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At Home Abroad, Abroad at Home: International Liberalization and Domestic Stability in the New World Economy*

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The two most enduring contemporaneous accounts of the inter-war period are E. H. Carr's *The Twenty Years' Crisis* and Karl Polanyi's *The Great Transformation*.¹ The perspectives from which the two authors wrote could barely have differed more. Carr is best remembered today for pulverizing the idealist foundations of liberal internationalism, and thereby preparing the ground for the postwar ascendancy of realist discourse in the academic study of international relations. Polanyi's intellectual pedigree and legacy are more complex. He delivered a searing indictment of the social destructiveness of unregulated market forces and the moral mutilation he attributed to market rationality. For these views, Polanyi was later adopted by the New Left. However, he anchored his critique in an organic conception of society that was, in point of fact, deeply conservative in the traditionalist sense of that term.

Despite their differences, Carr and Polanyi reached similar conclusions about the future of the world economy. Both believed they had witnessed, in Polanyi's words, 'the passing of capitalist internationalism'; or, as Carr depicted it, the 'abnormal, *laissez-faire* interlude of the nineteenth century'.² Further, both felt that the drive to reimpose social and political imperatives on the self-regulating market, which had swept the industrialized countries in the 1930s, would be extended into the international arena after the war. 'Internationally,' Carr felt, 'the consequences of absolute *laissez-faire* are as fantastic and as unacceptable as are the consequences of *laissez-faire* within the state.'³ Polanyi concurred that '[o]ut of the ruins of the Old World, the cornerstones of the New can be

seen to emerge: economic collaboration of governments *and* the liberty to organize national life at will'.⁴

For nearly half a century, the economic collaboration of governments that Carr and Polanyi foresaw has been pursued within a form of multilateralism consistent with the maintenance of domestic stability, what I have elsewhere called the embedded liberalism compromise.⁵ Societies were asked to embrace the change and dislocation attending international liberalization. In turn, liberalization and its effects were cushioned by the newly acquired domestic economic and social policy roles of governments. At the same time, the measures adopted to effect domestic cushioning were expected to be limited in duration, commensurate with the extent of external disruption and compatible with the long-term expansion of international economic transactions.

Due in part to the success of this postwar arrangement, capital has become globally more mobile, as well as more transnationalized in organization and integrated in scope, than Carr or Polanyi could ever have imagined. We are, therefore, entering an entirely new era in the evolution of the world economy. In this chapter, I develop a provisional schematic formulation of this new world economy's key institutional features and consequences. I focus on three sets of issues in particular: the growing role of domestic domains as issues of contention in international economic policy; the denationalization of control over significant decisions regarding production, exchange and employment; and the growing difficulty experienced by governments in living up to their part of the domestic social compact on which postwar liberalization has hinged.

Some observers may find the new world economy 'fantastic', in the positive sense of the word, because of its presumed global efficiency and welfare effects. However, it could end up being 'fantastic' as Carr meant: fanciful, due to doubts about its domestic political viability. In some respects, then, the world in 1995 finds itself faced with a challenge that is not unlike the one it faced in 1945: devising compatible forms of international liberalization and domestic stability. However, there are two critical differences. First, the ability and willingness of the United States to act in support of the overall international economic order is considerably less today than in 1945. Second, the lack of consensus on core conceptual issues regarding the international and domestic policy realms alike suggests that the intellectual context today is also less conducive to a successful resolution. The combination of these factors implies that considerable turmoil may lie ahead.

Contested domestic domains

It was no secret to economists in the 1930s that imperfect competition, and patterns of domestic industrial organization more generally, produced significant effects on international trade.⁶ Articles 46–54 of the Charter of the International Trade Organization (ITO) reflected these concerns, as they sought to curtail a variety of restrictive business practices that might affect trade flows. By virtue of Article 46, for instance, members of the ITO would have pledged ‘to prevent ... business practices affecting international trade which restrain competition, limit access to markets, or foster monopolistic control, whenever such practices have harmful effects on the expansion of production or trade ...’⁷ In the immediate postwar years, these concerns were removed from the international trade agenda through a two-step process. The first was the defeat of the ITO in the US Senate, which left conventional point-of-entry barriers as the sole portfolio of the quickly assembled General Agreement on Tariffs and Trade (GATT). Second, GATT then avoided the related conceptual problems posed by state-trading nations, such as the Soviet Union, by calling for state-trading enterprises in their external purchases and sales simply to behave like private economic units: ‘solely in accordance with commercial considerations’, in the words of Article XVII of the GATT, that is, in response to factors such as price, quality, transportation costs and similar terms of purchase or sale.⁸ Thus, the external significance of divergent domestic institutional factors was assumed away.

Now that point-of-entry barriers have become progressively lowered or eliminated, the impact of domestic economic policies and institutional arrangements on international economic transactions has soared in salience. Over a decade ago, Richard Blackhurst, a well-known GATT staff economist, foresaw ‘the twilight of domestic economic policies’.⁹ Blackhurst noted that, in distinguishing between ‘international’ and ‘domestic’ economic policy, a shift was taking place from a definition of international as border measures, to *any* policy which had an ‘important’ impact on international transaction flows, no matter what the instrument was or where it was applied. Moreover, Blackhurst predicted that,

barring either a major retreat into protectionism such as occurred in the 1930s or a massive reduction in the level of government intervention in the economy, the reclassification will continue into the foreseeable future, aiming towards an end point where few eco-

conomic policies of any consequence will be considered primarily domestic.¹⁰

To some extent, this trend affects monetary relations as well as trade. However, it is more advanced in trade, and also more intense because domestic trade relief measures make compensatory and retaliatory moves more readily accessible. The GATT, and now the World Trade Organization (WTO), was designed, in the words of one legal scholar, 'to maintain a balance of [external] concessions and obligations, not to restructure nations'.¹¹ Yet, 'restructuring nations', at least certain aspects of nations, is what trade disputes increasingly have come to be about. Below, I describe briefly some of the issues in contention.

