

Globalization and the Embedded Liberalism Compromise: The End of an Era?

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Outgoing United States Labor Secretary Robert Reich, in a January 1997 address, maintained that the second Clinton administration's »unfinished agenda is to address widening inequality« in America. Indeed, he questioned whether the United States was abandoning »the implicit social contract« it had maintained with workers for half a century. Technological advances and global economic integration, he noted, »tend to reward the best-educated and penalize those with the poorest education and skills,« and government policy had not yet effectively responded to the new economic realities. The press promptly portrayed his address as a swan song of liberalism in Washington (quoted in David E. Sanger 1997: 3).

But Reich's fears were anticipated by London's conservative *Financial Times* as long ago as December 1993. With the demon of communism slain, an *FT* editorial rejoiced in »the most capitalist Christmas in history.«¹ But it also expressed concern about the consequences within the Atlantic nations of growing competition from »the younger, harsher, more robust capitalism« of the Asian economies:

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.

Governments must devise »radical policies,« the editorial concluded, to ensure that »the fruits of capitalism« reach all segments of society.

This article is drawn from and builds upon chapter 6 of the author's most recent book, *Winning the Peace: America and World Order in the New Era* (Columbia University Press, 1996).

1 »Capitalism at Christmas,« *Financial Times*, December 24, 1993, p. 6.

Reich's views, as a self-confessed liberal, are understandable. But what moved the *FT* to worry about the economic security of the middle classes and the poor – and, even more curiously, to go on and suggest that governments have an active role to play in achieving it? The answer is surprisingly simple. The editors of the *FT* are conscious of the fact that the extraordinary success of postwar international economic liberalization hinged on a compact between state and society to mediate its deleterious domestic effects – what I have elsewhere termed the embedded liberalism compromise (Ruggie 1982). They sensed that this compact is fraying throughout the western world. And they feared that if the compact unravels altogether, so too would public support for the liberal international economic order. In short, out of a firm commitment to free trade this stalwart of *laissez-faire* developed grave concerns about the growing inability or unwillingness of governments to perform the domestic policy roles they were assigned under the postwar compromise.

Thus, thoughtful observers on both sides of the political aisle have begun to worry about the relationship between globalization and domestic economic insecurity.² This article investigates that relationship further and suggests that the concerns are warranted. In the first section I offer a schematic sketch of economic globalization. In the second section I review the direct effects of globalization on economic insecurity as well as the indirect effects, through globalization's impact on the ability of the state to live up to its side of the postwar domestic compact. And in the third section I take up the future fate of the embedded liberalism compromise, under the twin challenge of external economic and internal political factors.

Globalization

Much has been written about economic globalization and nearly as much has been dismissed as »globaloney.« The world economy is far from becoming a single economy, governed by the law of one price, as are domestic economies (Friedman 1989). Moreover, the external sector remains a substantially smaller component of the U.S. economy today than was true of Britain in the 19th century, and in most of the other major economic powers the external

2 For a provocative though flawed populist account, see Greider (1997).

sector only in recent decades has resumed levels comparable to the early years in this century (Waltz 1970). To that extent the skeptics are correct.

But what is different about the economic internationalization of recent decades is not simply its magnitude but its institutional forms: the growth of increasingly diverse and integrated links and relationships forged within markets and among firms across the globe. Illustrating the poverty of conventional concepts, the result 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.

The simple typology of markets, hierarchies, and networks will help us grasp intuitively the changes underway.³ Begin with markets, and take first the financial sector. The popular image of globally integrated markets – functioning »as if they were all in the same place,« in real time and around the clock (Stopford and Strange 1991: 40) – is most closely approximated by foreign exchange transactions. This is also the biggest global market, towering over world trade by a ratio of more than 60:1.⁴ International bank lending began to take off in the 1960s; its net stock grew from \$265 billion a decade later to \$4.2 trillion by 1994. Bond markets, led by U.S. Treasury issues, became globally integrated in the 1980s. Equity markets are also proliferating and integrating but more slowly, and cross-national equity holdings remain relatively modest.⁵ As for markets in goods and services, average annual trade as a proportion of gross domestic product for a group of 15 OECD countries increased from roughly 45 percent in the 1960s to 65 percent twenty years later (Garrett 1995: 661, Figure 1).

