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## *International Political Economy: Global and Domestic Interactions*

International Political Economy (IPE) is a relatively new subdiscipline within political science. The first textbook in the area was published in 1977 (Spero 1977), and courses were not routinely offered until the middle 1980s. Even today, the boundaries of IPE are not always clear—the overlap with political economy research in comparative and American politics is especially great. We take the field to include all work for which international economic factors are an important cause or consequence. This ranges from the domestic politics of trade and exchange rate policy, through the politics of World Trade Organization (WTO) dispute settlements, to the impact of international flows of goods or capital on national political systems.

Despite imprecision about the definition of IPE, in the past twenty years the field has approached consensus on theories, methods, analytical frameworks, and important questions. This is not to say that scholars in IPE all agree with one another. However, disagreement today generally takes the form of contention among productive, theoretically and empirically motivated claims, rather than the paradigmatic clashes that earlier characterized IPE. Scholars typically see alternative approaches as complementary or applying under different, specifiable conditions. Other disagreements might be debates about the relative weights that we should attribute to alternative explanatory variables. These types of scholarly differences are the hallmark of a mature field of research that has moved from sweeping attempts at self-definition to formulating refutable analytical claims and evaluating their fit with empirical regularities.

This essay presents what we believe to be the consensus among political scientists with regard to the analysis of the politics of international economic relations. The review we present is not intended to be exhaustive. We do not, for example, attempt to include the work of scholars who challenge the positivist approach that is assumed here. We believe that this survey does reflect the principal focuses of North American scholarship, although it is not reflective of much European scholarship. Most publica-

tions in the principal U.S. journals of the profession and the subdiscipline, and most North American graduate training and research, are within the range of the theoretical and empirical topics and approaches presented here.

The most challenging questions in IPE have to do with the interaction of domestic and international factors as they affect economic policies and outcomes. Modeling interactive effects is complex, but there have been exciting research efforts in IPE along these lines. We begin with a survey of some of the more-promising efforts in this direction. It quickly becomes evident that many of the advances made in the study of domestic-international interaction would have been impossible without firm foundations in the analysis of domestic and of international factors in and of themselves. Indeed, recent work on the international-domestic research frontier builds heavily on progress made over the last couple of decades in the analysis of the domestic and international levels; and these analyses provide the essential building blocks for the current and future study of interaction.

The second section therefore turns to a discussion of the domestic politics of foreign economic policymaking. Here scholars typically begin with a picture of the principal economic interests at stake and their forms of organization, then investigate how these interests transit through institutions of national political economies that determine patterns of delegation and aggregation.

We follow with a discussion of the international level of analysis. This starts with strategic interaction among national states as they relate to one another in international economic affairs. It continues with a more-detailed analysis of the role that international institutions play in this interaction, with institutions as both cause and consequence of variation in these international economic relationships.

Throughout the paper, we call attention to empirical puzzles and outcomes that have received extensive attention in IPE, as well as some that have not received as much attention as we think they deserve. The research frontier for IPE is thus defined in terms of empirical puzzles as well as a theoretical agenda, although we do not cover more than a sample of the empirical work that has been done over past decades. One relatively well developed empirical subject area, from which we draw many of our illustrative examples, is international trade. Monetary relations have received somewhat less attention but are now the subject of substantial research efforts. Other areas, such as foreign direct investment, have been the subject of some scholarship in the past, but are now relatively neglected and are prominent candidates for modern analysis. Many of these substantive topics are relevant to ongoing debates about the causes and consequences of globalization for national and international political economies.

We also identify strands of research that are organized around general

concepts, such as international cooperation or stability, rather than specific issue areas. Scholars have long been interested in such general questions as the sources of interstate conflict or collaboration. We do, however, note that some of this sort of scholarship on international interaction would benefit from the use of more-nuanced and measurable outcomes than cooperation. We also note that, despite a generally accepted theoretical architecture for their analysis, there has been strikingly little detailed empirical work on international economic institutions.

## ■ Domestic-International Interaction

For decades, a principal challenge to students of international politics generally, and international political economy specifically, has been the need to take into account both the domestic political economy of foreign economic policy and the role of strategic interaction among nation-states and nonstate actors. While all scholars recognized the domestic and international levels as necessary building blocks of a more systematic and integrated analysis of international relations, the difficulties of this integration were just as evident. Recent models of domestic-international interaction have pushed IPE research forward along these lines in important ways, although of course much remains to be done. In this section, we present and discuss some of the frameworks that have been developed to guide the study of domestic-international interaction in IPE.

The core of the domestic-international connection is the impact of domestic institutions and interests on international interaction, and vice versa. Our ultimate goal is a simultaneous understanding of this mutual causation, recognizing feedback effects at both levels—a general equilibrium model, rather than a partial equilibrium one in which one level is held fixed while the other varies. Of course, endogenizing two such complicated levels is extremely complex, and progress has been made in small steps at best. Nonetheless, there have been some promising efforts at integration. Taken as a body of scholarship, they suggest the troubling yet exciting possibility that what we think we have learned from studies lodged solely at the domestic or international level may have to be revisited when we take interactive effects more seriously.

Like all of IPE, the interaction of domestic and international conditions can be analyzed in terms of three factors: interests, institutions, and information. The interests of economic and political actors are a driving force behind economic policy decisions, and scholars attempt to specify these interests with some precision. How interests are translated into outcomes depends on the strategic environment, especially institutions and information. Interests are aggregated through institutions, which also delegate responsibility for decision making to particular actors. The structure of

information similarly influences bargaining and policy choice. All three of these factors—interests, institutions, and information—are important at the international and domestic levels, and domestic-international interaction can often be examined by looking in a more-focused way at these factors. For example, we might ask how domestic institutions affect available international information or how international institutions affect domestic interests. This more-disaggregated approach to the relationship between the national and the global helps us formulate arguments amenable to empirical evaluation.

One approach to domestic-international interaction looks directly at how the international economy affects domestic interests, institutions, and information in ways that then feed back to national policies.<sup>1</sup> The international economy might affect foreign national economic policymaking through two related channels. The first runs directly from the global economy to the preferences of national socioeconomic and political actors. In this variant, international economic trends directly affect the interests of domestic groups, leading them to move toward new policy preferences or to change their domestic political behavior. For example, the expansion of world trade can have a powerful impact on firms' or industries' trade policy preferences. New export opportunities can lead previously protectionist firms to turn toward free trade, as some argue was the case for U.S. manufacturers after World War II; alternatively, the opening of new export markets can lead free-trade firms to redouble their lobbying efforts. In a Stolper-Samuelson framework (for example, Rogowski 1989), the expansion of world trade strengthens owners of nationally abundant factors, such as labor in poor countries and capital in rich countries. Similarly, the state of international capital markets can have a big impact on the preferred policies of groups in potential borrowing countries: the prospects of access to thriving global financial markets can lead firms and sectors to champion national trade, monetary, or exchange rate policies they might not otherwise support. Again, all these involve a common causal mechanism: change in the international economic environment affects the policy preferences and behavior of domestic groups, and thus has an impact on national policymaking and foreign economic policies.

