them not only to develop efficient domestic economies, but also to exercise economic power or leverage in the struggle for international markets. Nations and groups of nations, therefore, are changing their economic strategies and attempting to position themselves for success or at least to avoid failure in the process of economic globalization.

In the international political economy it is necessary to participate in the world market and to intervene in the market through new policy instruments. The most dramatic development is, of course, Soviet leader Mikhail Gorbachev's concerted effort to restructure (*perestroika*) the Soviet economy and to prepare for the re-entry of this socialist economy into the larger world capitalist economy. His efforts and the slim chances for their ultimate success in this direction have captured the imagination of Western Europe and the United States. However, it should be noted that his political initiatives in Western Europe and in the area of arms

control have not, at least as the decade of the 1990s opened, been matched by similar Soviet efforts towards Asia and a reconciliation with Japan. Yet, it is difficult to envisage effective Soviet participation in the 21st century world economy without a reconciliation with the world's third largest economy.

Actually, there were five restructurings of domestic and regional economies taking place as the new decade began. In the United States, Western Europe, Japan, and the more advanced developing countries as well as in the Soviet bloc, a process of profound economic and political change had begun by the end of the 1980s. Let us consider each of these responses to the emergent transnational world economy.

The restructuring of the American economy taking place is due in large part to the shift of the United States from its position as the world's leading creditor to that of its leading debtor nation. This significant change in the international status of the United States could be attributed in part to the economic policies of the Reagan administration, in particular its huge budget and trade deficits. It also reflected, however, long-term or secular trends, for example, the relative decline in American competitiveness, a relatively low savings rate, and the erosion of technological leadership. While the United States continued to be the world's largest and most productive economy, it had declined significantly in relative terms.

The piecemeal responses of American political and economic leaders to the underlying weaknesses of the American economy have resulted in a fitful and, in some cases, thoughtless fashioning of new national policies and restructuring of the economy. Although the United States remained committed to multilateral approaches to global economic problems, as witnessed in the Uruguay GATT negotiations, unilateralism and bilateralism gained significant support. The Omnibus Trade and Competitive Act of 1988 (which could seriously reverse the postwar American commitment to liberal multilateralism, returns to the pre-war policy of bilateralism and conditional reciprocity), the expansion of bilateral negotiations (especially with Japan and Western Europe), and the free trade agreement with Canada are significant new developments whose ultimate effects, for better or for worse, have yet to be seen. On a more positive note, American exports increased dramatically as the dollar was devalued, even though American imports continued to outpace exports. The savings rate improved, due in part to tax legislation and demographic changes. The burden of huge defense expenditures on the economy was slowly being reversed. Greater attention was being focussed on the sad state of American education and the problems of technological innovation. Inflation, which was a scourge in the 1970s, appeared to be under control and a "soft landing" of the economy seemed to be taking place as the 1990s began. Further, changes in national policies and economic arrangements accelerated as the United States turned to the enormous task of repaying its huge international debt and re-establishing its overall competitive position. Despite the initiatives that had been taken and the positive signs, the

challenges facing the American economy and society continued to be formidable.

Another significant development was the increasing role of Japanese corporations, Japanese capital, and Japanese technology in the American economy. The formation of corporate alliances among American and Japanese firms, the importation of Japanese capital to finance the federal budget deficit, and the fact that something like 40 percent of Japanese imports into the United States were component parts for "American" products, illustrate this re-structuring and the development of close ties between the American and Japanese economies. The creation of this Nichibei economy and the increasing integration of the American and Japanese economies, however, raised concerns in the United States and complicated relations with Western Europe.¹³

Another major restructuring was taking place in Western Europe. The decision taken in 1988 to implement the Single European Act with its program for the Completion of the Internal Market by 1992 was an economic and political initiative of historic significance. Integration of the several European national markets into a single market of 320 million people, and possibly larger, will obviously be very difficult to achieve and will require many years to complete; the shape of the internal European market or the definition of its policies toward the rest of the world will not be clear for some time. Will a Fortress Europe or an open Europe emerge? This question cannot be answered at the moment. By the close of the 1980s, it was quite obvious, however, that the 1992 decision meant a radically changed stance on the part of Western Europe.

The West Europeans appeared to be motivated by several factors. The first was a disenchantment with the United States and the desire for a greater voice in the world. The erratic nature of American economic policy, significant differences over foreign policy and arms control, and the fear of abandonment by America underlay this distancing among the NATO allies. A second motivation was a realization that Europe is falling behind the other advanced economies. West Europeans were keenly aware that for the first time in modern history non-European nations in Asia and North America were taking a commanding lead in many of the technologies of increasing importance for military power and industrial competitiveness. The stimulus of a huge united internal market, it was argued, would propel the West Europeans into the race. Thirdly, the Europeans appeared to be especially worried over the perceived "threat" of Japanese and, to a lesser extent, east Asian competition. They were concerned that they will be caught between the high technology economy of Japan and the low wage economies of the developing world. They have begun preparing to meet the challenge of what they called the new international

¹³ This Nichibei economy is discussed in Robert Gilpin, with the assistance of Jean Gilpin, *The Political Economy of International Relations*, Princeton: Princeton University Press, 1987.

division of labor being created by the third industrial revolution and the diffusion of existing industries to developing countries.