Thus, not only are economic boundaries more open than ever before in the postwar era. Markets have also become more directly linked with one another, from goods and services on up to the most liquid – and globally most integrated – foreign exchange markets, in which »rates are set by armies of bellowing 22-year old traders, amid flailing arms, blinking screens and flashing telephones.«⁶ But in some ways an even more important shift has occurred in the global organization of production and exchange of goods

3 The typology is due to Williamson (1975) and Powell (1990).

4 This and the following figures are taken from »A Survey of the World Economy: Who's in the Driving Seat?« *The Economist*, October 7, 1995.

5 As of 1993, only about 6 percent of U.S. stocks, for example, were owned by foreigners (Blinder 1995: 7).

6 »A Survey of the World Economy,« p. 24.

and services: increasingly, it has taken the form of »administrative hierarchies rather than external markets« (Kobrin 1991: 20).

This shift began simply enough. For a variety of reasons, starting in the 1960s more and more firms began to set up subsidiaries abroad to serve local markets. Since then, this outward movement was progressively transformed into »the global factory« (Grunwald and Flamm 1985). Led initially by the automobile and consumer electronics industries, this pattern now includes most advanced technological sectors. Components production, input sourcing, assembly, and marketing by multinationals are spread across an ever wider array of countries, exploiting shifting advantages of different locales. Consequently, by the 1980s international production – that is, production by multinational enterprises outside their home countries – began to exceed world trade. By the early 1990s, the worldwide annual sales of multinational firms reached \$5.5 trillion, a figure only slightly less than the entire U.S. gross domestic product. The revenues of U.S.-based multinationals from manufacturing abroad are now twice their export earnings.⁷ Not surprisingly, therefore, intrafirm trade – trade among subsidiaries or otherwise related parties – is growing far more rapidly than arms-length trade. It now accounts for about one third of all world trade, and a far higher share of U.S. trade.⁸

In short, even as national borders have become progressively more open to the flow of international economic transactions, in an institutional sense the global division of labor is becoming increasingly *internalized* at the level of firms. Administrative hierarchies that span the globe manage the design, production, and exchange of parts, finished products, and services; the synoptic plans that orchestrate these processes, including their location; the allocation of strategic resources, including capital and skills; and the information as well as telecommunications systems that make it possible to manage globally in real time.

Analysts and policymakers are still struggling to understand these globally integrated structures of production and exchange, but the corporate world has already generated the next wave of institutional innovation. It has been described as network forms of organization, more commonly known as strategic alliances. The sheer size of investments and magnitudes of risks in

7 »The discreet charm of the multicultural multinational,« *The Economist*, July 30, 1994, p. 57.

8 Comparative figures are hard to come by, but for orders of magnitude see Jane Sneddon Little (1987).

many rapidly changing areas of high technology increasingly are beyond the capacity of even the largest firms, driving them to establish strategic alliances – as in, for example, the automobile, commercial aircraft, semiconductors, and telecommunications industries.⁹ This organizational form is also regarded to be »especially useful for the exchange of commodities whose value is not easily measured,« including »know-how, technological capability, a particular approach or style of production, a spirit of innovation or experimentation, or a philosophy of zero defects« (Powell 1990: 304). Even in industries where foreign ownership is strictly limited or prohibited by national regulations, such as airlines, international strategic alliances are creating globally »seamless« systems.¹⁰

Contrary to the nostrums of orthodox economists and realist political scientists, then, there *is* something new under the world economic sun: a profound institutional transformation in the global organization of markets as well as structures of production and exchange. How justified are fears that these changes adversely affect the working public and the process of economic policymaking? We turn next to that subject.

Economic Insecurity

Average real wages for most categories of workers in the United States have been stagnant since the mid-1970s; during the twelve-month period ending in September 1995, they rose at the lowest rate since the U.S. Department of Labor began to collect these statistics.¹¹ Official studies also confirm Robert Reich's observation, cited at the outset of this article, that income disparities have grown significantly in the United States over the past two decades, and are now the widest of any industrialized country (Atkinson, Rainwater, and Smeeding 1995; also see Freeman 1997). Both wage levels and income distribution have held up better in Western Europe. But unemployment has been greater there – indeed, at ten-percent-plus in France and Germany, it has reached postwar highs (Drozdiak 1994: A1). Hence the somber assess-

9 Kobrin (1993) stresses this causal factor.

10 For example, »Sabena, Austrian and Swissair Strengthen Cooperation with Delta,« *International Herald Tribune*, January 9, 1997, p. 11; the proposal includes joint reservation services, unified fares, and full revenue sharing.