In addition to affecting domestic interests, the international economy might also affect domestic institutions, as by making a previously feasible policy difficult to sustain. For example, national capital controls are relatively easy to impose and enforce when the world's capital markets are dormant or barely active, as was the case until the middle 1970s. However, the explosion of international financial activity in the 1980s and 1990s made it

1. The essays in Keohane and Milner (1996) contain some recent examples; the tradition is closely related to early work on interdependence (for example, Cooper 1968; Keohane and Nye 1977), and also to dependency-influenced arguments about the effects of international markets on development.

extremely difficult for national governments, especially in the more financially developed industrial world, to sustain controls on cross-border investment. While this process reflected previous policy choice by some major governments, it can be taken as the exogenous result of economic and technological trends for most countries, and it dramatically altered the set of policies feasible for governments to contemplate (Goodman and Pauly 1993; D. Andrews 1994). For example, Eichengreen (1996) argues that movement toward Economic and Monetary Union (EMU) in Europe was made inevitable by the increasing difficulties European nations had in sustaining capital controls that allowed them to run independent monetary policies, and more generally that high capital mobility has forced most countries to choose between irrevocably fixed and freely floating exchange rates, eliminating the possibility of defending intermediate exchange rate systems.

One variant of analysis of the impact of the international economy on domestic institutions is about the effects of globalization on the prospects for the social-democratic welfare state and similar social policies. For example, Rodrik (1997) has argued that economic integration has reduced the ability of governments to tax capital, thus limiting the scope for government policies to deal with the social dislocations that globalization itself creates. Others believe that these effects are less limiting, still allowing for different national economic policy paths (Garrett 1998b). All these arguments share a common causal approach connecting the international and domestic levels: globalization, understood as developments in international economic integration, alters the choices available to national governments; this in turn affects national policy (and, one could continue, international outcomes).

While these perspectives look at the impact of international factors on domestic interests and institutions, they can be turned around to look at how the structure of international economic institutions alters the information available to and the policy incentives for some domestic actors. It has been argued, for example, that this is the secret of the effectiveness of WTO provisions allowing one country to retaliate for WTO-illegal policies by another country by excluding some of the violator's exports. This will lead exporters in the violator to lobby *domestically* against national trade policies that might lead to such retaliation, even though, in the absence of the prospects for retaliation, they would be indifferent (Goldstein and Martin 2000). For example, if country A obtains WTO permission to sanction country B for its barriers to A's clothing exports, and country A then puts a tariff on country B's grain exports to A, this will give B's grain farmers an incentive to lobby *within their own domestic political economy* for a reduction in B's barriers to clothing imports. In fact, some scholars argue that one important effect of international institutions is to change domestic informational and institutional conditions so as to permit such linkages among domestic policies, mobilizing exporters against their own government's

trade protection. This line of thinking has been applied especially to the highly structured nature of interstate bargaining within the European Union, where cross-issue linkages are rife and often draw contending domestic interests into the political fray (L. Martin 2001). Here, too, the chain of causation goes from international institutions to domestic institutions, information, and interests, then to national foreign economic policies.

In all these approaches, international factors affect national policy by way of their direct effect on the domestic political economy. This effect may take place by restricting the set of feasible policies, by constraining domestic institutions, by altering domestic information, or by changing the preferred policies and behavior of domestic actors.

Another approach, not necessarily exclusive from the foregoing, posits that national governments stand between the domestic and international levels, intermediating between them in ways not reducible to one or the other level and in ways that bring interaction between the levels to the fore. A powerful metaphor for this view of national governments as mediating the domestic-international interaction is that of two-level games (Putnam 1988). Initial work on this problem had a very simple characterization of the relevant domestic institutions and interests. First, the central domestic institutional actor was assumed to be the "chief of government" (COG) or head negotiator, operating at both the domestic and international levels. Second, domestic interests were summarized in terms of the "win set," the set of all international deals that would be preferred to the status quo by domestic society. In fact, much research in the two-level games tradition concentrates on the determinants of the win set. Third, initial work assumed that the COG was a disinterested representative of the interests of his or her constituency. This assumption has often been dropped in work building on the metaphor, as the COG is allowed to have independent interests. Adding another set of interests leads to the identification of the "acceptability set," those international agreements that the COG finds preferable to the status quo. Any deal reached and implemented must lie within both the win set and the acceptability set.

The two-level game framework provides tools for thinking about domestic-international interaction. It also hints at more fully interactive analyses, inherent in what Robert Putnam called "reverberation" and what Jack Snyder called "synergy" (1993a). Synergy represents new possibilities that open up as the result of interaction between the domestic and international levels and might occur when negotiators are able to use international negotiations to create previously unattainable outcomes, thus enlarging their domestic win sets. Yet treatments of two-level games have not yet made much progress toward full interaction between the two levels. Most work in this tradition has focused on how domestic interests, institutions, and information influence negotiation and cooperation on the international level. One promising avenue is to look at the impact of legis-

latures on the ability of governments to commit to international agreements (L. Martin 2000). In democracies, legislatures have the ability to block or frustrate the implementation of international commitments even if they do not require formal legislative approval. Therefore, agreements negotiated without legislative participation may lack credibility. Agreements gain credibility when the legislature has been involved in a structured, institutionalized manner in the negotiating process. One major reason has to do with considerations of uncertainty, as legislative participation reveals information to both its own government and others about which deals will be implemented. Evidence drawn from the United States and the EU demonstrates that the credibility of commitments rises with institutionalized legislative participation.

Other productive applications of the two-level games approach include work on trade bargaining that formalizes ideas about win sets and ratification, and treats uncertainty explicitly (Milner and Rosendorff 1997; Milner 1997). These models identify a president with preferences over the degree of trade liberalization and a legislature that must ratify any international agreement. They assume two countries; for simplicity, the domestic politics of the "foreign" state are not treated in as much detail as those of the "home" state. On the international level, a Nash bargaining solution specifies the outcome of negotiations. Analytical interest thus turns primarily to the effect of the ratification requirement in the home state. Here, two factors get the most attention: the interests of the legislature, particularly how its ideal point differs from that of the president, and the degree of uncertainty associated with international negotiations.

These models give rise to a rich set of conjectures about the conditions under which agreements will be reached and the distribution of benefits within these agreements. One of the important contributions of this work has been to identify the conditions under which the Schelling conjecture holds. This is the idea, present also in the two-level games metaphor, that negotiators can often benefit from having their hands tied. If a legislature must ratify an international agreement and if the legislature will only approve a narrow range of agreements, the negotiator can use this fact as bargaining leverage. Therefore, negotiators might see advantages in being bound by a legislature. Formal approaches show that this logic holds in some but not all circumstances. For example, when the legislature is too hawkish—it has little interest in trade liberalization, in contrast to the president—ratification requirements will undermine the prospects for any international deal.

Domestic informational conditions, in these models, have an important impact on international interaction. The work assumes that the legislature may not know precisely the content of a negotiated agreement, perhaps because legislators may not know just how any agreement will influence economic outcomes in their districts. The effect of such uncertainty on the prospects for international cooperation is complex.

"Endorsers" can come into the picture, experts or interest groups who send signals about whether they find the agreement acceptable. When such endorsers exist, uncertainty does not impede international cooperation; in fact, the prospects for cooperation may be better under these conditions than in the complete information game. Mansfield, Milner, and Rosendorff (2000) extend this framework to consider interaction between democracies and autocracies, where autocracies do not require legislative ratification. They find—perhaps consistent with the Schelling conjecture—that pairs of democracies have more success in lowering barriers to trade than pairs that match a democracy with an autocracy. Statistical work bears out this proposition.