Domestic structures

One of these issues concerns domestic economic structures: defined broadly to include both government policies and policy networks, as well as patterns of private sector industrial organization. Sylvia Ostry, a former official of the Organization for Economic Cooperation and Development (OECD), differentiates three stylized forms among the leading capitalist countries: the pluralist market economy characteristic of the United States, the social market economy of continental Europe and Japan's corporatist market economy.¹² For the moment, Ostry would accept behaviour, tastes and institutions that have 'cultural and historical roots' as 'given', because the 'appropriate domain for international policy co-operation is government policy'.¹³ To reconcile the most serious trade effects of economic policy differences among these three forms of market economies, Ostry suggests, requires convergence in the following areas: competition policy, including merger law; research and development policies, especially subsidies; the asymmetry of access in the investment area, which largely targets Japan; and financial regulation as it affects corporate governance, such as, for example, bank ownership of firms.¹⁴ Even if we accept Ostry's concession to culture and history, achieving policy convergence in the remaining areas on her list is a daunting task.

The deepest difference on each of these policy dimensions lies between Japan and the other two. The Japan case makes clear that a narrow focus on specific policies alone, as Ostry recommends, is simply not practical. Among the factors that have been identified as shaping Japan's trade and investment posture are its labour market, capital markets and systems of ownership, production and distribu-

tion; the economic role of the state; and, indeed, the nature of its electoral system.¹⁵ Scholars disagree on whether differences in domestic economic structures are declining, as liberal economists tend to believe, or are more enduring features of Japanese society.¹⁶ Alas, policy-makers elsewhere lack the luxury of waiting to find out who is right.

As difficult as it is, however, the highly charged case of Japan masks a more generic problem that would be with us in any event. Now that border barriers have been reduced to insignificant levels, domestic economic structures *ipso facto* are taking centre stage in international trade disputes. If they diverge systematically and have 'important' effects on international transaction flows, then an international political problem potentially exists.

The domestic economic structures of one's trading partners typically enter the trade policy agenda via 'unfairness' claims. Potentially, this has at least four deleterious consequences. First, what constitutes 'fairness' tends to be determined unilaterally by the aggrieved party. As Robert E. Hudec points out, 'there are relatively few international agreements regulating the substance of such claims, and there is no recognised tribunal to adjudicate them in common law fashion'.¹⁷ GATT had nothing to say on the subject, and progress within the WTO is likely to remain modest, focused largely on such traditional issues as anti-dumping and countervailing duties.

Second, by their nature, fairness claims call for unilateral concessions on the part of the accused party: '[t]o say that certain conduct is unfair is to say that the guilty party must correct it for that reason alone'.¹⁸ As Ryutaro Komiya and Motoshige Itoh characterize US demands regarding those Japanese trade practices which it deems to be unfair: '[u]sually trade negotiations between two countries take the form of give-and-take, but in these negotiations, which have been going on almost continuously since 1976, the subject matter has been simply how much and how soon Japan would make concessions, with the United States offering little if anything in exchange'.¹⁹ In contrast, GATT processes, and presumably corresponding processes in the WTO, rest on mutual concessions as the basis for agreement, unless specific legal obligations can be shown to have been violated. When it comes to fairness claims, therefore, the GATT and WTO are in the impossible position of having to cope with structural asymmetries by means of symmetrical accommodation.

Third, if policy harmonization were to become the preferred vehicle for dealing with the international effects of domestic policies and

arrangements, questions such as these would arise immediately: Harmonization to whose standard? Who decides whose standard will become the norm, and how? In addition, the slippery slope of policy harmonization is steep, as indicated by the 240 items raised by the United States in the US–Japan Structural Impediments Initiative talks.²⁰ Fourth, and finally, unilateral measures can become the instrument of choice to achieve, for instance, market access abroad, as has often been the case for the United States in relation to Japan. When these measures are generalized across multiple issues and numerous countries the likelihood of retaliation and cycles of escalation can only grow.

In addition to the ‘fairness’ of domestic policies and institutional arrangements, the differential impact of domestic standards is becoming a critical trade policy issue. Labour and environmental standards are the most intrusive. Former Vice-President Al Gore announced to officials from 109 countries assembled to sign GATT’s Uruguay Round accord in Marrakech, Morocco, in April 1994, that Washington would seek to give pride of place to environmental and labour standards in future WTO negotiations.²¹

In short, the premise that differences in domestic economic structures and practices could be ignored in organizing the international trade regime no longer holds. Intrinsicly, the issue has little to do with protectionism, although, of course, it is susceptible to capture by protectionist forces. It has everything to do with the growing irrelevance of the traditional distinction between ‘internal’ and ‘external’ policy domains, or the contestation of where, precisely, the one ends and the other begins. There are no simple solutions to the policy problems posed by this transformation. Blackhurst recommends that governments adopt new multilateral rules to defend themselves from pressures originating at home no less than abroad:

general international rules are at least as useful in protecting a government from domestic interest groups as they are in protecting it from abuses by other governments. It is no paradox that the observance of general rules *increases* a government’s freedom and ability to pursue genuine national interests.²²

However, the process will be more difficult than Blackhurst supposed. As Peter Cowhey and Jonathan Aronson have suggested, even narrowly construed commercial policy requires a subtle but significant shift, away from trade *per se*, towards both formal and informal conditions governing market access.²³ Moreover, because non-border policy

measures are in the hands of a variety of domestic agencies other than trade ministries, the international trade policy process will increasingly involve international agencies in addition to WTO. Finally, the inclusion of environmental and labour standards entangles trade relations in very intimate domains of domestic social policy.

Intangibles

The blurring of boundaries between domestic and international realms is both hastened and deepened by the growing significance of traded services. Services used to be 'invisible' appendages to merchandise trade: shipping, insurance and tourism. Today, the list is longer and the magnitude higher. It now includes information services; various financial, professional and business-related services; construction; cultural services; and many more. Their volume has reached somewhere between one fifth and one quarter of total world trade, although, because of definitional and statistical anomalies, the balance of world services imports and exports is routinely off by \$100 billion or so per annum, and that still understates hard-to-measure services that are embodied in traded products, such as design, engineering or data processing.²⁴ The expansion of traded services is due to transnationalized goods production; technological developments, especially the informatics revolution; and domestic deregulation, particularly of capital markets and telecommunications.