11 Reported in Hershey, Jr., (1995: A1). Inflation for the same period was 2.5 percent, producing a 0.2 percent rate of increase in real wages.

ment by Paul McCracken, who chaired President Richard Nixon's Council of Economic Advisers:

Those entering the work forces in Western Europe and even in the U.S. confront labor market conditions more nearly resembling those of the late 1930s than those prevailing during the four decades or so following World War II.
(McCracken 1994: A10)

But the issue before us is to what extent the forces of globalization are responsible for these conditions.

Direct Effects

The first thing to note about the United States is that the American economy has also suffered from low rates of economic growth since the 1970s, while the labor force has expanded rapidly. That alone would put downward pressure on wages. The most direct cause of slow growth has been anemic productivity increases.¹² Growing foreign competition is only one of the contributing factors, however; domestic economic practices and policies together with demographic changes are far more significant. At the same time, it is true that recent productivity improvements have come »largely from record layoffs« – from fewer workers at home doing more work and jobs migrating overseas (Madrack 1995: 14). The outward migration affects not only semi-skilled and skilled labor, but growing numbers of white-collar positions.¹³

Evidence directly linking low rates of wage increases in the United States to outsourcing production to lower-wage countries remains elusive. The strongest case for such a link has been made by Adrian Wood: drawing on the insights of the classical Heckscher-Olin model, he concludes that the decline in relative wages of less-skilled workers in the North are due to trade with countries in the labor-abundant South (Wood 1994). Critics maintain, however, that the wage effects in the North of labor-reducing technologies and skills-biased technological changes have not yet been rigorously distinguished from the effects of globalization.¹⁴ Nor, Jagdish Bhagwati contends,

¹² Since 1973, it has barely averaged annual increases of 1 percent. See Maddison (1991: 51).

¹³ Some of the U.S. figures are cited in Bradsher (1995: A1).

¹⁴ For a good survey of the literature, see Harris (1993). Also see »Trade and Wages,« *The Economist*, December 7, 1996, p. 74.

have such studies shown the logically necessary intermediating step that relative prices of goods using unskilled labor have declined in the North, which would put downward pressure on domestic wages (Bhagwati 1995; also see Bhagwati and Dehejia 1994).

But in one rigorous study, Dani Rodrik establishes the plausibility of a causal sequence that runs through the mechanism of relative power shifts in labor markets: globalization makes the services of large numbers of workers more easily substitutable across national boundaries, he argues, as a result of which the bargaining power of immobile labor vis-à-vis mobile capital erodes. Thus, labor is obliged to accept greater instability in earnings and hours worked, if not lower wages altogether, and to pay a larger share of benefits as well as improvements in working conditions (Rodrik, forthcoming).

Bhagwati has proposed another hypothesis, compatible with Rodrik's. Globalization has narrowed, or made more thin, he suggests, the margins of comparative advantage many industries in the OECD countries enjoy. Those industries, therefore, are becoming »more footloose than ever,« resulting in higher labor turnover and frictional unemployment, which in turn logically implies flatter earnings for labor (Bhagwati 1995). More generally, Bhagwati suggests, the capitalist economies may be experiencing the rise of »kaleidoscopic« labor markets, as opposed to continuous and cumulative employment patterns, a trend that, if borne out, would further diminish the structural bargaining power of labor. The proliferation of strategic alliances reinforces this process: most are intended from the start to be temporary, and many »are in the business of closing plants and refashioning markets.«¹⁵

A vivid illustration of this disjuncture between globalizing production relations and internationally immobile work forces may be found in a U.S. Department of Commerce study. It sought to measure what the American position in the overall world market for goods and services would be if the standard balance-of-trade account were combined with net sales by U.S.-owned companies abroad less sales by foreign-owned companies in the United States. The study found that on this more inclusive measure of global sales »the United States« consistently has been earning a surplus, rising from \$8 billion in 1981 to \$24 billion in 1991, even as its trade deficit deteriorated

¹⁵ »The discreet charm of the multicultural multinational,« *The Economist*, July 30, 1994, p. 58.

during the same period from \$16 billion to \$28 billion (Landefeld, Whichard and Lowe 1993). The study presented this finding as up-beat news about the competitive performance of American industry, and as an antidote to gloomier balance-of-trade figures. And in one sense it is: the strategies of U.S.-owned multinationals and their valuation by stock markets reflect their contribution to this broader »American« share of global sales. The problem is, however, that the surplus does not accrue to »the United States« as such, especially not to immobile factors of production like labor, but to increasingly globalized and denationalized capital.