An alternative approach to the formal analysis of how the informational setting affects domestic-international interaction considers domestic politics the source of uncertainty about international agreements (Downs and Rocke 1995). For example, when two countries sign a trade agreement, they are uncertain about the exact economic implications for domestic groups and about which domestic groups will be mobilized to apply political pressure in the face of unwelcome economic consequences. This implies that deeper cooperation—that which provides greater mutual benefits but also involves greater unilateral risks—requires more flexibility, or "imperfection," in agreements. Tightly binding agreements that do not allow states temporary breathing room in the face of unexpectedly high domestic costs will be unstable. Some room for maneuver, such as less-than-perfect enforcement of commitments, allows states to cooperate over the long term, even if they sometimes deviate temporarily from the strictures of the agreement.

Work on domestic-international interaction has made substantial progress over the past fifteen years. The two-level games project stimulated such work and provided a language for discussing the nature of interaction, and further work has developed the approach in very promising ways. Yet there is much to be done. At this point, the analysis of domestic-international interaction requires heroic assumptions and simplifications, such as to reduce domestic institutions to an executive and a legislature or to reduce domestic interests to a median voter. Future work will need to allow for more nuance and development, incorporating such other domestic institutions as political parties, courts, and central banks and a more-sophisticated treatment of domestic interests.<sup>2</sup> Models of domestic-international interaction will also need to address more issue areas than international trade, where they have been developed most successfully, perhaps because of the strong preexisting microfoundations. Despite the

2. Some progress along these lines has been made in the analysis-of-trade literature, where Grossman and Helpman (1995) provide microfoundations for both economic and political interests; politicians are assumed to be competing over campaign contributions from special interests.

continuing weaknesses and large agenda for the future, the analysis of domestic-international interaction has made substantial advances and holds great promise. One reason this progress has been possible is that scholars were able to build on well-developed domestic and international analyses, specifically of the domestic politics of foreign economic policy and of international strategic interaction. Without these prior bodies of scholarship, whatever the weakness of a focus restricted to the solely domestic or global level, research progress on the *interrelationship* of the national and the international would have been impossible. It is to these two bodies of research that we now turn.

## ■ | The Domestic Political Economy of Foreign Economic Policy

Understanding how domestic and international factors interact to determine the politics of international economics requires a firm foundation in theories both of domestic political economy and of international interaction. Most of the work in IPE has been directed toward providing these two sets of building blocks. The first large area of IPE research examines national policies toward the international economy. This sometimes comes close to the investigation of purely domestic factors about a policy that just happens to involve foreigners. More commonly, the international connection itself plays an important part in the making of foreign economic policy. In any case our understanding of the domestic politics of international economic policy requires careful analysis of the economic interests at stake and of how they work their way through domestic political institutions. Substantial work on both these aspects of the problem has greatly enhanced our understanding. This is especially true of trade policies, which we use heavily as an example.

In this domestic analysis, we identify three analytical steps. First, scholars specify the economic interests at stake. Second, they characterize the organization of these interests. Third, they investigate how these interests are mediated through political institutions. In carrying out this analysis, we can also differentiate between broad public policies and mass interests—such issues as inflation, growth, and economic reform—on the one hand and narrower policies and special interests—such issues as trade protection, industrial subsidies, and sectoral regulations—on the other.

### ECONOMIC INTERESTS

Most IPE scholarship on foreign economic policymaking begins with an explicit or implicit model in which politicians confront a combination of pressures from concentrated interests and the broad public. This frame-

work and its emphasis on the demand side coming from self-interested socioeconomic actors has roots in three perspectives: the Stigler-Peltzman approach to the political economy of regulation; the analysis of rent-seeking, or directly unproductive behavior; and the analytical Marxism that applies neoclassical tools to traditionally Marxist concerns. In all these frameworks, governments weigh benefits to special interests against costs to the general public, as well as clashes among special interest groups, and different levels of concern over broad public goods. Variation in foreign economic policy is due, at least as a first cut, to differences in the character and intensity of the interest-group and public pressures, and to differences in the incentives of governments to respond to these pressures. Analysis of domestic interests can be structured along two dimensions: specifying the content of groups whose interests are at stake and specifying the organization of these interests.

An important starting point for domestic IPE is to ascertain the interests, or policy preferences, of groups both broad and narrow. This can be done inductively, by observation, interviews, surveys, and other empirical techniques to map the interests of the relevant populations. There has in fact been a great flowering of work along these lines recently, especially making sophisticated use of surveys of public opinion in the United States and western Europe. Scholars have used public opinion surveys to explore both interest-group and mass-public preferences about European integration in general (Dalton and Eichenberg 1993; Gabel 1998), about EMU in particular (Gabel 2001), and about trade policy (Scheve and Slaughter 2001a, b) in imaginative and instructive ways. These empirical investigations of individual, group, and mass public policy preferences are an important source of information.

Scholars have also deduced policy preferences on the basis of prior theories of how characteristics of particular groups will lead them to desire particular policies. One example of how this approach has been used with great effect is the study of trade policy. Here political scientists have had the raw material of trade theoretic conclusions from economists interested in the differential impact of trade policies, who have developed three models of the distributional effects of trade liberalization and protection. The first, the Stolper-Samuelson theorem, predicts that factors of production that are scarce in a country will benefit from trade protection, so that labor in capital-rich (developed) countries and capital in labor-rich (developing) countries should be protectionist. The Ricardo-Viner, or specific-factors, approach emphasizes comparative costs and asserts that factors of production specific to import-competing (exporting) industries will be protectionist (free trade). More recent developments look at scale economies, typically to argue that larger firms should prefer more-open trade.<sup>3</sup>

3. Alt and Gilligan 1994 surveys the first two; Milner and Yoffie 1989, Richardson 1990, and Chase forthcoming survey the latter, which is less developed.

There are other arenas in which theory helps us understand the expected interests of socioeconomic actors. Where economists have explored the distributional effects of foreign economic policies, political scientists can deduce the policy preferences of the affected interests. Sometimes there is only a short step from existing work in economics to these deductions, as in the analysis of immigration; at other times, it requires substantial extension and imagination, as in the analysis of foreign direct investment, currency policy, or financial regulation. And there are many issue areas in which there is little or no preexisting work to serve as a starting point for deriving groups' interests. Here scholars of IPE have developed original arguments about the impact, for example, of financial structure on currency policy preferences (Henning 1994) or of portfolio diversification on trade policy preferences (Schonhardt-Bailey 1991).

Just as scholars have deduced group interests from the distributional impact of targeted economic policies, they have also searched for theoretically grounded ways to specify mass interests over such broad areas as macroeconomic policy and the provision of public goods. One useful baseline is the simple idea that the public prefers those policies most likely to raise national income. This was in fact the unstated presumption of early studies of trade policy (notably Schattschneider 1935), based on the economic argument that free trade is the most efficient policy for any nation. In other areas, we can draw on efficiency and social welfare arguments to designate the purportedly most desirable policy—low inflation, effective countercyclical currency policy, social insurance against exogenous terms of trade shocks—and posit, at least as a first approximation, that these are the public will. Another possibility is to focus not on society as a whole but on the median voter and attempt to establish the expected policy preferences of such pivotal actors.<sup>4</sup> This is standard in studies of income redistribution, where it is common to assume that the net expected benefits of redistributive policies on the median voter will determine their electoral viability.<sup>5</sup> The generally applicable point is that if the median voter—more generally, the politically pivotal portion of the public—can, roughly speaking, be identified, it may also be possible to identify the policy preferences of this segment of the population.

The content of the foreign economic policy preferences of concentrated interests, mass publics, and pivotal actors is important, but politics involves a series of exchanges and exchange implies that socioeconomic and political actors are willing to trade off policy dimensions: firms that

4. While there are instances in which the median voter's interests are those which maximize social welfare, this is not always (and perhaps not usually) the case. The median voter, in other words, is not necessarily a representative agent of society; it is simply his or her pivotal position in the relevant political space that makes him or her crucial.