The institutional challenge posed by traded services is not quantitative, however, but qualitative. The GATT was designed for merchandise trade: ballbearings and bananas cross frontiers, passing through customs houses on the way. Invisibles were left uncovered by GATT. Indeed, according to an etymological survey by William J. Drake and Kalypso Nicolaidis, services had not been regarded as being 'traded' before 1972, when they were first so construed in an OECD experts' report: 'the group took a huge leap by suggesting tentatively that the transactions in services could be considered trade, that the principles and norms for trade in goods might apply, and that the challenge in the emerging transition was to avoid "protectionism"'.²⁵ As the world's largest producer and 'exporter' of services, the United States quickly embraced these notions. The United States pushed for GATT rules to govern traded services as early as the Tokyo Round of the 1970s, but with little success. The United States also had great difficulty getting services onto the agenda of the Uruguay Round, and when it did succeed the victory initially appeared largely symbolic.²⁶ Even so, in

the end, the Round did produce a General Agreement on Trade in Services (GATS).

Essentially, the GATS consists of a set of general principles, a number of special conditions or exceptions and initial liberalization commitments.²⁷ Traded services generally are to be governed by the classical GATT principles of non-discrimination and transparency of domestic rules and regulations, but countries have the right to exclude specific services from the principles of national treatment and the right of market access. Safeguards provisions are included and mechanisms for dispute settlement provided for. In short, trade in services will be brought under the GATT/WTO umbrella, with an ultimate balance of obligations between domestic and international objectives which is more qualified than for merchandise trade and also more individualized.

It is important to realize, however, that the GATS only marks the conclusion of one chapter in a continuing story of very difficult economic diplomacy. It brings within the conventional trade framework that portion of traded services which countries are willing to include. A number of highly contentious issues remain beyond the reach of this framework. Intrinsicly, this fact has little to do with what one normally regards as trade barriers or protectionism, but stems largely from the unique attributes of services that differentiate them from goods.

First, because the concept of services has no well-established place in economic theory, its definition tends to be *ad hoc* and arbitrary: intangible activities not included in agriculture, mining and manufacturing. Attempts to define services more theoretically have focused on their being non-storable, therefore requiring simultaneity in provision and use.²⁸ However, this insight has generated endless lists that can be endlessly argued about, rather than a finite and universally agreed set. With tongue only half in cheek, the *Economist* once proposed defining services as '[t]hings which can be bought and sold but which you cannot drop on your foot';²⁹ but in fact architectural plans, computer disks and magnetic tapes, not to mention Big Macs in Moscow or Budapest, can be dropped on one's foot. In short, unlike the case of merchandise trade, in traded services the very definition of the phenomenon remains subject to strategic behaviour by governments. There is no reason to expect that contested definitions will yield to consensus simply because a GATS has been reached.

Second, governments typically regulate domestic service industries more rigorously than other economic activities. Entry into many services, such as medicine, law or accounting, is strictly licensed.

Governments often still reserve the right to approve utilities prices, which in many places still include transportation and telecommunications. Financial institutions, such as banks, insurance firms and securities traders, are subject to prudential supervision. Finally, in many countries, the state still owns outright certain service industries. Most of these regulatory objectives and instruments were not designed with trade in mind. Where they apply, the principles of non-discrimination, transparency and national treatment should moderate somewhat the impact of differences in national regulatory environments, but they will not eliminate the problem.

Furthermore, despite what Drake and Nicolaidis characterize as the 'revolution in social ontology' that reconceived services,³⁰ the fact remains that relatively few services are 'traded' in any recognizable sense of the term. In merchandise trade, the factors of production and the consumers stand still while the finished product moves. In traded services, the factors of production do the moving while the product is fixed in location. Thus, trade in services amounts to provider-mobility across borders. However, why, for example, should provider-mobility encompass US banks offering financial services in Seoul, but not South Korean construction workers providing their services in Seattle? This issue exercised developing countries during the GATS negotiations and will remain contentious in the future. Indeed, because of the difficulty of accommodating such trade-offs in the domestic policies of the OECD countries, it would not be entirely surprising if a second 'ontological revolution' were to occur somewhere down the road: this time, tying services more closely to the realm of investment policy rather than trade.

Finally, one suspects that services-related conflicts will be higher in the Asia-Pacific region, particularly vis-à-vis Japan, than elsewhere among the industrialized countries. Regulatory environments are more opaque, inviting the imputation of worst-case motivations, and if past experience from the difficulties encountered in the areas of direct foreign investment and patent protection is any guide, then in Japan, at any rate, the efficacy of institutional solutions (like the right of establishment) may prove elusive and generate as many bilateral disputes as they resolve.³¹

In conclusion, the postwar trade regime was intended to achieve and maintain a sustainable balance between the internal and external policy objectives of governments, in keeping with the embedded liberalism compromise. It was not designed to restructure domestic institutional arrangements. Yet, domestic restructuring is what the trade policy

agenda increasingly has come to be about. Highly politicized trade policy disputes and potential instability in trade relations appear to be the virtually inevitable consequence of successful liberalization.

Globalization

Much has been written about globalization and nearly as much has been dismissed as 'globaloney'. Milton Friedman has put the negative case most categorically, as is his wont: '[t]he world is less internationalised in any immediate, relevant, pertinent sense today than it was in 1913 or in 1929'.³² Friedman contends that the divergence between the price of the same good in different countries, which became distinctly pronounced after the Great Depression, has remained in place despite steadily decreasing transportation costs, thus 'demonstrating vividly how powerful and effective government intervention has been in rendering the law of one price far less applicable after 1931 than it was before'.³³

Friedman's observation that the world economy is far from being a single economy governed by the law of one price is largely correct, but also irrelevant to the point at issue. Globalization today is assuming various microeconomic forms of increasingly extensive, diverse and integrated institutional webs forged within markets and among firms across the globe. Illustrating the poverty of conventional concepts, this phenomenon is typically described as 'off-shore' markets and 'off-shore' production, as if they existed in some ethereal space waiting to be reconceived by the economic equivalent of relativity theory.

Most international economists have devoted little attention to these organizational forms because institutional economics is not much in vogue among them. The conventional notions of international politics do not go far to describe or explain them either, whether the liberal proclivity to discover that sovereignty is everywhere at bay, or the realist security blanket under which nothing ever fundamentally changes. At the moment, little can be established conclusively about this transformation because no official definitions exist of the relevant categories of analysis, and so no uniform data are collected. Nevertheless the simplest of typologies, the distinction between markets, hierarchies and networks will help us intuitively to grasp the issues at stake.³⁴ It derives from the work of the otherwise unlikely pairing of business school economists and their economist counterparts on the left, together with organizational political scientists

and sociologists. A stylized discussion of these forms and their implications follows.