In sum, globalization does bear at least some responsibility for the »funk de siècle« that afflicts the working public in the capitalist countries, to borrow Ikenberry's clever turn of phrase (Ikenberry 1995).

Indirect Effects

At the same time, policy demonstrably affects outcomes. Richard Harris has compared globalization and wage growth as well as inequality in Canada and the United States. Even though Canadian industry is relatively more internationalized, wage growth has slowed less and income distribution is more equal. »Public policy,« Harris concluded, »accounts for a large part of this difference.« (Harris 1993: 761). Similarly, Geoffrey Garrett, in a statistical analysis of 15 OECD countries, shows that the political strength of social democratic parties as well as organized labor results in policies that compensate for potentially deleterious effects of globalization (Garrett 1995).

But is not the efficacy of key policy instruments itself undermined by the forces of globalization? »When markets evolve to the point of becoming international in scope,« Richard Cooper has written, »the effectiveness of traditional instruments of economic policy is often greatly reduced or even nullified« (Cooper 1986: 96). Cooper's claim has not gone unchallenged, but it seems to be supported by the best available evidence. We take up first some policy effects of capital mobility, and then of globalization in production and exchange.

Financial integration, it appears, has had contradictory consequences. On the one hand, governments have far greater access to capital and can borrow more cheaply than earlier in the postwar era, as reflected by growing public

sector debt in the OECD countries for the past twenty years.¹⁶ There is, of course, a point at which markets decide, often quite suddenly, that debt is too high. On the other hand, governments are less free to deploy monetary policy in the pursuit of desired domestic outcomes »independent of external constraints« (Andrews 1994: 204). This is so because the markets will demand higher bond yields from governments of whose policies they disapprove, or drive down their currency exchange rates. All else being equal, then, capital mobility has increased market-based pressure for policy convergence within a range of acceptability that the markets determine.

Advocates of these changes feel that little is lost because markets only take away from governments the power to do »wrong« things.¹⁷ But the markets have not demonstrated that they are sufficiently sophisticated and function sufficiently smoothly to discriminate between good and bad policy objectives at the margin any more than governments in the past were able to fine-tune the economic cycle. Lastly, there is little dispute that globalization has restricted governments' ability to increase taxes, especially on business. As a result, even *The Economist* concedes that »if governments need to cut budget deficits, they have to look mainly to public spending.«¹⁸ Whether they like it or not governments seem stuck with their lot, for »the costs of resisting capital mobility either in isolation or in combination have dramatically escalated, with the results that states have by and large chosen to accommodate the phenomenon« (Andrews 1994: 201).

Global capital markets also pose entirely new policy problems. Existing systems of supervision and regulation as well as tax and accounting policies were created for a nation-based world economic landscape.¹⁹ Steps have been taken to coordinate the supervision of international banking by establishing capital adequacy standards and a lender-of-last-resort understanding through the Bank for International Settlements. But international securities trading, as well as the international banking and securities clearance and settlements systems, remain weak and vulnerable. Moreover, although markets in exotic financial derivative instruments help manage risks for individual

16 As a proportion of GDP, public sector debt increased from 15 percent in 1974 to 40 percent twenty years later (»A Survey of the World Economy,« p. 15).

17 In the words of *The Economist*: »borrow recklessly, run inflationary policies or try to defend unsustainable exchange rates« (»A Survey of the World Economy,« p. 37).

18 *Ibid.*, p. 16.

19 U.S. regulatory authorities have been particularly worried about this problem. See, for example, Corrigan (1987: 2). Corrigan at the time was President of the New York Fed, and did much to push this agenda.

firms and investors, they may make the system as a whole more vulnerable. George Soros, a leading global financier, testified to this effect at Congressional hearings on hedge funds: »The instrument of hedging transfers the risk from the individual to the system ... So there is a danger that at certain points you may have a discontinuous move«²⁰ – which, when it occurs in stockmarkets, is called a crash. But to date only some derivatives markets have the margin requirements or »circuit-breakers« that have long existed in stockmarkets.

