International Political Economy: Beyond Hegemonic Stability

by Helen V. Milner

International political economy is a growth industry. Beginning its boom after the oil crises in the 1970s shook both world markets and states, the field now encompasses not only a great deal of political economy but of comparative and international politics as well. The end of the Cold War also helped shift attention to the field's main focus: how markets and states affect one another.

Scholars in the field have tried to explain at least four aspects of the international political economy. First, many of its pioneers thought that economics was too narrow to explain central aspects of the international economy. Consider one of the more visible theoretical gaps: Although economic theory showed that free trade was optimal, in reality, protectionism characterized most states' trade policies for years. Seeking to explain such paradoxes created by economic theory, scholars have proposed explanations that are more political. In particular, they have emphasized how politics determines the stability and openness of the international economy, a focus inspired by the trauma of the Great Depression in the 1930s and the desire to avoid repeating any such experience.

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Second, scholars have focused on explaining states' foreign economic policy choices. In part, many believe that these choices are the most important factor shaping the nature of the international economy. For example, explaining why states choose to protect their economies, or how they set their exchange rates, or why they give foreign aid have been central preoccupations for the field. These explanations, however, have sought to interpret such choices by adducing domestic and international factors as well as economic and political ones.

Third, the field has paid attention to why certain states grow rapidly and develop over time, while others fail to do so or decline. This interest in the changing positions of states in the world economy has also been approached eclectically. Economic causes for such changes are usually supplemented by political ones, while domestic causes of the rise and decline of states are paired with international factors.

Finally, scholars have been interested in the impact of the international economy on domestic politics, an issue often explored under the rubric of the globalization of national economies.

Researchers in this field have generally sought answers to these kinds of questions by looking into four categories of explanatory factors: 1) the distribution of world power, especially the role of a hegemonic state; 2) the structure, function, and consequences of international institutions; 3) the impact of nonmaterialist factors such as ideas and beliefs; and 4) the effect of domestic politics.

Does Hegemony Breed Stability?

Robert Gilpin, Stephen Krasner, and other scholars from the realist tradition have identified the distribution of power among states as a central factor in explaining the openness and stability of the international economy. "Hegemonic stability theory," first espoused by Charles Kindleberger in the 1970s, focuses on the role of leading states—for example, Great Britain in the nineteenth and the United States in the twentieth centuries—and on how changes in the distribution of capabilities affect the world economy. This theory argued that the overwhelming dominance of one country was necessary for the existence of an open and stable world economy. Such a hegemon served to coordinate and discipline other countries so that each could feel secure enough to open its markets and avoid beggar-thy-neighbor policies. Conversely, the theory asserted that the decline of a hegemon tends to be associated with economic closure, instability, and the creation of competing regional blocs.

During the nineteenth century, Britain exercised a form of economic hegemony over much of the world. Britain's leadership was associated with the globalization of markets, the openness of international trade and capital movements, the rise of multinational corporations, and the general economic and political stability that characterized at least Europe. World War I brought an abrupt end to both British hegemony and the conditions that it had promoted. Increasing protectionism, the formation of regional blocs, and the decline in capital mobility in the 1920s and early 1930s ate away at the foundations of the global economy, contributing to growing economic instability and the depression.

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The cause of this tragic chain of events has often been laid at America's doorstep. The United States was, at the end of World War I, the world's strongest economic power. But it steadfastly refused to take on the leadership role that Britain could no longer play. This "irresponsibility" was most vividly exemplified in the minds of many people by the infamous Smoot-Hawley Tariff (1930), which raised the average tax on imports to the United States by about 40 percent. At the beginning of the depression, the United States shut its markets to foreign goods and thus helped propel the world economy into its worst swoon ever. The unwillingness of the United States to coordinate its monetary and currency policies with other countries merely exacerbated the situation. This isolationist posture on the part of the world's economic hegemon had negative consequences for most other countries and the United States itself.

The perils of isolationism seemed to have been well learned by American policymakers after the end of World War II. Then, the United States quickly assumed a leadership role and steadily moved forward to create an open international trade system based on the General Agreement on Tariffs and Trade (GATT) and a stable monetary system founded on the Bretton Woods system. The Marshall Plan was perhaps the direct antithesis of the Smoot-Hawley tariff. It symbolized recognition of America's special role and responsibility for peace and prosperity beyond its borders—indeed, globally. U.S. leadership, it is asserted, helped create the conditions necessary for the steady economic growth experienced by the industrial countries up to the 1970s and the rapid development of countries such as Japan and South Korea.