Markets

One of the core premises of the postwar economic regimes was that international economic transactions are conducted at arm's length between distinct and disjoint national economies. Several private sector institutional transformations have called this premise into question, as well as the policy measures based on it. The first concerns the mediating mechanism of the market itself.

The most significant institutional changes exhibited by international financial markets are their growth, diversification and integration across national economies, beyond even the wildest expectations of policy-makers when they first decided to unleash them. Once an adjunct of trade, financial transactions now tower over annual trade flows. In addition to old-fashioned investment capital, there are international markets in currencies and equities, as well as derivatives of all of these, including options, futures and swaps. Although they are physically separated, these markets are global in that they 'function as if they were all in the same place',³⁵ in real time and around the clock.

This evolution, perhaps revolution is the more appropriate term, has serious consequences for economic policy-making. Virtually by definition, taken for granted cause-effect relations and trade-offs between exchange rates and trade balances, say, or between interest rates and exchange rates, are confounded by the complexities of this new financial world. Richard N. Cooper summarizes the general point thus: '[w]hen markets evolve to the point of becoming international in scope the effectiveness of traditional instruments of economic policy is often greatly reduced or even nullified'.³⁶

Similarly, the international markets for goods and services have expanded and diversified. Their most significant institutional change, however, is the fact that they have become overshadowed altogether by new organizational forms which internalize both production and exchange within global corporate structures. I briefly describe two characteristic forms and their implications for policy.

Hierarchies

The rate of increase in international production, that is, production by multinational enterprises outside their home countries, began to exceed the rate of increase in world trade in the 1960s. Sometime in the 1980s, the actual volume of international production began to

exceed trade flows. Today, the worldwide sales of multinational firms, at \$5.5 trillion, are only slightly less than the entire US Gross Domestic Product (GDP). Multinationals based in the United States play a major role in international production: their revenues from manufacturing abroad are now twice their export earnings.³⁷

A recent US Department of Commerce study sought to measure what the US position in world markets would look like if the standard balance-of-trade measure were combined with the net effects of sales by US-owned companies abroad, and by foreign-owned companies in the United States. It found that, on this more inclusive indicator of global sales and purchases of goods and services, the United States has consistently been earning a surplus, rising from \$8 billion in 1981 to \$24 billion in 1991, even as its trade deficit deteriorated during the same period from \$16 billion to \$28 billion.³⁸ The strategies of US-owned multinationals, as well as the assessment of these firms by stock markets, reflect this broader US net position in world markets. US labour, in contrast, lives in the world of the standard balance-of-trade figures. The growing gap between the two expresses a fundamental source of dislocation in the American political economy.³⁹

The fact that US firms now produce more abroad than they export is in itself important. However, an even more profound institutional shift follows from it: the dominant mode of organizing goods production and exchange in the world economy is increasingly 'through administrative hierarchies rather than external markets'.⁴⁰ The process began simply enough. For a variety of reasons, firms set up subsidiaries abroad to service local markets. Over the course of 30 years or so, this process gradually was transformed into systems of sourcing, production and distribution that have been described as 'the global factory'.⁴¹

As a result of this transformation, the template, the mental picture of the economic world, on the basis of which postwar economic policy-making and the international economic regimes were conceived, has been rendered obsolete. In that picture, production was national, and countries were linked into an international division of labour by arm's length trade, portfolio investment and direct investment in raw materials sectors or to secure local market access. Today, in significant measure the international division of labour is becoming *internalized* at the level of firms. Integrated administrative structures that span the globe increasingly manage the design, production and exchange of parts, components and finished products; the allocation of strategic resources, including funds and skills; and the synoptic plans that ratio-

nalize these processes, including their location, for success in a competitive environment that is itself increasingly global. In short, for virtually every major industry, whether manufactures or services, the primary mode for the international organization of economic transactions has shifted away from reliance on international markets towards global administrative hierarchies.⁴² Thus, even as borders everywhere have become more open, in this specifically institutional sense, global production and exchange may be said to have become more 'closed'. Even though states are actively involved in bargaining with firms about conditions of access, for example, nowhere is economic policy-making remotely equipped to deal with the systemic policy consequences of this shift.

One direct consequence is the growth of intra-firm trade: trade among subsidiaries or otherwise related parties. At the moment, few official and uniform intra-firm trade statistics are collected. Episodic studies show that it is growing at a rate considerably more rapid than conventional trade and they indicate that intra-firm trade is far less sensitive than conventional trade to such policy instruments as exchange rates.⁴³ Other policy-related concerns include transfer pricing for the purposes of cross-subsidization and to minimize tax obligations.

Furthermore, this institutional transformation has begun to turn the conduct of trade policy into a metaphysical exercise, poignantly captured by Robert Reich's question: '*Who is US?*'⁴⁴ The US International Trade Commission (ITC), for example, not long ago confronted a case of anti-dumping brought by a Japanese firm producing typewriters in the United States, against a US firm importing typewriters into the United States from off-shore facilities in Singapore and Indonesia.⁴⁵ In making its decisions, what weights should government assign to the nationality of ownership, the locale of production and contributions to the economy, when these are no longer covariant? The growing tendency by US firms to internationalize research and development in costly high-technology sectors has raised related concerns.⁴⁶

Finally, this institutional transformation challenges what was perhaps the central relationship in the entire postwar American political economy. As Cowhey and Aronson depict its prevailing model of industrial organization, the federal government assumed that its primary role was to manage levels of consumer spending, provide R&D funding and otherwise help socialize the costs of technological innovation via military procurement and civilian science programmes. The major US companies would take it from there.⁴⁷ Today, it is getting harder to determine not only whether something is a US product, as

Reich observes, but more importantly, whether the legal designation, 'an American corporation', describes the same economic entity, with the same consequences for domestic employment and economic growth, that it did in the 1950s and 1960s.⁴⁸ The NAFTA debate about how many US jobs would be lost or gained made it clear how little is known about the links between transnationalized production and trade policy, on the one hand, and domestic employment and economic growth, on the other. It also demonstrated that previous premises about the nature of economic entities and relationships no longer fully capture essential features of the US political economy.

