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

John Gerard Ruggie

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

Despite their differences, Carr and Polanyi reached similar conclusions about the future of the world economy. Both believed they had witnessed, in Polanyi's words, 'the passing of capitalist internationalism'; or, as Carr depicted it, the 'abnormal, *laissez-faire* interlude of the nineteenth century'.[2] Further, both felt that the drive to reimpose social and political imperatives on the self-regulating market, which had swept the industrialised countries in the 1930s, would be extended into the international arena after the war. 'Internationally', Carr felt, 'the consequences of absolute *laissez-faire* are as fantastic and as unacceptable as are the consequences of *laissez-faire* within the state'.[3] Polanyi concurred that '[o]ut of the ruins of the Old World, the cornerstones of the New can be seen to emerge: economic collaboration of governments *and* the liberty to organize national life at will'.[4]

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1. E.H. Carr, *The Twenty Years' Crisis, 1919-1939: An Introduction to the Study of International Relations*, Second Edition (New York, NY: Harper & Row, 1964, First Edition 1939), and Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston, MA: Beacon Books, 1944, reprinted 1957).
2. Polanyi and Carr, both *op. cit.*, in note 1, pp. 248 and 116 respectively.
3. Carr, *op. cit.*, in note 1, p. 121.
4. Polanyi, *op. cit.*, in note 1, pp. 253-54, emphasis in original.

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

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

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

~. Joh~ **Ge.rard Ruggie, 'International Regimes,** Transactions, ~d **Change: E'mbedded** Liberalism **In the Postwar** Econom~c **Order',** ***InternationalOrganizatipn0!ol.*** **36, No.2, , 1982),** p~. **379-415: See also** Ruggie, **'Embedded Liberalism Revisited: Institutions and Progress In** Inte~ahonal **Economic. Relations' ~ in Emanuel Adler and Beverly Crawford** (eds.), ***Progress In Postwar*** *Iruemational Relations* **(New York, NY: Columbia University** Press, 1991.),pp. 201-34.

Contested Domestic Domains

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

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

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6. Two works that readily come to mind are Edward Chamberlin, *The Theory of Monopolistic Competition* (Cambridge, MA: Harvard University Press, 1929), and Joan Robinson, *The Economics of Imperfect Competition* (London: Macmillan, 1931).
7. Articles 47 through 52, as well as Article 54, further defined the salient terms and specified the remedies available under the ITO. Article 53 made special provisions for handling restrictive practices in traded services. The full text is reprinted in Clair Wilcox, *A Charter for World Trade* (New York, NY: Macmillan, 1949), pp. 281-87.
8. These words were taken almost verbatim from the ITO Charter, which the Soviets had a hand in drafting. See Jacob Viner, 'Conflicts of Principle in Drafting a Trade Charter', *Foreign Affairs* (Vol. 25, No. 4, 1947), pp. 612-28, and Herbert Feis, 'The Conflict Over Trade Ideologies', *Foreign Affairs* (Vol. 25, No. 2, 1947), pp. 217-28.
9. Richard Blackhurst, 'The Twilight of Domestic Economic Policies', *The World Economy* (Vol. 4, No. 4, 1981), pp. 357-74.

> barring either a major retreat into protectionism such as occurred in the 1930s or a massive reduction in the level of government intervention in the economy, the reclassification will continue into the foreseeable future, aiming towards an end point where few economic policies of any consequence will be considered primarily domestic."

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

Domestic Structures

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

. 10. *Ibid.,* p. 363. , .

11. Patricia Kalla, 'The GAIT Dispute Settlement Procedure in the 1980s: Where Do'We Go from .Here?', *-1?ickinson Journal of International La~* (Vol. -5, No.1, 1986), p. 95.

12. SY~Vla.Ostry, Beyond the Border: .The New. International **Policy Arena', in** *Strategic Industries **In a Global Economy*** **(Pans:** Organization **for Economic Cooperation 'and** Development, 1991), pp. 83-84. .

13. *Ibid.;* p. 84.

14. *Ibid.,* pp. 87-89.

The deepest difference on each of these policy dimensions lies between Japan and the other two. The Japan case makes clear that a narrow focus on specific policies alone, as Ostry recommends, is simply not practical. Among the factors that have been identified as shaping Japan's trade and investment posture are its labour market, capital markets, and systems of ownership, production, and distribution; the economic role of the state; and, indeed, the nature of its electoral system.[15] Scholars disagree on whether differences in domestic economic structures are declining, as liberal economists tend to believe, or are more enduring features of Japanese society.[16] Alas, policy-makers elsewhere lack the luxury of waiting to find out who is right.