By liberalizing regulations, governments first facilitated the emergence of global capital markets. Private and public economic actors derive benefits from these markets. But their expansion and integration have also eroded traditional instruments of economic policy while creating wholly new policy challenges that neither governments nor market players yet fully understand, let alone can fully manage.

Globalization in production relations also has had significant effects on traditional policy instruments. One of its byproducts, as noted above, is the growth of intrafirm trade. Studies indicate that this form of trade is far less sensitive than conventional trade to such policy instruments as exchange rates (Little 1987). It also lends itself more readily to transfer pricing for the purposes of cross-subsidization and minimizing tax obligations (see Cassons 1986) – indeed, within global firms these become core objectives of strategic management. Intrafirm trade also reduces the effectiveness of »process protectionism,« which has been one of the key policy instruments by means of which governments have buffered deleterious domestic effects of surges in imports (see Ruggie 1996: chap. 5).

Furthermore, globalization has turned some aspects of trade policy into a virtually metaphysical exercise – poignantly captured by Robert Reich's question: »Who is ›US‹?« (Reich 1991b: chap. 25). Symbolizing this existential state, the U.S. International Trade Commission not long ago found itself confronted with antidumping charges brought by a Japanese firm producing typewriters in Bartlett, Tennessee, against an American company importing typewriters into the United States from its off-shore facilities in Singapore and Indonesia.²¹ But the »who is us« issue is not limited to minor

20 George Soros, »Hedge Funds and Dynamic Hedging,« an edited version of testimony given to the U.S. House of Representatives Committee on Banking, Finance, and Urban Affairs on April 13, 1994 (New York: Soros Fund Management, May 1994), p. 13.

21 The case involved Brothers Industries Ltd. of Japan, assembling typewriters in the United States, and Smith Corona, doing so abroad. Adding another element of complexity, Smith

cases of portable typewriters. The tendency by American firms to forge strategic alliances for costly high technology projects has raised serious concerns in the defense community (see Moran 1990).

Finally, globalization of production challenges what was perhaps the central policy premise guiding the postwar American political economy. As Cowhey and Aronson depict it, the federal government assumed that its primary role was to manage levels of consumer spending, support research and development, and otherwise help socialize the costs of technological innovation by means of military procurement and civilian science programs. America's corporations would take it from there (Cowhey and Aronson 1993: 16–17). Today, it is getting harder not only to determine whether something is an American product, but more critically whether the legal designation, »an American corporation,« describes the same economic entity, with the same positive consequences for domestic employment and economic growth, that it did in the 1950s and 1960s. In the absence of an alternative, the major default option for government is the »denationalized« economic policy posture of competing with other, similarly situated, capitalist countries in providing a friendly policy environment for transnational capital irrespective of ownership or origins. A British scholar calls this model »the residual state« (Cerny 1995: 619).

The Future of Embedded Liberalism

As noted at the outset, the postwar international economic order rested on a grand domestic bargain: societies were asked to embrace the change and dislocation attending international liberalization, but the state promised to cushion those effects by means of its newly acquired domestic economic and social policy roles. Unlike the economic nationalism of the thirties, then, the postwar international economic order was designed to be multilateral in character. But unlike the *laissez-faire* liberalism of the gold standard and free trade, its multilateralism was predicated on the interventionist character

Corona is owned 48 percent by Hanson P.L.C., a British group (Reich 1991a: 9). The Brothers request was subsequently denied, the ITC concluding that the firm was not enough of a domestic producer to claim injury.

of the modern capitalist state. Increasingly, this compromise is surpassed and enveloped externally by forces it cannot easily grasp, and it finds itself being hollowed out from the inside by political postures it was intended to replace.

Quite apart from the diminished capacity of governments to employ traditional policy instruments due to the forces of globalization, a pendulum-like swing in political preferences and mood has been gaining momentum throughout the capitalist world in a neo-laissez-faire direction. This political shift is too big and its outcome still too fluid for us to explore it fully here. But we do need to take up those aspects of it that implicate our subject at hand.