Concerns about U.S. power arose again in the late 1960s and early 1970s. America's economic advantages over the rest of the world seemed to be rapidly dissipating, while other countries were catching up. In response, protectionist sentiment within the United States grew, leading to many domestic challenges to the traditional policy of freer trade. The stability of international currency markets was also disrupted by American behavior. The simultaneous pursuit of the Vietnam War and the Great Society program helped fuel inflation in the United States, which was exported abroad because of the dollar's role in international exchange. America's allies, especially France and Germany, became very concerned over the impact of this erosion in the dollar's value as the world's reserve currency. Ultimately, these problems led to the U.S. abandonment of the Bretton Woods fixed exchange rate system and to the emergence of a more volatile era of floating exchange rates. Hence, although American policy may have laid the groundwork for the growing globalization of markets, the decline of American leadership prompted many, especially in the United States, to worry about the future stability and direction of the world economy. Critics of U.S. power, however, especially Susan Strange, have either denied any decline in U.S. capabilities or lauded the effects of the decline of "irresponsible" U.S. power.

Why Power Isn't Everything

Nowadays, such concerns about American power have receded. By the mid-1990s, the decline of U.S. hegemony no longer seemed so assured. Claims about the decrease in U.S. power appeared exaggerated given the demise of the Soviet Union, persistent recession in Japan, high unemployment and slow growth in Europe combined with the challenge of integrating Eastern Europe into the European Union, and American industry's return to competitiveness. Moreover, the relationship between hegemony and an open, stable world economy has been cast into doubt by a number of scholars, such as Robert Keohane and David Lake. As U.S. behavior during the interwar period illustrates, the possession of superior resources by a nation does not translate automatically into great influence or beneficial outcomes for the world.

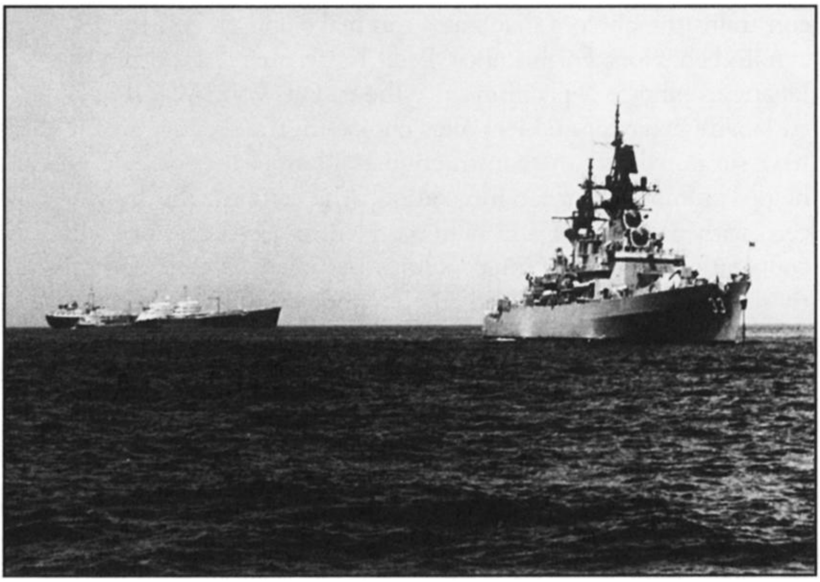
Institutions to Govern the World Economy

One reason why the distribution of power among countries is not seen as the exclusive factor shaping the workings of the international economy is the important role played by international institutions. Keohane has made the most ambitious claims about the role of these institutions. He argues that although hegemony might be necessary for creating such institutions, once begun, they take on a life of their own, and states come to see them as worth preserving. Multilateral institutions such as the United Nations, International Monetary Fund (IMF), World Bank, World Trade Organization (WTO), and EU provide information to states about each others' behavior, reduce the cost of negotiating agreements, and can expose, and sometimes even punish, violations of agreements by states. The claim is that without these institutions the international economy—and international politics—would be much more unstable, less open, and more conflictual. In the case of the EU, for example, many see peace in Western Europe over the past 40 years as partially a product of this institution; and scholars and politicians often cite the maintenance of peace in Europe as a primary motivation for monetary union.