5. Meltzer and Richard 1981 is the classic source.

prefer both free immigration and free trade may compromise by forgoing the former to put together an effective coalition for the latter. Public opinion may be hostile to devaluation but even more hostile to the expenditure reductions and tax increases necessary to defend the exchange rate. For this reason, we need to know the relative intensities of actors' policy preferences, the weights groups and individuals place on their various policy goals.

The basic determinant of preference intensities is the size of the stakes. This may be a direct consequence of the amount of money transferred directly or indirectly or of the policy rents otherwise created. As with policy preferences themselves, scholars have also suggested some general characteristics of actors that affect their preference intensities. One such characteristic is the specificity of the actor's assets—physical or human capital, for example—to a particular use. The idea, drawn loosely from transaction-cost-based analysis, is that the more specific the asset the greater the actor's incentive to defend its value in its current use (Frieden 1991b; Alt and Alesina 1996). Firms with very specific investments will be more concerned to protect themselves from foreign competition; workers with specific skills will be more adamant about demanding social insurance to protect them against unemployment.

Although it is important to have a clear sense of the narrow and broad interests at stake, scholars also need a sense of the ways in which these interests are organized. One simple and powerful starting point is to distinguish between concentrated and diffuse interests, especially as most scholars have believed that concentrated interests are likely to dominate diffuse interests. This was the view, for example, of Schattschneider's pioneering study (1935) of the Smoot-Hawley tariff. Schattschneider assumed that concentrated protectionist industries would dominate the diffuse free-trade interests of disorganized consumers. The explanatory power of this general proposition has been confirmed in many contexts, as scholars find that mass publics or electorates often have little impact on policies whose effects are difficult to discern or technically complex.<sup>6</sup>

But simply distinguishing between concentrated and diffuse interests is not enough. For one thing, there are frequently conflicts of interest among concentrated interests. Many studies of trade policy, for example, have shown that antiprotectionist exporters, multinational corporations, and consuming firms can effectively counteract the influence of those who would like to restrict imports (Milner 1988; Destler and Odell 1987). Concentrated interests may also have intense views on general public policies.

The insight has been explored in much more detail since the publication of Olson 1965, which focused attention on such problems of collective action. In the realm of IPE, Gourevitch (1986), following on his influential 1977 article, found this bias in favor of concentrated groups to hold across many countries and time periods.

For example, while the simple concentrated-diffuse dichotomy might regard macroeconomic stabilization as a general interest policy of diffuse concern and opposition to stabilization as largely emanating from special interests, there are often concentrated groups with intense interests in broad stabilization policies. This might be the case of the financial sector, typically seen as strongly supportive of anti-inflationary policies despite their diffuse impact. Finally, despite the fact that policy is often biased in favor of special interests, there is no question that diffuse interests often have a powerful impact on policy. After all, politicians in democracies must be elected; most authoritarian regimes need support from at least portions of the mass public. And there is little doubt that mass publics do in fact, at times, have strong desires related to international economic policy, especially when it affects such prominent issues as inflation, unemployment, and taxation. Even where mass publics are not organized around such policy issues, there may well be incentives for political entrepreneurs to address these concerns. In other words, it is almost certainly untrue that debates over foreign economic policy always pit concentrated interests against the public or that the mass electorate is always bested by concentrated interests.<sup>7</sup>

In this context, it is important to note the ways in which groups, and even broad segments of the public, are organized, for this pattern of organization can have a powerful impact on policy. This is especially the case because individuals and firms often have crosscutting material interests, and similar economic agents can be organized into very different collectivities across countries; even within a single country, over time the organization of interests can change dramatically. An autoworker has at one and the same time economic interests associated with his industry, with a range of similarly constituted exporting or import-competing sectors, with the working class generally, with her or his region, and with her or his status as consumer. In addition, she or he may have strong partisan, ethnic, or other ideological commitments. It is perfectly plausible that in one setting, autoworkers will cohere and identify primarily with their industry, while in other settings they may divide in many different ways. Perhaps the most striking example of these differences is the tendency of workers in Japan to be organized along firm lines, in the United States along industrial lines, and in much of Europe along class lines.

Variation in the organization of economic interests has important implications for the making of policy. An obvious example is the difference

7. Gowa (1988) argued for such a position as applied to international trade and monetary policy, specifically that the former implicated specific interests much more than the latter and would therefore be more politicized. But the highly politicized nature of European monetary integration and currency problems in the developing world would seem to indicate the shortcomings of an approach based on such assumptions, perhaps because they misidentify the specific interests or underestimate the importance of mass publics.

between labor or management interests that are organized on sectoral as opposed to class lines. Where sectoral forms of association prevail, there is likely to be much more pressure for particularistic policies: trade protection, export subsidies, controls on or subsidies to foreign investment. Where class politics prevails, policies are less likely to focus on industry-specific benefits and more likely to involve concerns of broader interest to labor or capital as a whole. Scholars have long noted that northern European-style social democracies, with their densely organized and centralized labor movements, have tended to eschew trade protection in favor of class-based social insurance schemes, while countries with less of a tradition of class political organization (such as the United States and Japan) have tended to engage in more sectoral protection.<sup>8</sup> While this and other such relationships have been investigated with regard to the organization of labor, they also hold for the organization of business interests, which vary in similarly important ways among countries.

Scholars studying the domestic politics of foreign economic policy, then, pay considerable attention to the policy preferences of interest groups and of the broad public, to the intensity of these policy preferences, and to the organizational forms of these special and broad interests. This has been true in the analysis of international trade, financial regulation, currency policy, and foreign investment. The analysis of trade is probably the best developed of these literatures. We now have quite a nuanced understanding of which economic actors are most likely to demand protection or trade liberalization and under which circumstances. We have a preliminary sense of similar issues in international monetary policy, such as which actors are most likely to prefer fixed or flexible exchange rates. In areas such as financial regulation and foreign direct investment, our knowledge is more rudimentary, with some intriguing puzzles and preliminary analyses but only relatively sketchy theoretical and empirical work. The analysis of the content and organization of domestic interests promises to continue to make advances as it is extended to these underexplored empirical areas.

## POLITICAL INSTITUTIONS

The interests, preference intensity, and organization of socioeconomic actors is only a starting point for the analysis of domestic constraints on foreign economic policy. These interests are mediated through domestic political institutions in ways that can fundamentally affect outcomes. This is especially true of the organization of the political system as it responds to political pressures.

8. Katzenstein 1985b is the classic statement. Some might argue that the small size of these countries dictated the form of interest aggregation. Whatever the direction of causation, there appears to be a strong correlation between the two.

Institutions perform two general functions: aggregation and delegation. Some institutions aggregate interests in ways that affect the ability of groups to organize and the weight they will have in the political process. Other institutions delegate decision-making authority to particular actors, similarly changing the weight of various interests in the political process. Still other forms of legislative and bureaucratic organization are best understood as delegating authority from one group of actors to another. In one way or another, electoral, legislative, and bureaucratic institutions serve to mediate the pressures brought to bear by organized interests and the general public and to transform them in ways that directly affect policymaking.