This form of, in essence, denationalization may be welcomed by trade theorists and academic specialists in trade law, in the belief that it will enhance global economic efficiency and welfare while decreasing government intervention, and thereby will reduce trade disputes. However, it may have just the opposite effect. If governments find that their array of policy tools, including the relatively benign option of the 'new protectionism', no longer suffices to achieve their objectives, there is no telling what measures they might turn to in exasperation. The most constructive posture of 'cosmopolitan' policy analysts, therefore, is not to applaud the failure of 'parochial' governments, but to help them devise new means to do their jobs.

Networks

Even as analysts and policy-makers are trying to assimilate the consequences of globally integrated structures of production and exchange, the corporate world has already pushed ahead with the next generation of institutional innovations. Generically, these have been described as network forms of organization. In large-scale, high-technology sectors they are more commonly known as 'strategic alliances':⁴⁹

Networks ... are especially useful for the exchange of commodities whose value is not easily measured. Such qualitative matters as know-how, technological capability, a particular approach or style of production, a spirit of innovation or experimentation, or a philosophy of zero defects are very hard to place a price tag on. They are not easily traded in markets nor communicated through a corporate hierarchy.⁵⁰

In addition, the sheer size of investments and magnitudes of risks in many rapidly changing areas of high technology are increasingly

beyond the capacity of even the largest firms, driving them to establish alliances.⁵¹

Paraphrasing Walter Powell's typology, networks are a collaborative form of organization, based on complementary strengths, characterized by relational modes of interaction, exhibiting interdependent preferences, stressing mutual benefits and bonded by reputational considerations. The field of strategic alliances is dominated by technology-intensive industries, such as semiconductors, telecommunications, commercial aircraft and automobiles. The major home bases of firms entering into alliances are the United States, European Union (especially Germany), Japan and Korea. Finally, Powell suggests that, as the globally integrated firm is discovering strategic alliances at the high end of R&D and in some instances production, it is also rediscovering the market at the low end of standardized components.⁵²

Numerous questions attend the future of strategic alliances, especially concerning their viability and permanence. As the *Economist* warns: 'Managing such vaguely defined relationships is difficult enough at the best of times; distance, language and culture bring added complications. Add to this the fact that many networks are in the business of closing plants and refashioning markets, and you have a recipe for trouble.'⁵³ However, if networks were to become a central and permanent feature of international economic organization, then the focus of collective economic policy-making inevitably would shift towards questions of global industrial policy. At a minimum, it would entail negotiating market access, as Cowhey and Aronson suggest, but negotiating market shares might not be far behind.⁵⁴

In sum, the reconfiguration of global structures of production and exchange, via markets, hierarchies and networks, increasingly has rendered problematical core assumptions on the basis of which governments throughout the capitalist world had pursued the domestic objectives of economic growth, full employment, and social stability. No new consensus is at yet at hand on how, or even whether, these objectives can be successfully combined in the new world economy.

Welfare capitalism

In the autumn of 1993, the editors of the *Economist* thought they had detected, and vigorously applauded, a new grand economic strategy on the part of the Clinton administration. This purported to offer Americans what the journal described as a 'new deal': '[i]ts outlines

are simple: you accept change (such as the North American Free Trade Agreement) and we'll help to give you [occupational, health care, and personal] security'.⁵⁵ The *Financial Times* later that year, even while editorially basking in 'the most capitalist Christmas in history', reflected on the pressing need for a new deal for the entire capitalist world:

[t]he world is changing rapidly; the Atlantic nations in general and Europe in particular face competition from the younger, harsher, more robust capitalism of south Asia. ... Even the middle classes, who have benefited most from economic growth, fear that they may lose what they have, while those outside note that however rich the super-rich may get, large-scale unemployment persists. Lower down the income scale the picture is far worse. ... If welfare capitalism is to be sustained, its managers must find new means of controlling its cost, and minimising the cost to employers. Radical policies, centred around the notion of giving the poor a hand-up rather than a hand-out must be pursued.⁵⁶

These two British publications are among the most irrepressible and articulate advocates anywhere of free markets and free trade. What, then, possessed them to worry about the economic security of workers and sustaining welfare capitalism and, even more curiously, to suggest that governments have a role to play in achieving those objectives? The answer is surprisingly simple. Both realize that the extraordinary success of postwar international liberalization has hinged on a domestic social compact between state and society. Both see that this social compact is everywhere fraying; and both fear that if it unravels altogether, so too will international liberalization.

Social expenditures began to rise rapidly in the OECD countries in the 1960s, and now average roughly one third of GDP. However, contrary to widespread misconceptions in the United States, these expenditures levelled off some time ago. In the United States they nearly doubled, from roughly 10 per cent of GDP in 1960 to just under 19 per cent in 1975. They peaked there, and by 1985 had drifted lower than a decade before. Indeed, in 1985, only Spain and Japan devoted a smaller share of GDP to social expenditures than the United States.⁵⁷ On the other hand, the US economy has generated far more jobs than any other in the OECD for the past two decades, though the uniformity of their quality is in dispute and long-term unemployment has increased.⁵⁸

In Western Europe, the social safety net has held up more firmly than in the United States, but at the cost of eroding competitiveness and an anaemic rate of job creation. Production costs are among the highest in the world, thanks to generous benefits and high payroll taxes, and the workforce is immobile and inflexible. As a result, unemployment is at a postwar high, averaging 11 per cent. The situation is far worse in Eastern Europe. It remains masked in Japan by the employment practices of firms, but is a latent threat.⁵⁹ Surveying these trends, Paul McCracken, who chaired President Nixon's Council of Economic Advisers, reached a sombre conclusion in a *Wall Street Journal* article: '[t]hose entering the work forces in Western Europe and even in the US confront labour market conditions more nearly resembling those of the late 1930s than those prevailing during the four decades or so following World War II.'⁶⁰

Budget deficits and tax-averse publics make it impossible for governments to expand the web of social policies that has characterized welfare capitalism since the Second World War. Even for the most social democratic and neo-corporatist welfare states, the costs have become unsustainable. Moreover, there is a growing sense that some of these policies have become part of the problem, not the solution. This is not only because of their financial burden, but also because many are perceived not to work well any longer and are even thought to create perverse disincentives. US Labor Secretary, Robert Reich, reflected a growing consensus, when he proposed that several job-related social programmes be terminated: '[i]nvesting scarce resources in programs that don't deliver cheats workers who require results and taxpayers who finance failure.'⁶¹