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

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

Second, by their nature, fairness claims call for unilateral concessions on the part of the accused party: '[t]o say that certain conduct is unfair is to say that the

15. This expansive view is held not only by the so-called 'revisionists', but also by Japanese analysts and relatively dispassionate US observers. See Chalmers Johnson, 'The Japanese Political Economy: A Crisis in Theory', *Ethics & International Affairs* (Vol. 2, 1988), pp. 79-97; Shigeto Tsuru, *Japan's Capitalism: Creative Defeat and Beyond* (Cambridge: Cambridge University Press, 1993); Daniel I. Okimoto, *Between MITI and the Market: Japanese Industrial Policy for High Technology* (Stanford, CA: Stanford University Press, 1989); and Dennis J. Encarnation, *Rivals Beyond Trade: America Versus Japan in Global Competition* (Ithaca, NY: Cornell University Press, 1992). On the nature of the electoral system as it affects Japan's multilateral commitments, see Peter F. Cowhey, 'Elect Locally—Order Globally: Domestic Politics and Multilateral Cooperation', in John Gerard Ruggie (ed.), *Multilateralism Matters: The Theory and Praxis of an Institutional Form* (New York, NY: Columbia University Press, 1993), pp. 157-200.

16. The two positions are illustrated, respectively, by Jagdish N. Bhagwati, *The World Trading System at Risk* (Princeton, NY: Princeton University Press, 1991), pp. 24-44, and Kozo Yamamura, 'Will Japan's Economic Structure Change? Confessions of a Former Optimist', in Yamamura (ed.), *Japan's Economic Structure: Should It Change?* (Seattle, WA: Society for Japanese Studies, University of Washington, 1990), pp. 13-64.

17. Robert E. Hudec, '"Mirror, Mirror, on the Wall": The Concept of Fairness in United States Trade Policy', paper presented at the 'Roundtable on Fair Trade, Harmonization, Level Playing Fields and the World Trading System: Economic, Political and International Legal Questions for the 1990s', Columbia University, 10 January 1992, p. 1.

guilty party must correct it for that reason ·alone'." As Ryutaro Komiya and Motoshige Itoh characterise US demands regarding those Japanese trade practices which it deems to be unfair: '[u]sually trade negotiations between two countries take the form of give-and-take, but in these negotiations, which have been going on almost continuously since 1976, the subject matter has been simply how much and how soon Japan would make concessions, with the United States offering little if anything in exchange'." In contrast, GAIT processes, and presumably corresponding processes in the WTO, rest on mutual concessions as the basis for agreement, unless specific legal obligations can be shown to have been violated. When it comes to fairness claims, therefore, the GAIT and WTO are in the . . impossible position of having to cope with structural asymmetries by means of symmetrical accommodation.

Third, if policy harmonisation were to become the preferred vehicle for dealing with the international effects of domestic policies and arrangements, questions such' as these would arise immediately: harmonisation to whose standard? Who decides whose standard will become the norm, and how? In addition, the slippery slope of policy harmonisation is steep, as indicated by the 240 items raised by the United States in the US-Japan Structural Impediments Initiative talks." Fourth, and finally, unilateral measures can become the instrument of choice to achieve, for instance, market access abroad, as has often been the case for the United States in relation to Japan. When these measures are generalised across multiple issues and numerous countries, the likelihood of retaliation and cycles of escalation can only grow.

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

. In short, the premise that differences in domestic economic structures and practices could be ignored in organising the intemationaltrade regime no longer holds. Intrinsically, the issue hils little to do with protectionism, although,. of course, it is susceptible to capture by protectionist forces. It has everything to do **With the growing irrelevance of the traditional' distinction between" 'internal'. and**

18. *Ibid.* ..: .. .

19. Ryuta~oKomiya a!1dMojoshige Itoh, .'Japan's.Intemational Trade and Trade Policy, 1955-1984 , in Takashi Inogllcbl andDaniel L.Okimoto (eds.), *The Political Economy of Japan, VolumeIl: The Changing International Context(Stanford,* CA: Stariford University Press, 1988), p. 203. ..