The impact and role of international institutions are controversial. Realists, with their emphasis on power, denigrate the role of such institutions, often seeing them as having little independent impact, and argue that their influence is derived from the actions of the states within them. In the EU example, they might cite the hegemonic role of Germany as the key to monetary union. Others, especially European scholars, believe that many international institutions are controlled by the United States, and thus reflect its interests. In particular, the United States is seen as using the IMF and World Bank as subtle mechanisms to exert its influence on countries. As realists, these scholars emphasize the impact of state power over the character of the institutions themselves.

The Power of Values

The emphasis on power and international institutions misses a central element necessary to explain political behavior: the purposes or goals that states and their leaders choose to pursue with their resources. Nonmaterialist explanations of the international political economy attach key interest to how states' purposes or goals are defined. Two central approaches have taken on the task of explaining this. The "ideas approach," exemplified by the work of Keohane and Judith Goldstein, proposes that the ideas that policymakers carry in their



Pax Americana: The USS *Fox* escorting ships in the Persian Gulf in 1987.

heads are very important in explaining their policy choices. Ideas, whether about the proper role of the state in the economy or the means-ends relationship between economic policy instruments and outcomes, shape how policymakers act.

Dominant ideas—ones that capture the attention of large segments of the policy-making community—define states' actions and coordinate their behaviors in critical ways. Scholars have identified both the rise of the belief in Keynesian macroeconomics after World War II and the later dominance of monetarist beliefs as central explanations for the creation of various international institutions and the coordination of states' policies within them. Some attribute the movement toward European monetary union to the spread of monetarist ideas among European policymakers. In another area, Anne Krueger has shown how changes in the prevailing ideas on how to induce economic development led, in the 1950s, to the use of import substitution policies and, more recently, to their abandonment.

Like scholars who emphasize ideas, the so-called constructivists focus on how policymakers' and states' purposes are defined. This approach goes beyond the adoption of ideas to the definition of social identity. A core proposition of this approach is that the social construction—hence, the term "constructivism"—of states' identities constrains the choices that states can make and propels them toward certain behaviors. For instance, Peter Katzenstein has argued that the Japanese embrace of pacifism since the end of World War II has affected Japan's behavior and its policy choices in the security area. Others have suggested that the construction of a European social identity has helped promote European integration. And certainly the growing concern with nationalism and national identity as sources of conflict or cooperation in international politics has been part of the constructivists' agenda, as evidenced in the work of Ronald Jepperson and Alexander Wendt. These nonmaterialist explanations of the international political economy emphasize states' purposes and choice of goals, which their proponents see as fundamental to states' behavior.

The Impact of Domestic Politics

Domestic political explanations of the international political economy also focus on the definition of states' purposes, but they tend to emphasize political processes and examine the way that national interests are defined through a struggle among domestic actors. Scholars in this area usually focus on two sets of factors: In the first case, they see social groups such as labor organizations, capitalists, multinational corporations, import-competing firms, and ethnic groups as having identifiable preferences about international economic policy that often translate into national policy. Those domestic groups who benefit from international economic exposure or have strong international ties already will favor greater international openness and stability and press their governments to enact policies that promote such market characteristics. The more such groups exist domestically, the greater will be the pressure on policymakers to orient their policies in this direction. For example, Jeffrey Frieden has argued that European monetary union has become more tenable because of the growing external orientation of European firms and banks and their concomitant interest in European economic openness and currency stability.

In the second case, some scholars point to a greater role for the state and policymakers in both the definition and execution of international economic policy. For them, the character of the state is what matters. The institutional structure of the state and its imperviousness to societal pressures shape the policy preferences of political actors and their capacity to implement these preferences. For example, Katzenstein and others identified France and Japan as states with institutional structures that allow technocratically inclined policymakers to play a leading role in defining foreign economic policy and pursuing interventionist policies.