Efforts radically to overhaul the capitalist welfare state cannot focus only on retrenchment, however, if the project of international liberalization is to remain domestically viable. To succeed, these efforts must 'review and redesign', not merely 'slash and trash', in the words of Lloyd Axworthy, Canada's Liberal Minister of Human Resources.⁶² Kenneth Clarke, Britain's former Conservative Chancellor of the Exchequer, echoed the sentiment: 'I intend,' he said at the outset of a speech, 'to extol the virtues of both a flexible labour market and a strong welfare state. ... I believe that, properly directed, the two complement one another.'⁶³ Further, in January 1994, President Clinton warned the allies at the NATO summit that, unless the United States, Europe and Japan create greater economic and social opportunities at home, 'it will be difficult for the people of ... all our nations to continue to support [a] policy of involvement with the rest of the world.'⁶⁴

So, the compromise of embedded liberalism has come around full circle. Once again, governments are groping to find a mutually compatible set of policies for international and domestic stabilization. However, they are doing so in an institutional context wherein little remains the same except an implicit normative commitment to sustain both, and in an international political environment in which their common enemy is not a clear and present geopolitical threat, but more diffuse fears of the consequences of policy failure.

Conclusion

The new world economy that has emerged over the past few decades poses significant challenges to governments because it is disembedded in several key dimensions. The first is in its policy templates: the mental maps of spaces and structures with which policy-makers visualize the basic contours of their world. These have been severely strained and even left behind by the breakdown in the distinction between domestic and international policy realms, the growing role of the ontologically ambiguous transactions called traded services and the shift from markets to hierarchies and networks as core forms in the global organization of production and exchange. The second, related source of disembeddedness is the world of policy-making itself. International as well as domestic economic policy targets are increasingly elusive because instrumentalities are no longer as effective. This loss of efficacy, in turn, reflects the fact that the theoretical, conceptual and statistical bases of policy too often still reflect previous policy templates and the cause–effect relations that pertained in that earlier world. Last, the new world economy is increasingly disembedded from the domestic social compact between state and society on which the political viability of the postwar international economic order has hinged. Policy attitudes towards the new world economy have shifted in the direction of neoliberalism to an extent that is beginning to be of concern even to staunch guardians of market orthodoxies in the leading financial journals of Britain and the United States.

Constructing a contemporary analogue to the embedded liberalism compromise will be a Herculean task. Last time around, the most decisive negotiations took place, in essence, between two countries: the United States and Britain. This time, partly because of the diffusion of economic power but also due to the nature of the issues themselves, the relevant parties must include all leading capitalist nations, in many instances the newly industrializing countries, and in some cases

members of the poorer developing world. What is more, last time around there was widespread consensus about what needed to be done and how to do it in the professional circles on which policy-makers drew in the relevant 'epistemic communities', as I have called them elsewhere.⁶⁵ Today, it is more appropriate to speak of epistemic disarray in the community of scholars and policy analysts. Finally, the overall international geostrategic situation is very different today, requiring more precise and balanced quids-pro-quos in international economic relations.

It is exceedingly unlikely that any new grand bargain can be forged, except in the most general of terms. At best, we are likely to see a series of normative framework agreements and their specific operationalization in specific sectors, based on varying levels of commitments, made by shifting groups of countries. Making sure that these minilateral and plurilateral schemes recognize the organic link between domestic social and economic security on the one hand, and the durability of international systems of production and exchange on the other, is the toughest challenge of all.

Notes

- * An earlier version of this chapter was presented as the 1994 Jean Monnet Lecture at the European University Institute in Florence.
- 1. E. H. Carr, *The Twenty Years' Crisis, 1919–1939: An Introduction to the Study of International Relations*, second edition (New York: Harper & Row, 1964, first edition 1939), and Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston, MA: Beacon Books, 1944, reprinted 1957).
- 2. Polanyi, *ibid.*, p. 248 and Carr, *ibid.*, p. 116.
- 3. Carr, p. 121.
- 4. Polanyi, pp. 253–4, emphasis in original.
- 5. John Gerard Ruggie, 'International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order', *International Organization*, Vol. 36, No. 2 (1982), pp. 379–415. See also Ruggie, 'Embedded Liberalism Revisited: Institutions and Progress in International Economic Relations', in Emanuel Adler and Beverly Crawford (eds.), *Progress in Postwar International Relations* (New York: Columbia University Press, 1991), pp. 201–34.
- 6. Two works that readily come to mind are Edward Chamberlin, *The Theory of Monopolistic Competition* (Cambridge, MA: Harvard University Press, 1929), and Joan Robinson, *The Economics of Imperfect Competition* (London: Macmillan, 1931).
- 7. Articles 47 through 52, as well as Article 54, further defined the salient terms and specified the remedies available under the ITO. Article 53 made special provisions for handling restrictive practices in traded services. The

full text is reprinted in Clair Wilcox, *A Charter for World Trade* (New York: Macmillan, 1949), pp. 281–7.