(~OA~;~~~§O~; ~Ity,'Deal OpensJapan Market to US Satellites', *Chicago Tribune*

21. Se~ ~ditor}al. 'Expp.rting La?or Standards', *Washington Post* (I0 April1994);'p. C-6'; Alan Riding, Gore InSISts Envircnrrient is a Trade Issue'" v k T· . (15 A il 1994) P. D-s l ; and Willi-l lam D roz diak, fHi lak, Historic Trade P S' *Hew* d *t or Imes* .pn PerSISt', *Washington Post* (16 April 1994), p. A-l2. act ignec, But Global Tensions

'external' policy domains-or the contestation of where, precisely, the one ends and the other begins. There are no simple solutions to the policy problems posed by this transformation. Blackhurst recommends' that governments adopt new multilateral rules to defend themselves from pressures originating at home no less than abroad:

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

However, the process will be more difficult than Blackhurst supposed. As Peter Cowhey and Jonathan Aronson have suggested, even narrowly construed commercial policy requires a subtle but significant shift, away from trade *per se,* towards both formal and informal conditions governing market access." Moreover, because non-border policy measures are in the hands of a variety of domestic agencies other than trade ministries, the international trade policy, process will increasingly involve international agencies in addition to WTO. Finally, the inclusion of environmental and labour standards entangles trade relations in very intimate domains of domestic social policy.

Intangibles

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

22. Blackhurst, *op. ctt.,* **in note 9, p. 369, emphasis in original.**
23. Peter F. Cowhey and Jonathan D. Aronson, ***Managing t~e World J!.conomy:. The Consequences of Corporate Alliances*** **(New York, NY: Council on** Foreign Rel~ttons. 1993), Chapter 8.
24. William J. Drake and Kalypso Nicolaidis, **<Ideas, Interests, and Institutionalization: "Trade in Services" and the Uruguay Round',** ***International Organization*** **(Vol. 46, No. 1,** 1992), p. 37 and n. I.

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

Essentially, the GATS consists of a set of general principles, a number of special conditions or exceptions, and Initial liberalisation .commitments." Traded services generally are to be governed by the classical GAIT principles of nondiscrimination and transparency of domestic rules and regulations, but countries have the right to exclude specific services from the principles of national treatment and the right of market access. Safeguard provisions are included and mechanisms for dispute settlement provided for. In short, trade in .services will be brought under the GAITfWTO umbrella, with an ultimate balance of obligations between domestic and international objectives which is more qualified than for merchandise trade, and also more individualised.

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

. First, because the concept of services has no well-established place in economic theory, its definition tends to be *ad hoc* and arbitrary: intangible activities not included in agriculture, mining, and manufacturing: Attempts to

25. *Ibid.,* p. 45.

26. ~or a brief summary, .see 'Nothing to Lose but its Chains: A Survey of World Trade, *The Economist* (22 September 1990).

,27. S~e I?rake and Ni~olaidis, *0J? ci~.* in note 24, and John M, Curtis and Robert Wolfe, Nothing 15 Agn;e~ until Everything IS Agreed: First Thoughts on the Implications of the Urugu~y Round, In Maure~n Appel Molotand Harald von Riekhoff (eds.),,A *Part a/the* ~8~ce. *Canada Among Nations* 1994 (Ottawa: Carleton University Press, 1994), pp. 101-

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

Second, governments typically regulate domestic service industries more rigorously than other economic activities. Entry into many services, such as .medicine, **law, or accounting is strictly licensed. Governments often still reserve** the right to approve utilities prices, which in many places still include transportation and telecommunications. Financial institutions, such as banks, insurance firms, and securities traders are subject to prudential supervision. Finally, in many countries, the state still owns outright certain service industries. Most of'these regulatory objectives and instruments were not designed with trade .in mind. Where they apply, the principles of nondiscrimination, transparency, and national treatment should moderate somewhat the impact of differences in national regulatory environments, but they will not eliminate the problem.

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

Finally, one suspects that services-related conflicts will be higher in the Asia-Pacific region, particularly *vis-a-vis* Japan, than elsewhere among the **industrialised countries. Regulatory environments are more opaque, inviting the'**

28. See Jagdish N. Bhagwati, **'Trade. in Services and the Multinational Trade** Negotiations', *World Bank Economic Re~lew* (Vol. I, *No.4*, \987), pp. 549-69.
29. 'A Gatt for Services', *The Economist* (12 October 1985), p. 20.
. 30 Drake and Nicolaidis, *op. cu.*, ID note 24, p. 38.

imputation of worst-case motivations, and if past experience from the difficulties encountered in the areas of direct foreign investment and patent protection is any guide, then in Japan, at any rate, the efficacy of multilateral solutions may prove elusive and generate as many bilateral disputes as they resolve.[31]

In conclusion, the post-war trade regime was intended to achieve and maintain a sustainable balance between the internal and external policy objectives of governments, in keeping with the embedded liberalism compromise. It was not designed to restructure domestic institutional arrangements. Yet, domestic restructuring is what the trade policy agenda increasingly has come to be about. Highly politicised trade policy disputes and potential instability in trade relations appear to be the virtually inevitable consequence of successful liberalisation.