*Electoral institutions* matter to the making of foreign economic policy because they affect the transmission of societal interests to politicians. One impact is on the need for politicians to respond to policy-relevant concerns of the broad electorate: the more the electoral system reflects the preferences of the mass public (or median voter), the more policy has also to reflect these preferences. Some have hypothesized that systems of proportional representation, or more generally larger electoral districts, tend to reduce the impact of special interests and increase the electoral importance of the median voter. This would imply that such systems would be more likely to incline toward freer trade, and fewer sectoral benefits and subsidies, than first-past-the-post systems in which local or regional interests may be more powerfully represented.<sup>9</sup>

Different electoral systems may also affect the influence of special interest groups in ways other than local or regional particularism, such as when politicians rely heavily on private campaign contributions. Where election funding is entirely public, the scope for a direct contributions-based channel for the influence of interest groups is presumably more limited than in systems in which private contributions are very important. And as national electoral systems—or simply electoral environments—evolve over time, this can affect policy. For example, it has been argued that the increasing importance of urban middle-class voters in Japan facilitated the deregulation of the country's international financial institutions and put pressure on the government to allow the yen to appreciate (Rosenbluth 1993).

In addition to differences among countries' electoral systems, there are also differences in the electoral bases of different branches of government in a single country. This is not usually the case in unitary parliamentary systems, but in federalist systems or those with a division of powers, it is common for different levels or branches of government to be elected in different ways. Because it is uncommon for subnational units of a federal system to have a major role in foreign economic policy, the more important

9. Rogowski 1987b, McGillivray 1997, and Alt and Gilligan 1994 all present variants of these arguments, for which the evidence remains mixed.

differences in electoral institutions are among branches of government, such as different electoral institutions for two chambers of the legislature or for the legislature and the executive. Just as variation in district magnitude or proportionality may have a systematic impact on representation in comparative perspective, so will they affect the political incentives of, say, the upper and lower houses of the Japanese Diet or the U.S. Congress and president. The most common argument along these lines is indeed, as above, that smaller districts are more likely to reflect special interests, while upper chambers and executives are more concerned with broader or even national public opinion. This should tend to make the upper chambers and executives less favorable to trade protection, sectoral or regional subsidies and incentives, and other particularistic policies. The overall impact of these differences on policy depends, of course, on the legislative institutions by which policy is made and implemented.

*Legislative organization*, then, is a second important set of political institutions that affect foreign economic policymaking. The importance of agenda control, veto points, and other interactions among policymaking institutions is well established in the broader political science literature, and direct consideration of these factors has been drawn into analyses of the making of foreign economic policy as well. Where there are clear electoral differences among chambers or branches, it is important to determine the relative influence of the different units on policy. A constitutional structure, for example, that gives trade policy authority to the more localist legislature will produce different outcomes from one that delegates all trade policymaking to the executive. The areas in which different branches or chambers dominate; the constitutional status of international agreements and treaties; the order in which laws are designed, amended, vetoed, and approved—all these will affect policy.

The most-developed work on the impact of legislative institutions on foreign economic policy has to do with U.S. trade policy. One strand of scholarship asserts that Congress will be systematically more protectionist than the president, given the executive's national constituency. The disaster of the 1930 Smoot-Hawley tariff led policymakers to redesign trade policy institutions so that the president could, within carefully specified constraints, negotiate reciprocal trade agreements with other countries. This evolved into a system in which the executive essentially proposes trade policy to a legislature that can only make limited changes or none at all. This change in the institutional structure of U.S. trade policymaking is often given credit for the general liberalizing trend in U.S. trade policy (Haggard 1988; Bailey, Goldstein, and Weingast 1997).<sup>10</sup> More-differentiated analyses have extrapolated from the expected impact of this institutional structure to draw inferences about the effects of partisan control of Congress and the presidency on the outcome of trade policy.

10. But see Irwin and Kroszner 1999 and Hiscox 1999 for contending views.

Specifically, Lohmann and O'Halloran (1994) have argued that divided U.S. governments are likely to give rise to more protectionist policies than unified governments.

Even in unitary parliamentary systems, legislative institutions can be important. In the general political science literature, it has been argued that divided government in the U.S. system is analogous to minority government in parliamentary systems (Laver and Shepsle 1991). In similar ways, scholars have looked at the role of parties in parliamentary systems. One such approach focuses on the degree of party discipline, on the principle that a disciplined national party, like the U.S. president, is concerned about a national constituency. This leads to expectations that electoral and legislative institutions that lead to strong party discipline will typically deliver policies less in thrall to special interests, such as freer trade (McGillivray 1997). Another approach looks at the incentives to individual parties in multiparty governments, arguing that these differ from those faced by single-party majority governments. Where the government is made up of a coalition, it is difficult for voters to assign blame or credit to a particular party for government policy. This reduces the incentives for opportunistic partisan manipulation of foreign economic policy. One implication is that countries that typically have multiparty governments are more likely to adopt fixed exchange rates that prohibit the manipulation of currency values for partisan electoral purposes, or to put it differently, that single-party governments are more likely to choose adjustable exchange rates so that they can manipulate them for partisan electoral purposes (Bernhard and Leblang 1999).

The third sort of domestic political institutional variable commonly considered by IPE scholarship is *bureaucratic institutions*, especially patterns of delegation to bureaucratic and other agencies. The previously mentioned work on U.S. trade policy is about delegation from one elected body (Congress) to another (the president). In recent years, this delegation has become even more explicit, with the frequent use (or attempted use) of fast-track bargaining authority by the executive. Trade policy in the United States also involves a number of independent agencies, such as the International Trade Commission and the U.S. trade representative, with the potential authority to deal with trade policy issues ranging from allegations of dumping to other instances of unfair trade. The recent upsurge of interest in standards that relate to trade—environmental, labor, health and safety—has also led to the creation of delegated institutional mechanisms to deal with these issues, such as the independent agencies established under the auspices of the North Atlantic Free Trade Association (NAFTA). In the European Union, trade policymaking is delegated to the European Commission and, within this, to industry-specific groups that include representatives from many member states. Trade policy is not unique. International financial policy is typically handled by independent agencies with special

responsibilities for national banking systems: central banks, national regulators, finance ministries.

The impact of delegation on the making of foreign economic policy is complex and controversial. Some scholars see independent agencies as particularly likely to be captured by special interests. Most scholars, however, regard independent bureaucratic entities from an explicit agent theoretic perspective in which the agency responds to the policy needs of politicians, albeit with some room for maneuver (slack). Often independent agencies are regarded as providing politicians a protective cushion from day-to-day or particularistic demands, while also ensuring their accountability to the public. The interplay of independence and accountability depends strongly on the issue area and on other characteristics of the political economy.

One well-developed literature is that on central bank independence, which typically begins with the assertion that independence can mitigate the time inconsistency of monetary policy.<sup>11</sup> Politicians can thus best respond to the policy preferences of the mass public (median voter) for low inflation by insulating the central bank from the temptation to alter monetary policy, within the boundaries of ultimate accountability to the political authorities. Central bank independence has also been drawn into analyses of international monetary policies. For example, it has been argued that governments in countries with independent central banks are less likely to engage in electorally motivated manipulations of exchange rates. A related argument has been made that governments that can commit credibly to low inflation with an independent central bank are less likely to need to fix their exchange rate in order to gain anti-inflationary credibility, so that central bank independence and fixed currencies are policy substitutes (Clark and Reichert 1998; Clark and Hallerberg 2000; Broz forthcoming). In all these cases, the relationships between political leaders and bureaucratic institutions have been drawn into the analysis of foreign economic policies.