The shift is especially pronounced in the United States. America has never had a significant socialist movement or labor party. Nor has it had a Tory (or Junker) tradition. As a result, »America [has] been the most classically liberal polity in the world from its founding to the present.«²² America's sense of community has been defined in civic, not economic, terms. And the welfare state in the United States, therefore, has been more narrowly conceived and has rested on far more tenuous foundations than in Europe, where its historical roots flourished in the ideological soil not of the left but also, as exemplified by Disraeli and Bismarck, the right.

The New Deal state was America's version of the universal reaction against the collapse of laissez-faire liberalism in the Great Depression and the economic warfare that preceded the outbreak of military hostilities in World War II. It was also the platform from which the United States sought to reconstruct the postwar international economic order. The current domestic political struggle over what kind of state should replace the New Deal state, therefore, has profound implications not only for America but for the future of international economic stability.

The New Deal state was considerably more modest in aims and less intrusive in means than European-style social democracy and corporatism, let alone socialism.²³ Its objective was to stabilize the capitalist order, not transform it, and its means were largely limited to Keynesian-type monetary and fiscal policies in pursuit of the principle of full employment, and a safety net of social services for those in need. The Great Society initiatives of the 1960s added several layers of welfare programs onto this base. But they were rendered politically acceptable only by strict and extensive specifica-

22 The reasons have been extensively analyzed by Seymour Martin Lipset. See, most recently, Lipset (1996, the quotation is from p. 33).

23 At least, this was true of its post-1938 variant, as Alan Brinkley shows in his recent study (Brinkley 1995).

tion of the boundaries of state intervention, eligibility requirements, and the modalities of private sector provision of public services. Over time, this produced »the paradox of liberal intervention,« in Mary Ruggie's felicitous phrase, whereby the state was drawn into ever-deeper and clumsier intervention, spawned a sizable bureaucracy, and fought legal battles with advocacy groups – all necessitated by its desire for the scope of intervention to be as contingent and circumscribed as possible.²⁴ Today, anti-government sentiment in the United States is driven, at least in part, by this experience. The West European states, in contrast, avoided this particular problem by making many of the same programs universally available, though escalating costs have now forced stricter limits in Europe as well.²⁵

There are several routes linking the future domestic policy role of the American state, not simply to welfare at home, but to stability in the world economy at large. One involves labor. In keeping with its underlying commitment to market institutions, the New Deal state employed relatively unintrusive labor market policies (see Fraser 1989). In the 1950s, then-Senator John F. Kennedy took up the cause of trade adjustment assistance for labor, gaining its enactment as President. This provided workers or firms hurt by imports with federal financial and technical assistance for job retraining and worker relocation, securing labor support for the trade liberalization that was about to unfold (Destler 1992: 23). Trade adjustment assistance was enhanced in the 1970s with the same objective in mind. However, the policy was doing progressively less to promote actual »adjustment« – by then it amounted to little more than an extended duration of unemployment benefits (Destler 1992: 152–153). The Reagan administration sharply reduced it. The Clinton administration has proposed eliminating it altogether, and using the savings for more productive retraining efforts (See Swoboda 1994). But for now, virtually nothing is in place.

Furthermore, compared to its OECD trading partners, the United States ranks dead last in public spending for job training and placement, as a percent of GDP²⁶ – lower even than Japan, which, until recently, has required no policy thanks to lifetime employment practices by firms. Moreover, U.S.

24 Ruggie (1992). Note also Garry Wills' characterization of President Clinton's original health care reform plan: »In seeking minimal government involvement, Clinton had produced the maximum feasible complication« (Wills 1997: 34).

25 For a comparative overview, constructed from the case of health care reforms, consult Ruggie (1996).

26 OECD (1993: Table 8.19). For a comprehensive survey of policies, see Janoski (1990).

health care benefits for workers are more precarious and less portable, while pension benefits are less secure. Outside the military, vocational training programs are episodic and typically of a low quality. Germany, for example, with less than one-third the U.S. population, has nearly six times the number of industrial apprenticeships.²⁷

It is hardly surprising, then, that American labor in recent decades has been an implacable foe of further trade liberalization.