8. These words were taken almost verbatim from the ITO Charter, which the Soviets had a hand in drafting. See Jacob Viner, 'Conflicts of Principle in Drafting a Trade Charter', *Foreign Affairs*, Vol. 25, No. 4 (1947), pp. 612–28, and Herbert Feis, 'The Conflict Over Trade Ideologies', *Foreign Affairs*, Vol. 25, No. 2 (1947), pp. 217–28.
9. Richard Blackhurst, 'The Twilight of Domestic Economic Policies', *The World Economy*, Vol. 4, No. 4 (1981), pp. 357–74.
10. *Ibid.*, p. 363.
11. Patricia Kalla, 'The GATT Dispute Settlement Procedure in the 1980s: Where Do We Go from Here?', *Dickinson Journal of International Law*, Vol. 5, No. 1 (1986), p. 95.
12. Sylvia Ostry, 'Beyond the Border: The New International Policy Arena', in *Strategic Industries in a Global Economy* (Paris: Organization for Economic Cooperation and Development, 1991), pp. 83–4.
13. *Ibid.*, p. 84.
14. *Ibid.*, pp. 87–9.
15. This expansive view is held not only by the so-called 'revisionists', but also by Japanese analysts and relatively dispassionate US observers. See Chalmers Johnson, 'The Japanese Political Economy: A Crisis in Theory', *Ethics & International Affairs*, Vol. 2 (1988), pp. 79–97; Shigeto Tsuru, *Japan's Capitalism: Creative Defeat and Beyond* (Cambridge: Cambridge University Press, 1993); Daniel I. Okimoto, *Between MITI and the Market: Japanese Industrial Policy for High Technology* (Stanford, CA: Stanford University Press, 1989); and Dennis J. Encarnation, *Rivals beyond Trade: America Versus Japan in Global Competition* (Ithaca, NY: Cornell University Press, 1992). On the nature of the electoral system as it affects Japan's multilateral commitments, see Peter F. Cowhey, 'Elect Locally – Order Globally: Domestic Politics and Multilateral Cooperation', in John Gerard Ruggie (ed.), *Multilateralism Matters: The Theory and Praxis of an Institutional Form* (New York: Columbia University Press, 1993), pp. 157–200.
16. The two positions are illustrated, respectively, by Jagdish N. Bhagwati, *The World Trading System at Risk* (Princeton, NJ: Princeton University Press, 1991), pp. 24–44; and Kozo Yamamura, 'Will Japan's Economic Structure Change? Confessions of a Former Optimist', in Yamamura (ed.), *Japan's Economic Structure: Should It Change* (Seattle, WA: Society for Japanese Studies, University of Washington, 1990), pp. 13–64.
17. Robert E. Hudec, "'Mirror, Mirror, on the Wall": The Concept of Fairness in United States Trade Policy', paper presented at the 'Roundtable on Fair Trade, Harmonization, Level Playing Fields and the World Trading System: Economic, Political and International Legal Questions for the 1990s', Columbia University, 10 January 1992, p. 1.
18. *Ibid.*
19. Ryutaro Komiya and Motoshige Itoh, 'Japan's International Trade and Trade Policy, 1955–1984', in Takashi Inoguchi and Daniel I. Okimoto (eds.), *The Political Economy of Japan, Volume 2, The Changing International Context* (Stanford, CA: Stanford University Press, 1988), p. 203.

20. Timothy J. McNulty, 'Deal Opens Japan Market to US Satellites', *Chicago Tribune*, 4 April 1990, p. C-3.
21. See Editorial, 'Exporting Labor Standards', *Washington Post*, 10 April 1994, p. C-6; Alan Riding, 'Gore Insists Environment is a Trade Issue', *New York Times*, 15 April 1994, p. D-1; and William Drozdiak, 'Historic Trade Pact Signed, But Global Tensions Persist', *Washington Post*, 16 April 1994, p. A-12.
22. Blackhurst, 'The Twilight of Domestic Economic Policies', p. 369, emphasis in original.
23. Peter F. Cowhey and Jonathan D. Aronson, *Managing the World Economy: The Consequences of Corporate Alliances* (New York: Council on Foreign Relations, 1993), Chapter 8.
24. William J. Drake and Kalypso Nicolaidis, 'Ideas, Interests, and Institutionalization: "Trade in Services" and the Uruguay Round', *International Organization*, Vol. 46, No. 1 (1992), p. 37 and n. 1.
25. *Ibid.*, p. 45.
26. For a brief summary, see 'Nothing to Lose but its Chains: A Survey of World Trade', *The Economist*, 22 September 1990.
27. See Drake and Nikolaidis, 'Ideas, Interests and Institutionalization'; and John M. Curtis and Robert Wolfe, 'Nothing is Agreed until Everything is Agreed: First Thoughts on the Implications of the Uruguay Round', in Maureen Appel Molot and Harald von Riekhoff (eds.), *A Part of the Peace: Canada Among Nations 1994* (Ottawa: Carleton University Press, 1994), 101-28.
28. See Jagdish N. Bhagwati, 'Trade in Services and the Multinational Trade Negotiations', *World Bank Economic Review*, Vol. 1, No. 4 (1987), pp. 549-69.
29. 'A Gatt for Services', *The Economist*, 12 October 1985, p. 20.
30. Drake and Nicolaidis, 'Ideas, Interests and Institutionalization', p. 38.
31. See Encarnation, *Rivals beyond Trade*, *passim*.
32. Milton Friedman, 'Internationalization of the U.S. Economy', *Fraser Forum* (February 1989), p. 10.
33. *Ibid.* Kenneth Waltz made a similar case in a controversial paper a quarter of a century ago, using as his measures of internationalization: (1) the size of the external sector of the major economic powers relative to their domestic economies, and (2) the degree of intersectoral specialization in their trade. See Kenneth N. Waltz, 'The Myth of National Interdependence', in Charles P. Kindleberger (ed.), *The International Corporation* (Cambridge, MA: MIT Press, 1970), pp. 205-23. With intra-sectoral trade flows dominating among the major economies, the second part of Waltz's definition is a truism. The first is less the case today than it was in 1970, but more importantly it is also less relevant, for reasons I will discuss presently.
34. The standard conceptual works are Oliver E. Williamson, *Markets and Hierarchies* (New York: Free Press, 1975), and Walter W. Powell, 'Neither Market nor Hierarchy: Network Forms of Organization', *Research in Organizational Behavior*, Vol. 12 (1990), pp. 295-336. For a suggestive application of these concepts to the evolution of international corporate strategies and structures, see Stephen J. Kobrin, 'Beyond Geography: Inter-Firm Networks and the Structural Integration of the Global Economy'