As this discussion illustrates, there is a clear logic to the approach commonly used by scholars in the analysis of the domestic politics of foreign economic policy. In any given policy arena, we first specify the interests at play, drawing on observations of expressions of policy preferences or on established bodies of theory or on both. It is useful to distinguish between special and mass interests and between policies of primarily narrow or sectoral incidence and policies that broadly affect public welfare. We then look at the ways in which these interests are organized. Finally, we examine political institutions that determine the impact of organized and mass interests on policy through both aggregation and delegation. Elec-

Classic presentations can be found in Grilli, Masciandaro, and Tabellini 1991 and in Alesina and Summers 1993.

total institutions affect the relationship among voters, interest groups, and politicians. Legislative institutions influence the ways in which politicians bargain toward policy outcomes. Bureaucratic institutions condition the ways in which policy is made and implemented, depending on the degree of autonomy delegated to bureaucratic agencies. Decades of scholarship in IPE demonstrate that this consensual method can provide convincing and ultimately revealing results.

This concatenation of methods has been applied successfully to the making of national policies toward international trade and finance, exchange rates, foreign investment, and other foreign economic policies. The literature on trade, particularly on the level of protection offered to various sectors, is especially well developed. That on international finance and exchange rates is moving forward rapidly, for example with detailed studies of the choice of exchange rate regimes and policy responses to market pressures on currencies. Foreign investment, both patterns of international investment flows and patterns of national policies toward foreign investment (regulation, control, international agreement), is a topic deserving of more and more-sophisticated study. In any case, the advances of this realm of IPE research have facilitated the systematic incorporation of domestic factors into a more integrated analysis of domestic-international interaction in the world's political economy.

## ■ | International Interaction

Along with the domestic politics of foreign economic policy, the second major building block of the larger IPE edifice is the analysis of strategic interaction at the international level. Scholars have developed theoretical and empirical approaches to the ways in which states relate to one another as they devise their international economic policies, and to the institutional forms that these international economic relations take. In this section we outline approaches to studying international interaction, illustrated with examples drawn from trade and monetary policies. In keeping with most U.S. research, the emphasis is on relations among states, rather than between states and such nonstate actors as multinational corporations or nongovernmental organizations. Many of the tools of analysis discussed here could, nonetheless, easily be adapted to these purposes.

### STRATEGIC INTERACTION AMONG STATES

Scholars of IPE have long understood that the interactions of states in the international system influence economic policies and outcomes in crucial ways. For tractability, most arguments about strategic interaction take the characteristics of states as given, typically informed by the work on domes-

tic political economy discussed above. Treating states as units—although not identical units—scholars ask how the constraints and opportunities offered by the international system and the processes of interaction with other states influence decisions and outcomes.<sup>12</sup>

The analysis of international interaction centrally involves three elements: the identification of state interests; the specification of the strategic setting; and the attention to the role of uncertainty, beliefs, and ideas in explaining policy choice.<sup>13</sup> Scholars typically strive to begin with a good understanding of state interests, the outcomes states desire. These interests are then placed within a strategic context that is largely determined by system characteristics. One important aspect of the strategic setting is the uncertainty on a particular issue (see Morrow 1999b), which makes state beliefs and how they change over time a central part of the analysis. While national interests are important to the analysis of international interaction, scholars are typically interested in identifying *patterns* of state interests and *variations* of interests across states and issues, rather than concentrating on individual states and actors within states. In other words, the goal is to come up with *general* patterns of state interests rather than particularistic, nationally specific ones. One approach is to build on the domestic analyses described above but to focus on commonalities among groups of countries. For example, patterns of interests can be characterized by specifying the degree of common interest among actors. Some studies of monetary cooperation during the interwar period suggest that changing perceptions of the degree of common interest were the primary determinant of international cooperation (Oye 1986a).<sup>14</sup> Even when a high degree of common interest exists, however, conflict about the distribution of gains from cooperation may intervene, even to the extent of delaying cooperation indefinitely (Fearon 1998a). In some settings, states may have no incentive to deviate from a cooperative outcome; in others, they may wish to renege if they can do so without punishment.

12. When states have a high degree of common interest, our attention is drawn to those factors that encourage or discourage realizing those common interests. These might be characteristics of the states themselves—for example, whether they have institutional structures that encourage living up to their commitments—or aspects of the international environment—for example, the costs of monitoring others' behavior. When the degree of common interest is low, in contrast, our attention turns to factors that influence outcomes in the presence of high levels of conflict. We might ask

12. For exposition of a framework similar to that outlined here, see Lake and Powell 1999a.

13. Information is, technically speaking, an aspect of the strategic setting. However, we isolate it as a third factor because of its importance.

14. Although other studies find more explanatory power in domestic economic interests and institutions; see Simmons 1994.

about first-mover advantages, the opportunity costs of using military force or holding out for a better deal, or the wherewithal of states to engage in coercive diplomacy.

A second approach is to look at how the position of nation-states in the international system affects their interests. That is, the focus is more outside in than inside out, asking how the international political or economic system shapes state goals. A simple starting point is to assume that all states want to maximize their economic welfare (although some combination of security and economic well-being is a common assumption as well). However, what policies allow a state to do so are heavily dependent on its position in the international political economy. Governments of large countries are more likely to be protectionist than governments of small countries, for example; the latter are likely to value exchange rate stability more highly than the latter.

Power differentials are often posited to affect state interests. Thus, a hegemonic state is said to have different interests in such issues as institutionalization, liberalization, and international cooperation than a weak state. For example, monetary coordination in Europe appears to be directly shaped by patterns of internationally determined interests. European countries most effectively coordinate their exchange rate and monetary policies when the United States acts in a manner that creates instability and negative externalities (Henning 1998). Thus, regional integration efforts in Europe have been most successful in the absence of hegemonic leadership (B. Cohen 1997). The long tradition of work in IPE that focuses on how patterns of interests depend on the distribution of power in the international system has developed from the initial presumption that a highly concentrated distribution of power led to preferences that facilitate cooperation (Kindleberger 1975; Krasner 1976). A second generation asked about the possibility of interests conducive to cooperation among small groups (Snidal 1985) and how the issues at stake influenced patterns of interests (Conybeare 1984; Gowa 1989). Recent work is even more careful about how the distribution of power influences interests, distinguishing among different types of players in the international system (Lake 1984) and considering the interaction of security and economic interests (Mansfield 1994). In one way or another, scholars interested in analyzing interstate interaction must begin with a clear (if simplified) picture of state interests, just as in domestic analysis.

Where the analysis of international interaction goes beyond domestic political economy is in its attention to the international political and economic strategic setting. By *strategic setting*, we mean the structure of interaction, the form of the game. How many states are involved in any particular negotiation or other mechanism of policy choice? Bilateral interactions create different constraints and opportunities than those involving a few states, which in turn differ from those involving large numbers of states. Can members of a "club" exclude outsiders, or is participation in

the process of interaction open to all who wish to join? Are states interacting in a highly institutionalized environment or one with few rules constraining the nature of the interaction? These questions may lead us to examine implicit or explicit voting rules, such as whether unanimity is required or whether some version of majority rule prevails. For example, studies of debt restructuring suggest that relationships among lenders have a great deal of structure, creating a hierarchical pattern of interaction with the IMF and a few large banks at the top (Lipson 1986). This structure allows banks to overcome collective action problems to respond to debt crises. The international environment also influences the order in which issues will be considered or which issues will be considered or which issues will be linked to one another. Some other important aspects of the strategic environment include questions such as how much weight actors put on future relative to immediate outcomes, that is, the relevant discount factors. Studies of trade wars suggest that a long shadow of the future mitigates pressures for conflict (Conybeare 1986). We also care about the prospects for enforcing agreements. Roughly accurate answers to all these questions are necessary in the attempt to specify how international interaction matters for IPE.