Another link between the domestic role of the state in America and international economic stability is via the social safety net more generally. It was a cardinal belief of New Dealers that society seeks protection from the deleterious effects of unmediated market forces, and that it will hold government responsible for providing that social protection. There were, and remain, sound historical grounds for that view.²⁸ Today, as we have seen, unmediated market forces increasingly emanate from the global economy. Publics in kaleidoscopic labor markets, slipping through a tattered safety net, witnessing income disparities that are unprecedented in their lifetime, at some point are highly likely to turn against those unmediated market forces. Ross Perot's image of the »giant sucking sound« created by jobs moving out attracted their attention in 1992. Pat Buchanan's proposed »social tariff« and his promise to withdraw from all »globalist« institutions, including NAFTA and the WTO, helped sustain his race in 1996.

Budget deficits and tax-averse publics make it impossible for governments to expand the web of social policies that have characterized welfare capitalism since World War II. Even for the most social democratic and neo-corporatist welfare states, the costs have become too high. Moreover, there is a growing sense that some of these policies have become part of the problem, not a solution, due to not only their financial burden but also because many are perceived not to work well any longer and even to create perverse disincentives. As Labor Secretary, Robert Reich reflected a growing sentiment in proposing the termination of several job-related social programs: »Investing scarce resources in programs that don't deliver cheats workers who require results and taxpayers who finance failure« (quoted in Swoboda 1994).

The prudent course of action, however, is to »review and redesign« the social safety net, not simply to »slash and trash« it, as Lloyd Axworthy put it

27 »Training up America,« *The Economist*, January 15, 1994, p. 27.

28 The seminal study of the ill-effects of believing otherwise remains Polanyi (1944, 1957). Also see Carr (1939, 1964).

in House of Commons Debates on Canadian welfare reforms when he was Minister of Human Resources (quoted in York 1994: A7). There are widespread misconceptions in the United States about the overall magnitudes involved. Social expenditures began to rise rapidly in the OECD countries in the 1960s, and average roughly one-third of GDP today (OECD 1988: 10, Table 1). But the rate of increase leveled off some time ago. In the United States, they nearly doubled from roughly 10 percent of GDP in 1960 to just under 19 percent in 1975. But 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. Hence, there should be ample degrees of freedom for the United States to adopt the prudential course.

A final link is provided, perhaps ironically, by the same economists who did so much to demonstrate the inability of Keynesianism to deliver on its macroeconomic promises. For example, Robert Lucas, the 1995 economics Nobel prize winner, showed in the 1970s that economic actors – business owners, investors, or consumers – learn to anticipate governments' actions and to incorporate those »rational expectations« into their own behavior, confounding the policies' efficacy. His work did much to help undermine confidence in what was left of the New Deal state. Lucas subsequently turned his attention to the determinants of economic growth. Here, he and fellow »new growth« theorists have found that the role of the state can be critical in providing collective goods that the market undersupplies, such as education, infrastructure, and research and development (see, for example, Lucas 1988 and Barro 1990). The policy recommendation that follows from this work is not to return to *laissez-faire*, but to rethink and reconfigure the political economy of the advanced capitalist state, bringing it into alignment with the new realities of global competition.

Conclusion

The distinguished economic historian Jeffrey Williamson has posed well the problem the capitalist countries face on the eve of a new century. Globalization produced inequality in the »new world« in the late 19th century, his careful econometric analysis shows. That fact, he concludes,

contributed to the implosion, deglobalization and autarkic policies between 1913 and 1950 ... [and] should make us look to the next century with some anxiety: will the world economy retreat once again from its commitment to globalization? (Williamson 1966: 2, 20)

For the moment, the American public and its leaders appear trapped by their own ideological predispositions, which make it difficult for them to see the contradiction between their increasingly neo-laissez-faire attitude toward government and the desire to safeguard the nation from the adverse effects of increasingly denationalized market forces. These contending forces were most poignantly – and dangerously – expressed in Pat Buchanan’s presidential candidacy: an abiding bias against government coupled with an avowed desire to enhance domestic economic stability and opportunities for working America. That combination left him with no alternative but a 1990s version of the 1930 Smooth-Hawley tariff, which caused the entire system to unravel. What is needed instead – for the sake of America and the world – is a new embedded liberalism compromise, a new formula for combining the twin desires of international and domestic stability, one that is appropriate for an international context in which the organization of production and exchange has become globalized, and a domestic context in which past modalities of state intervention lack efficacy or legitimacy. Until that is found, what Charles Kindleberger, in his classic study of the Great Depression, called »transition traps,« moments of discontinuity when things could go terribly wrong, lurk ahead (Kindleberger 1973).

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