- (Philadelphia, PA: William H. Wurster Center for International Management Studies, Wharton School, University of Pennsylvania, Working Paper 93-10, November 1993).
35. John M. Stopford and Susan Strange, *Rival States, Rival Firms: Competition for World Market Shares* (Cambridge: Cambridge University Press, 1991), p. 40.
 36. Richard N. Cooper, *Economic Policy in an Interdependent World* (Cambridge, MA: MIT Press, 1986), p. 96. A senior executive of Gillette, a major multinational consumer products firm, gives concrete expression to this generalization: '[i]n the long run currency fluctuations, up and down, don't mean a whit in the decision where to manufacture'. Cited in Louis Uchitelle, 'U.S. Corporations Expanding Abroad at a Quicker Pace', *New York Times*, 25 July 1994, p. D-2.
 37. 'The Discreet Charm of the Multicultural Multinational', *The Economist*, 30 July 1994, pp. 65-6.
 38. J. Steven Landefeld, Obie G. Whichard and Jeffrey H. Lowe, 'Alternative Frameworks for U.S. International Transactions', *Survey of Current Business*, Vol. 73, No. 12 (1993), pp. 50-61.
 39. Japanese multinationals exhibit a more pronounced tendency to import from home country suppliers rather than purchasing locally, thereby adding fuel to US-Japan trade disputes. See Encarnation, *Rivals beyond Trade*; Mordechai E. Kreinin, 'How Closed is Japan's Market? Additional Evidence', *The World Economy*, Vol. 11, No. 4 (1988), pp. 529-42; and United Nations Centre on Transnational Corporations, *World Investment Report, 1991: The Triad in Foreign Direct Investment* (New York: United Nations, 1991).
 40. Stephen J. Kobrin, 'An Empirical Analysis of the Determinants of Global Integration', *Strategic Management Journal*, Vol. 12 (1991), p. 20.
 41. Joseph Grunwald and Kenneth Flamm, *The Global Factory: Foreign Assembly in International Trade* (Washington, DC: The Brookings Institution, 1985).
 42. Kobrin's work is particularly helpful in conceptualizing this transformation. See Kobrin, 'Beyond Geography' and 'Empirical Analysis'. For a critical account of its consequences, in the industrialized countries as well as the Third World, see Richard J. Barnet and John Cavanagh, *Global Dreams: Imperial Corporations and the New World Order* (New York: Simon & Schuster, 1994).
 43. See Jane Sneddon Little, 'Intra-Firm Trade: An Update', *New England Economic Review* (May/June 1987), pp. 46-51; Mark Cassons, *Multinationals and World Trade* (London: Allen & Unwin, 1986); and the earlier but still useful study by Gerald C. Helleiner, *Intra-Firm Trade and the Developing Countries* (London: Macmillan, 1981).
 44. Robert Reich, *The Work of Nations* (New York: Knopf, 1991), Chapter 25.
 45. The case involved Brothers Industries Ltd, a Japanese concern assembling typewriters in Bartlett, Tennessee; and Smith Corona, a US concern doing the same off-shore. Adding another element of complexity, Hanson PLC, a British group, owned 48 per cent of Smith Corona. See Robert B. Reich, 'Dumpsters', *The New Republic* (10 June 1991), p. 9; and David E. Sanger, 'A Twist in Fair Trade Case: Japanese Charge a U.S. Rival', *New York Times* (12 August 1991), p. D-1. Sanger's story also recounts that Chrysler almost inadvertently filed an ITC claim against *itself* when it charged Japanese

- firms with dumping minivans in the US market – one of the vehicles covered by the definition was made for Chrysler by Mitsubishi. The Brothers request was subsequently denied, the ITC concluding that the firm was not enough of a domestic producer to claim injury.
46. Andrew Pollack, 'Technology without Borders Raises Big Questions for US', *New York Times* (1 January 1992), p. 1.
 47. Cowhey and Aronson, *Managing the World Economy*, pp. 16–17.
 48. Reich points out that of the \$20,000 an American consumer paid in 1991 for a Pontiac Le Mans, about \$6,000 went to South Korea for parts and operations, \$3,500 to Japan, \$1,500 to Germany, and an additional \$1,400 to various suppliers of products and services in these and other countries. Less than \$8,000 of the total was paid for goods and services that were produced in the United States. See Reich, *The Work of Nations*, p. 113.
 49. See Powell, 'Neither Market nor Hierarchy', and Kobrin, 'Beyond Geography'. The most extensive discussion to date of the policy implications of strategic alliances is Cowhey and Aronson, *Managing the World Economy*.
 50. Powell, 'Neither Market nor Hierarchy', p. 304.
 51. Kobrin, 'Beyond Geography', stresses this particular causal factor.
 52. Powell, 'Neither Market nor Hierarchy'.
 53. 'The Discreet Charm', p. 66, and 'Does it Matter Where You Are?', *The Economist*, 30 July 1994, p. 13.
 54. Cowhey and Aronson, *Managing the World Economy*, Chapters 8–10.
 55. 'In Search of Security', *The Economist*, 16 October 1993, p. 25.
 56. 'Capitalism at Christmas', *Financial Times* (24 December 1993), p. 6.
 57. OECD, *The Future of Social Protection* (Paris: Organisation for Economic Cooperation and Development, 1988), Table 1, p. 10.
 58. As the senior economist of the National Association of Manufacturers – which is not usually closely allied with labour – recently stated: '[t]here are large numbers of temporary, part-time and contract workers out there who are counted as employed but are in reality competing for permanent jobs'. Cited in Louis Uchitelle, 'A Matter of Timing – Debate on the Fed's Latest Rate Increase Focuses on Capacity and Wage Demands', *New York Times*, 18 August 1994, p. D-16.
 59. See Ferdinand Protzman, 'Rewriting the Contract for Germany's Vaunted Workers', *New York Times* (13 February 1994), p. E-5; 'Europe and the Underclass', *The Economist* (30 July 1994), pp. 21–3; Steve Coll, 'Economic Change, Social Upheaval', *Washington Post* (7 August 1994), p. A-1; and Drozdiak, 'New Global Markets'.
 60. Paul McCracken, 'Costlier Labor, Fewer Jobs, Unemployment – The Crisis Continues', *Wall Street Journal* (7 January 1994), p. A-10.
 61. Cited in Frank Swoboda, 'Reich Targets Several Job Programs', *Washington Post* (28 January 1994), p. A-1.
 62. Cited in Geoffrey York, 'Grits Vow Radical Social Reform', *Globe and Mail* (Toronto) (1 February 1994), p. A-7.
 63. Cited in 'Mr. Clarke's Manifesto', Editorial, *Financial Times* (5 May 1994), p. 17.
 64. Cited in E. J. Dionne, Jr., 'Europe's Preoccupation', *Washington Post* (11 January 1994), p. A-11.

65. John Gerard Ruggie, 'International Responses to Technology: Concepts and Trends', *International Organization*, Vol. 29, No. 3 (Summer 1975), pp. 569–70. For an application to the postwar economic negotiations, see G. John Ikenberry, 'A World Economy Restored: Expert Consensus and the Anglo-American Settlement', *International Organization*, Vol. 46, No. 1 (Winter 1992), pp. 289–321.