One aspect of the strategic setting that is especially important is the nature of uncertainty. Strategies in an environment of complete information differ tremendously from those in which states are unsure of others' preferences or of the relationship between policies adopted and outcomes achieved. To simplify somewhat, two types of uncertainty are important for IPE: uncertainty about the preferences of others and uncertainty about causal relationships.<sup>15</sup>

States may only have estimates of the preferences of others. For example, they may not know the value another government attaches to the aggregate welfare of citizens as opposed to the particularistic welfare of special interests. They may not know how willing others are to sacrifice economic benefits for security concerns. Rationalist approaches assume that beliefs are updated in a systematic manner through the process of interaction, as information is revealed by the choices of other states and by the observed outcomes resulting from these choices.<sup>16</sup> States first develop strategies based on a best guess about others' preferences, taking into account that others will also make their best guesses, and perhaps bluff or otherwise misrepresent their true interests. As interaction progresses, states observe the choices and signals of others and update their beliefs (typically using Bayes' rule). They also attempt to manipulate information, some-

15. A related typology of beliefs can be found in Goldstein and Keohane 1993b; see especially Goldstein and Keohane 1993a.

16. Sociological approaches, which have been more common in the study of international security than in IPE and in European scholarship, posit other dynamics of belief change.

times having an incentive to obfuscate, at other times having an incentive to try to reveal their true preferences.

One of the more important tools in the analysis of beliefs and uncertainty is game theoretic investigation of signaling and reputation (see Morrow 1999b; Morrow 1994b; Kreps and Wilson 1982). In most settings, signals sent by states are most effective in changing the beliefs of others if these signals are costly. Otherwise, intended recipients are likely to dismiss signals as cheap talk. Analyses of some international monetary regimes see them in this light, as commitment to a fixed exchange rate or a currency union involves a political cost that sends a signal about the intentions of governments (Giavazzi and Pagano 1988). However, in some circumstances even cheap talk can be an effective signal (Crawford and Sobel 1982). This occurs when states believe that they are likely to have a high degree of common interest and that they will be better off if they coordinate their actions rather than making independent choices. Alternative models of monetary regimes that see them as solving coordination problems rather than as commitment devices draw on this logic, identifying particular exchange rate systems as focal points (Frieden 1993; Broz 1997).

A second type of uncertainty in IPE is about the relationship between policies and outcomes, or causal relationships.<sup>17</sup> Some refer to this type of uncertainty as lack of precise knowledge about "the state of the world" (Goldstein and Keohane 1993a, 10). Examples of such uncertainty in IPE proliferate. Will fixed or flexible exchange rates improve investment flows and macroeconomic stability? What will be the costs of adjustment after conclusion of a trade-liberalizing agreement?

Where states are uncertain about the impact of their policies, prior beliefs again are central. Judith Goldstein's analysis of U.S. trade policy illustrates how the institutionalization of particular causal beliefs has structured the policymaking environment (Goldstein 1993). Uncertainty about the relationship between economic policies and outcomes, often called model uncertainty, can make efforts at monetary coordination counterproductive (Frankel and Rockett 1988; Iida 1990, 1999). While some authors refer to this type of uncertainty as states "not knowing their own interests," it is more fruitful to assume that states do know which outcomes they prefer, such as rapid economic growth, but are simply uncertain about which policies will get them closest to their goals.

In this setting, expert knowledge and learning are important. One common strategy in the face of causal uncertainty is to delegate some policymaking to experts, those with better knowledge about the relationship between policies and outcomes (Krehbiel 1991). This logic provides a way to ask about the influence of "epistemic communities" (Haas 1992) or "supranational entrepreneurs" (Moravacsik 1999). Another strategy is to

17. For theoretical discussions of causal knowledge, see Gilligan and Krehbiel 1989; Krehbiel 1991.

learn from observing the experience of others. Learning of this sort may account, for example, for diffusion of liberal economic policies in the last fifty years (Simmons and Elkins 2000).

The analysis of international interaction thus requires identifying the patterns of state interests, the strategic environment, and the nature of uncertainty and beliefs. With these factors in hand, analysts can go on to specify the strategies states will use. The interaction of state strategies, in turn, gives rise to equilibria, outcomes from which no state has an incentive to deviate. The goal of the analysis of international interaction is to identify equilibria, the circumstances under which they exist, and their characteristics in terms of aggregate welfare, the distribution of benefits and costs, and stability. Of course, completely and accurately taking all these steps is a mammoth undertaking, and one for which technology often fails us. Instead, most analysts isolate aspects of the problem, holding others constant or relegating them to the background, as in the examples summarized in this section.

The framework for understanding the impact of international interaction on IPE is well developed. It has been extended and applied in varied empirical contexts. However, substantial work remains to be done in this area to get a more precise sense of how international interaction matters for IPE. Greater attention to strategic interaction could inform empirical studies of the choice between trade competition and cooperation, including the choice to join and abide by trade agreements, the political problems associated with sovereign debt and its repayment, the logic behind currency unions and other exchange rate regimes, and the sources and implications of increased flows of foreign direct investment. One specific area in which such strategic interaction at the international level has assumed center stage is the study of international institutions and organizations, to which we now turn.

## INTERNATIONAL INSTITUTIONS

Information, uncertainty, and beliefs are important explanatory variables in the analysis of international interaction. Some of the work summarized above refers indirectly to issues of uncertainty, for example, in asking whether policymakers share the same model of monetary policy or in emphasizing transaction costs. However, few of these studies directly address the degree of uncertainty or the role of beliefs in explaining patterns of cooperation, while uncertainty is central to the study of domestic-international interaction. A body of literature that has concentrated directly on informational issues is that on international institutions. The rationale for the existence and influence of institutions at the international level is driven almost entirely by informational considerations. In a world of complete information, according to most current arguments, states would not demand institutions and institutions would have no impact on

outcomes. However, once we consider the myriad uncertainties that states confront, a potentially powerful role for institutions emerges.

The turn toward taking international institutions seriously can be traced to a collective project on international regimes (Krasner 1983) and to Robert Keohane's analysis of how institutions could facilitate the maintenance of patterns of cooperation "after hegemony" (1984). As Keohane's title suggests, much of the early work on institutions developed in reaction to the predictions of early hegemonic stability theory that international developed in reaction to the predictions of early hegemonic stability theory that international economic cooperation should plummet as U.S. power declined in the 1970s. However, in many areas of the international economy, cooperation appeared to be stable or to increase. At the same time, the international economy had become more highly institutionalized, and organizations such as the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) had gained prominence. Perhaps these two trends were related, and international institutions accounted for the persistence of cooperation.

The modern analysis of international institutions begins with simple assumptions. As a first cut, states are treated as unitary actors; domestic politics have barely begun to be integrated into the models. These states are assumed to confront generic collective action problems. They may take the form of Prisoner's Dilemma-type games, where cooperation would benefit all, but each has an incentive to renege if it could do so undetected or without punishment. They may take the form of coordination or bargaining problems, where the difficulty is to choose a particular equilibrium in a situation in which the states disagree on which outcome they prefer (Martin 1992b). It is also possible for these problems to coexist; states may face a bargaining problem followed by an enforcement problem. In a world of no transaction costs, states could solve these dilemmas to reach Pareto-superior outcomes. However, actual problems of incomplete information, such as costs of bargaining and monitoring, can prevent their resolution, leaving all states worse off. International institutions can perform information provision functions that allow states to overcome collective action problems and therefore have an impact on patterns of behavior, even if these institutions do not regulate, enforce, or otherwise take on the characteristics associated with strong institutions on the domestic level.