The impact of a state's institutional structures on its development prospects has also been a topic of interest. Why is it that in some countries (mostly in East Asia) the state has played a central role in fostering economic development, while in others (mostly in Africa and Latin America) state action seems to have impaired economic progress? Some scholars such as Chalmers Johnson and Stephan Haggard have concluded that certain institutional characteristics are more conducive than others to making the state an effective promoter of economic development. These institutional traits often enable the state to mediate between the international and domestic economies. More recently, concerns have grown about the extent of democracy within states. Some scholars such as Donald Wittman and Gerald Scully have argued that economic growth and international openness depend greatly on whether a state's institutions are democratic or not.

In more recent work, scholars such as Judith Goldstein, Beth Simmons, and I have tried to focus on both societal actors and state institutions, realizing that each plays a role in shaping foreign economic policy. Moreover, scholars have tried to connect international and domestic factors. Thus, two-level games, which link both the international and domestic environments and societal and state actors, have become more prominent. Robert Putnam's early version of this approach has been refined by others seeking to derive more specific propositions about how all of these factors interact. For example, a number of scholars have shown how divided government affects trade policy choices. These two-level models promise a better understanding of the interaction of the complex factors that create the international political economy.

The Pressures of Globalization

Globalization refers to the increasing integration of national economies into a global one. As mentioned before, globalization peaked in the late nineteenth century, reached its nadir in the early 1940s, and has since rebounded to levels comparable to the earlier highs. Globalization has thus increased, as most agree, but it is far from being complete. For many economists, globalization is a beneficial process since it produces net gains for most countries. More concern has been raised by political scientists over its political effects, especially domestic ones.

In the 1970s, the buzzword for globalization was interdependence. It was argued that rising interdependence was not only changing international politics but also rendering the nation-state obsolete. The expectation was that it would severely limit the range of action that states could take. The state would gradually become less and less important to its citizens as interdependence rose. This debate aroused much controversy and inspired a strong defense of the continuing relevance of the state in international and domestic politics.

In the 1990s, this debate has revived as globalization reaches new heights. Three issues are central to it: First, globalization has been seen as exerting pressure on all states to change their policies and institutions in certain ways. Globalization, scholars have argued, is forcing convergence in policies among countries most exposed to it. Liberalizing trade policy, removing capital controls, opening financial markets to foreign investors, and downsizing the role of the state in the economy are the generic policy prescriptions for effective participation in a global economy. Pressure for the reduction—or even abandonment of—the welfare state in developed countries, and for the liberalization of the economy in developing ones, has been seen as a byproduct of globalization.

Second, globalization has been seen as giving increased power to the holders of capital—investors, multinational firms, and global financial institutions. These actors now can demand that states make changes in their economic policies and can punish them if they do not comply by exiting the country or, better yet, speculating against the country in world currency markets. In contrast, labor has been weakened. Having less freedom to move from country to country, workers find their power to bargain with firms impaired. Membership in unions worldwide has declined, and unions have faced challenges to their acquired power in many states. Globalization moves jobs around the world and imposes constraints on wage increases as never before.

Finally, globalization, it is sometimes claimed, is irreversible. That is, no actor can resist its advance. This again calls into question the role of the nation-state. Can any state resist, or even reshape, the pressures generated by global markets? Or must a state submit to the ineluctable pressures of globalization and lose the capacity to direct its national economy?

On none of these issues is there much consensus. Although many events seem to support the above views—the rush to free trade and capital market liberalization, the reforms of many welfare states, and the creation of independent central banks globally—some critics have seen the other side of the coin. They note that the percentage of government spending in the economy has declined only slightly or not at all (even in Margaret Thatcher's England), countries have maintained extensive and distinct welfare systems, national ways of doing business have persisted, and unions have actually made a resurgence lately in some nations, including in the United States and France. These events suggest that globalization is neither producing convergence nor undermining labor, and may not be irreversible. States in fact are ever more important, for they are the means for countries to resist and reshape the pressures generated by globalization. In this view, strengthening the institutions of the state may be the most effective way for countries to reap the maximum benefits from a world of global markets. These contradictory perspectives on globalization are likely to persist until we have more evidence about its effects.

Some claim that globalization is not only a creation of the United States but also a creature controlled by it.

The relationship between American power and globalization is also a topic of much interest. It is undeniable that U.S. policies have helped create the current international economy. But some claim that globalization is not only a creation of the United States but also a creature controlled by it. Countries such as France and Malaysia have vehemently expressed the view that globalization is basically the extension of American economic practices and ideals to the world, and a tool for the exertion of American power. They see resistance to global market pressures as defiance of the United States. Or, as some South Koreans have claimed during the recent financial crisis there, the IMF is just doing America's bidding. That may be leadership, but it is not the type of leadership these countries would like to see.