In a united Europe, European corporations should be able to achieve the economies of scale already enjoyed by American and Japanese firms. The merging of European corporations and the rationalization of industrial production within and across national boundaries began to take place at an accelerating pace. West Europeans also realized that greater economic and political unity would increase their bargaining leverage vis-à-vis the United States, Japan, and the Soviet Union. Their emphasis on reciprocity in economic relations, their enforcement of very tough local-content measures, and their broad definition of "dumping" in trade pointed strongly in this direction. There can be little doubt also that a united Europe would use its increased economic and political strength to improve its political bargaining position with respect to the superpowers and its economic competitive position in what Schmidt called "the struggle for the world product". Western Europe has decided to play an important role in the evolving international political economy.

Japan too began to restructure its domestic economy and to change its economic policies. Developments in Japan have been, to a considerable extent, a mirror image of the American situation. As Japan became the world's foremost creditor nation with a high yen, its internal domestic and international policies had to change. With the implementation of the so-called Maekawa Report, Japan attempted to reduce trade friction with other countries and increase its own economic stability by shifting to greater dependence upon domestic economic growth. Of equal importance, however, Japan has used its financial and technological strength to create, through exports of capital and overseas production by Japanese multinational firms, strong links with economic partners in the Pacific Basin, in North America, and, if the West Europeans let them, in the unified West European market.

Although insufficiently appreciated in other countries, the economic restructuring and economic policy changes that have taken place in Japan are noteworthy. Contrary to Japanese and foreign mythology, Japan in the 1980s moved significantly in the direction of becoming a mass consumer society, domestic demand increased as a factor in economic growth, important steps were taken to open its markets, especially in agricultural products, and its huge trade surplus was dramatically reduced as Japanese exports declined. Furthermore, Japan undertook important economic reforms and began to exercise the expanded leadership role in the world economy that the United States and other nations had called upon it to perform. In particular, Japan had made a number of important initiatives regarding the debt problem of developing countries.

Despite these important changes in Japanese policies, its major trading partners believed that Japan must go even further to open its market and reduce its trade surplus. While Japanese foreign investment in manufacturing and the liberalization of its trade had reduced its export surplus

and lessened to some extent trade frictions, foreigners complained, as the 1990s began, that Japan imported too few manufactured goods from abroad. The United States and Western Europe continued to pressure Japan to remove what these countries regarded as impediments to imports such as the Japanese distribution system and the integrated structure of Japanese business. Perhaps these complaints are groundless and, as two prominent Japanese have recently argued, Japan should simply "say no". But these foreign demands will not go away and will affect how Japan, Western Europe, and the United States interact with one another in the transformed world economy.

The fourth re-structuring, if that is indeed the proper term, of the world economy occurred in what has been identified as the Third World. Generally outside the two major blocs of the First (the West) and Second (Soviet) worlds, these less developed countries (LDCs) had been passive actors on the international scene and had been regarded as an undifferentiated lot. This situation began to change significantly in the 1970s with the rapid industrialization of the East Asian NICs and the larger LDCs in Asia and Latin America. Although the global debt crisis set back temporarily the entry of certain LDCs such as Argentina and Brazil into the world economy, many developing nations began equipping themselves to play a much larger role in the 21st century international political economy.

The developing countries, especially the poorest among them, constitute one of the most serious challenges to the 21st century civilization. The weaponry of mass destruction is rapidly diffusing to these nations. They are acquiring nuclear, chemical, and biological weapons, including the means to deliver them to distant targets. The combination of mass poverty and arsenals of mass destruction is extremely dangerous. Without a doubt, a growing concern over this potentially explosive situation has caused the United States and the Soviet Union to cooperate in dealing with the issues posed by these developments.

If these developing nations are left outside the 21st century world economy and have no stake in it, they will have the capability to destroy it. For reasons of self-interest as well as for humanitarian reasons, it is imperative that these countries be brought into the system.

While the main burden rests squarely on these countries themselves and their governments, the advanced economies can and must help. A first step would be to solve the global debt problem. It is nothing less than tragic that more has not been done in this area. Then, the flow of investment capital must be increased and markets for the industrial products of these countries must be kept open in advanced countries.

The fifth and most notable economic restructuring, of course, has been that taking place in the Soviet Union and Eastern Europe. The dismantling of the rigid Stalinist legacy and the opening of these socialist economies to the capitalist West will eliminate the fragmentation of the international

economy wrought by the Bolshevick Revolution and by Stalin's concept of two opposed and irreconcilable systems.