This insight has led to a large body of theoretical and empirical literature on international institutions, both in IPE and international security (see Martin and Simmons 1998 for a review). Much of the empirical work has been plausibility probes—tests to see whether cases exist in which institutions perform the functions identified, and are associated with higher levels of international cooperation. Much of the early empirical work on institutions took the form of single case studies, and thus suffered from selection bias and difficulties in determining the causal impact of institutions. The latter is especially troubling in the study of institutions, since

they are obviously endogenous: states choose and create institutions when they see a demand for them. Endogeneity makes the process of isolating the causal influence of institutions on outcomes difficult. One way in which this problem can be mitigated is to examine a large number of cases and to control for alternative explanations for both cooperative outcomes and the involvement of institutions. This has been done in the study of economic sanctions, for example, and institutions are found to have a substantively and statistically significant impact on levels of cooperation (Martin 1992a).

While theories of international institutions have grown more sophisticated over time, empirical work on the effect of institutions in IPE has been limited. It has been more evident in security issues (Duffield 1995; Wallander 1999) and environmental affairs (Keohane and Levy 1996). Recent years have not seen many focused studies of specific economic institutions. One obvious exception is the literature on the European Union. However, little of this literature adopts a particularly institutionalist perspective on the EU (despite the term *institutionalists* being tossed into some theoretical labels) or takes the factors identified as central to institutionalist theories seriously.<sup>18</sup> Application of institutionalist theories to economic institutions thus appears to offer another promising, highly productive avenue for existing research. Basic theoretical precepts are in place, but they need to be adapted to the complexities and context of specific institutions and issues.<sup>19</sup> The scope for careful empirical work is enormous. For example, Beth Simmons's study of the legalization of international monetary affairs combines the theoretical insights of institutionalism with careful empirical work to show that concerns of commitment and reputation help explain states' decisions to create and comply with the rules of the IMF (Simmons 2000).

One of the few sustained studies of a particular economic institution looks at the International Coffee Agreement (ICA) (Bates 1997). As with most international agreements relating to the regulation of the production of commodities, the ICA can be understood as a cartel. However, the history of the coffee agreement shows that the actions of intermediaries—the roasters—and major consumers—the United States—have a significant effect on the ability of producers to limit supplies and so keep prices high. The ability to maintain the cartel, and U.S. willingness to support it, depends on security and other political factors as much as economic considerations. From an institutionalist perspective, one of the most-interesting findings is that specific agreements reached within the ICA, for example, about the distribution of production quotas, were typically implemented

<sup>18</sup> For one exception, see Andrew Moravcsik's work (1999) on the role of supranational entrepreneurs in the EU.

<sup>19</sup> Economists have also begun to elaborate theories of international economic institutions. See Bagwell and Staiger 1999; Maggi 1999.

and had measurable effects on the price of coffee, indicating a causal impact of institutions on cooperation. One could imagine similar analyses being carried out on other commodity arrangements, integrating more systematically the variables identified by institutionalist theories.

Multilateral trade organizations have received more empirical attention than most economic institutions. Much of this attention has been focused on the dispute resolution mechanisms of GATT and WTO. The analytical framework for studying international institutions draws our attention to their ability to provide information about standards and state behavior. These functions enhance the value of having a reputation for living up to international agreements and allow decentralized enforcement of cooperative agreements to take place. The framework naturally leads us to focus on dispute resolution characteristics of institutions. Empirically, this work has been particularly interesting in the GATT and WTO context, as dispute resolution has been highly formalized (Goldstein and Martin 2000). Institutional analyses of GATT dispute resolution ask about the conditions under which states turn to GATT to resolve disputes (Busch 2000) and the factors that determine the outcome of GATT disputes (E. Reinhardt 1999). Outside GATT, James McCall Smith has explored the variation in formality of dispute settlement provisions in regional trade agreements (J. Smith 2000). Given the trend of other work on international cooperation discussed above, it is perhaps not surprising that empirical studies of GATT dispute resolution emphasize the importance of domestic factors, such as trade dependence and democracy, in determining outcomes. While our analytical framework begins with the simplifying assumption that states can be treated as unitary actors, it is inevitable that analysts begin to integrate domestic politics in a systematic manner into this framework. This move brings us back to our starting point, theories that concentrate on the interaction between domestic and international politics. But the development of such attempts to integrate domestic and international factors can now build on well-developed approaches to international strategic interaction.

In some ways, the empirical research agenda for international factors resembles that discussed above for domestic sources of policy. Work on trade issues is the most advanced, matched closely by that on monetary issues. However, empirical work at the international level differs in that much of it has been focused on broad concepts such as cooperation or stability. While useful, this focus has sometimes distracted from in-depth attention to specific issue areas and particular institutions. The potential for future research seems particularly promising, as we explore the functioning of specific economic institutions in much more detail and compare institutionalized interaction to interaction without the structuring effects of institutions. Doing so will, in part, require a turn away from broad synthesizing concepts to a focus on more concrete variation in state behavior,

such as patterns of trade and investment flows and specific policy decisions. It will also allow us to feed this work back to the challenging attempt to integrate domestic and international analyses.

## Conclusions

The study of international political economy has made great advances in twenty-five years. After a period of internecine paradigmatic conflict, most scholars in the field have accepted a general, positivist approach to investigating issues in the politics of international economics. The subdiscipline has moved strongly in a direction in which new work builds self-consciously on, rather than firing broadsides against, existing work and in which abstract theoretical work complements empirical scholarship.

The study of IPE requires an understanding of how domestic and international factors interact, and this issue represents the current research frontier. However, understanding interaction requires solid building blocks on both the domestic and international levels. Thus, the investigation of an issue in IPE typically involves a series of interrelated and mutually complementary considerations. Scholars identify the socioeconomic interests at stake, how groups are organized, and how organized and general interests express themselves in the context of domestic electoral, legislative, and bureaucratic institutions. On this basis, other work focuses on the interaction of states at the international level, emphasizing especially the impact of the informational environment and the strategic setting on relations among states. The creation and operation of international institutions is a particularly important component of these international interactions.

While the general method of analysis is well established and widely accepted, this hardly means that IPE has exhausted its potential. In fact, it is surprising how narrow the range of analytical and empirical problems that existing scholarship has tackled in earnest is. Trade policy in the United States, the EMU in Europe, and a few international institutions have been studied in some detail; but almost every other area of IPE is wide open for investigation. It may be that a great deal of theoretical, analytical, and methodological brush needed to be cleared before scholars could give these issues as much attention as they warrant. If so, the academic study of IPE has virtually limitless opportunities to demonstrate the effectiveness and appropriateness of its theoretical and empirical tools.

We have identified both theoretical and empirical areas in need of further research. Theoretically, we see the most important frontier as the integration of the domestic and international levels of analysis. Some promising frameworks have been developed, but this work is in its infancy. We also see scope for applying existing frameworks to a wide variety of understudied empirical issues. Probably the best-studied area of IPE is trade,

followed closely by monetary issues. Financial issues, including international investment of various types, receive little attention in the current literature. Likewise, theoretical work on international institutions has far outstripped the quantity and quality of empirical work. As international organizations such as the WTO, IMF, and potential investment agreements are the focus of sustained political attention and at the forefront of debates about globalization, applying the analytical tools of IPE more seriously to these institutions is likely to be both important and fruitful.