Ironically, many Americans see globalization as beyond their country's control. Indeed, in their eyes, the United States is ever more constrained by global forces, just like everyone else: All states must heed the dictates of international bond traders and investors or face the consequences. The United States let globalization out of the bottle and now cannot contain it. This loss of national control is bemoaned by some and applauded by others, but none doubt its reality. What is striking in this debate is the difference in perception between Americans and the rest of the world about the relationship between globalization and American influence.

The impact of globalization remains an area of intense research. The recent economic travails in Asia have underlined how even well-developed states can be affected by international investors and the vast capital flows they now control. How this crisis is resolved will have important consequences for many countries and for the future of the global economy. Will the pressures exerted by international financial actors fundamentally change the relationship between Asian governments and their economies? Will the crisis lead to greater convergence between the economic practices of Asian institutions and those common in the West? Will the famed "industrial policy" practiced by many Asian governments disappear? This issue is especially important for China and other developing countries seeking models of how best to foster economic development.

Such questions beg a look at the role of the state in economic policy, both foreign and domestic. In the aftermath of the two world wars, government intervention in the economy became accepted practice at both the micro and macro levels for eliminating boom and bust cycles in the economy. Indeed, the twentieth century has witnessed the greatest growth in government intervention in the economy ever seen. Globalization and the spread of more "orthodox" economic ideas, however, have undermined confidence in such intervention in many areas. As states' roles in their economies are reduced, what will happen to both the economy and the states? Or is the withdrawal of the state from the economy a passing trend? Will new ideas arise that sanction a greater role for the state in the economy?

Finally, the impact of power and international policies on the global economy is of great interest. After all, political conflict and war after 1914 destroyed the global economy created in the late nineteenth century. What effects will the post–Cold War international system have on the world economy? Will major international conflicts reappear, thus fracturing it into blocs? Will institutions that have helped to keep the peace such as the EU, NATO, and UN disappear, while new political alliances form, reshaping economic flows? Critically, what impact will such changes in the distribution of power and the organization of international politics have on the global economy? These issues will form some of the general research agendas for scholars in international political economy.

Want to Know More?

While students of international political economy hold contradictory perspectives on the causes and effects of globalization, they admire the work of several scholars who have illuminated the pillars of the world economy. A respected primer is Robert Gilpin's ***The Political Economy of International Relations*** (Princeton, NJ: Princeton University Press, 1987). The father of hegemonic stability theory is Charles Kindleberger; see his seminal work, ***The World in Depression, 1929–39*** (Berkeley, CA: University of California Press, 1973). David Lake presents an updated case for the theory in **"Leadership, Hegemony, and the International Economy"** (*International Studies Quarterly*, Winter 1993–94).

The spirited debate over the role of ideas is presented in ***Ideas and Foreign Policy*** (Ithaca, NY: Cornell University Press, 1993), edited by Judith Goldstein and Robert Keohane. Those wanting to learn how societal actors shape foreign economic policy can turn to Ronald Rogowski's ***Commerce and Coalitions*** (Princeton, NJ: Princeton University Press, 1990). Beth Simmons' ***Who Adjusts? Domestic Sources of Foreign Economic Policy During the Interwar Years*** (Princeton, NJ: Princeton University Press, 1994) provides an in-depth exploration of how domestic politics can affect a state's approach to the world economy. Helen Milner's ***Interests, Institutions and Information*** (Princeton, NJ: Princeton University Press, 1997) develops two-level games. Keohane makes ambitious claims about the role of international institutions in ***International Institutions and State Power*** (Boulder, CO: Westview Press, 1989). The national security aspect of this field is outlined in Joanne Gowa's ***Allies, Adversaries, and International Trade*** (Princeton, NJ: Princeton University Press, 1993). Chalmers Johnson considers the effects of a state's institutional structures in his book ***MITI and the Japanese Miracle*** (Stanford, CA: Stanford University Press, 1982). FOREIGN POLICY has published several articles on globalization, including Dani Rodrik's **"Sense and Nonsense in the Globalization Debate"** (Summer 1997).

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