The ultimate success of Gorbachev's economic, political, and social reforms in the Soviet Union will of course be primarily determined by internal economic and political forces. Although significant initiatives had been taken, which were once regarded as politically impossible, the central problems of Soviet economic reform have yet to be addressed as this is written. For example, one basic problem is the massive amount of what economists call "forced savings" in the economy caused by continuing huge Soviet government deficits. These funds pose a powerful inflationary threat and unless they are removed, price reform and a convertible rouble, which are preconditions for the Soviet Union rejoining the world economy, can not take place.

Whether or not the Soviet Union joins the world economy is not merely an economic issue, but also a political and security issue. As the political issues dividing East and West are resolved, progress toward Soviet integration in the world economy will force a redefinition of the security ties in both Eastern and Western alliances. At this time, (January, 1990) major initiatives have been taken to settle these political differences and resolve security issues, but several fundamental issues have yet to be resolved.

As I write these lines, the political and economic restructurings in Eastern and Western Europe have become increasingly complicated and confused. As the Soviet Empire crumbles, long suppressed ethnic antagonisms and national aspirations are stirring once again and the postwar division of Europe is rapidly disappearing. What began as two separate and distinct processes of economic and political change have become intimately joined. With the tearing down of the Berlin Wall, the issues facing Eastern and Western Europe have greatly grown in importance. The unification of Germany, Western Europe, and of the European continent itself are now inseparable. The question of how these issues of great historic moment will ultimately be settled is impossible to answer. But whatever the answer is, it will have major implications for the nature of the international political economy.

Conclusion

In conclusion, three basic developments accompany the transformation of the postwar international economy into a highly interdependent and transnational global economy. The first is the increased importance of economic regionalism. In the areas of trade, money and investment, negotiations among regional actors have increased in significance. For example, the monetary system is decreasingly based on the dollar and instead is increasingly based on the dollar, the Yen, and the European Currency Unit (ECU). The second development is the formation of corporate alliances. In order to be a major participant in every important national economy and in each of the emergent regional blocs or trading regions, an outside firm must have local allies. To acquire such allies it must have some chips to put into the game. These bargaining chips are primarily technology, capital, and control over market access. The third development is the spread of economic protectionism and mercantilistic behavior. A shift is taking place from the multilateralism and unconditional reciprocity of the postwar system established at Bretton Woods (1944) to the pre-war emphasis on bilateralism, conditional reciprocity, and managed trade. Both globalization of the international economy and the spread of global mercantilism are taking place simultaneously.

International economic competition has increasingly become the pursuit of foreign policy by other means. This development is due in part to the constraint imposed upon the superpowers and other nations by nuclear weapons. It is also, however, a consequence of the increasing importance of Japan, Western Europe, and certain other countries in the world system. Lacking the military power of the superpowers and constrained by World War II memories, Japan and West Germany in particular regard their increasing economic power as a mean to achieve their political goals. This enhanced role of economic competition and economic power in world affairs is a partial fulfillment of MacKinder's prophecy that the increasing costs of war would lead to a struggle among nations for national efficiency.

The transformation of the international political economy leads to a number of pressing questions. What will the effects of these developments be on the economic welfare and political position of the major players in the world economy? How might a unified western Europe and an economically strong Japan use their newly-gained economic power? How will the revolution in Eastern Europe affect economic relations within the former Soviet bloc and the development of the 1992 initiative? Where do the Soviet Union and the Eastern bloc fit into this process of globalization and economic alliances? What are the possible implications of these economic and political changes for the economic prospects of the LDCs? If regional actors or trading regions are becoming more important, which ones might form alliances? In seeking answers to these questions, it will

be necessary to give greater attention to the ways in which diplomacy, economics, and strategy interact with one another.

The transformed international political economy holds great promise. While it is certain that some will gain more than others in MacKinder's "struggle for relative efficiency" and Schmidt's "struggle for the global product", it should be possible for all countries to progress economically. This possibility, however, is threatened by increasing mercantilism with its emphasis on bilateral arrangements, conditional reciprocity, and export surpluses; the possibility of regional trading blocs, especially in North America and Western Europe; and the continuing failure of the world economy to integrate the developing countries into the system. Unless these issues are resolved international economic instability and even economic warfare could be the result.

As noted above, action by individual governments is required to solve these problems. Beyond these unilateral steps certain multilateral initiatives are also required. The institutions such as the GATT and the IMF, which manage the world economy must be reformed and reconstituted to reflect the redistribution of global economic power. The rules themselves that govern international economic activities will have to be changed to reflect the fact that the international economy has become transnational and highly interdependent. For example, existing rules do not cover those economic activities that have become of increasing importance in the world economy such as services and foreign investment. But most important of all, this transnational and global economy necessitates much greater cooperation among the three major powers of the international political economy.