Globalisation

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

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

Most international economists have devoted little attention to these organisational forms because institutional economics is not much in vogue among

31. See Encarnation, *op. cit.*, in note 15, *passim.*

32. Milton Friedman, 'Internationalization of the U.S. Economy', *Fraser Forum* (February 1989), p. 10.

33. *Ibid.* Kenneth Waltz made a similar case in a controversial paper a quarter of a century ago, using as his measures of internationalization: (1) the size of the external sector of the major economic powers relative to their domestic economies, and (2) the degree of intersectoral specialization in their trade. See Kenneth N. Waltz, 'The Myth of National Interdependence', in Charles P. Kindleberger (ed.), *The International Corporation* (Cambridge, MA: MIT Press, 1970), pp. 205-23. With intra-sectoral trade flows dominating among the major economies, the second part of Waltz's definition is a truism. The first is less the case today than it was in 1970, but more importantly it is also less relevant, for reasons I will discuss presently.

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

Markets

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

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

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

34. The standard conceptual works are Oliver E. Williamson, *Markets and Hierarchies* (New York, NY: Free Press, 1975), and Walter W. Powell, 'Neither Market Nor Hierarchy: Network Forms of Organization', *Researchin Organizational Behaviour* (Vol. 12, 1990), pp. 295-336. For a suggestive application of these concepts to the evolution of international corporate strategies and structures, see Stephen J. Kobrin, 'Beyond Geography: Inter-Firm Networks and the Structural Integration of the Global Economy' (Philadelphia, PA: William H. Wurster Centre for International Management Studies, Wharton School, University of Pennsylvania, Working Paper 93-10, November 1993).
35. John M. Stopford and Susan Strange, *Rival States, Rival Firms: Competition for World Market Shares* (Cambridge: Cambridge University Press, 1991), p. 40.

in scope the effectiveness of traditional instruments of economic policy is often greatly reduced or even nullified'."

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

Hierarchies

The rate of increase in international production-that is, production by multinational enterprises outside their home countries-began to exceed the rate of increase in world trade in the 1960s. Sometime in the 1980s, the actual volume of international production began to exceed trade flows. Today, the worldwide sales of multinational firms, at $5.5 trillion, is only slightly less than the entire US Gross Domestic Product (GDP). Multinationals based in the United States play a major role in international production: their revenues from manufacturing abroad are now twice their export earnings."

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

"36. Richard N. Cooper, *Economic Policy in an Interdependent World* (Cambridge. MA: MIT Press, 1986), p_ 96. A senior executive of Gillette, a major multinational consumer products finn, gives. concrete expression to this generalization: '[i]n the' long. run ... curren~y fl~ctu~tIons, up and down, don't mean a whit in the decision where to m~ufacture " CIted In Louis Uchitelle, 'U.S. Corporations Expanding Abroad at a QUlc~er Pace, *New York Times* (25 July 1994), p. D-2.

37. The Discreet Charm of the Multicultural Multinational', *The &onomist* (30 July 1994), p. 65-66.

38. J: Steven Landefeld; qbie G. Whichard, and Jeffrey H. Lowe, 'Alternative Frameworks for U.S. International Transactions', *Survey of Current Business* (Vol. 73, No. 12,1993), pp. 50-61.

39. Japanese ~ultinationals exhibit" a.more pronounced tendency-to import from home-c~mntry suppliers rathe~ than purchasing locally, thereby adding fuel to US-Japan trade dlsput;S. See Encarn~t~on, *op. ,cll.,* ııı note 15; Mordechai E. Kreinin, 'How Closed is Japan s Market? .Additional EVidence', *The World Economy* (Vol. 11, No.4, 1988), pp. 529-42, and United ~atlons Centre. on Transnational Corporations, *World Investment Report*, 1991:. *The Triad in Foreign Direct Investment* (New York, NY' United Nations 1991).

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

As a result of this transformation, the template—the mental picture of the economic world—on the basis of which post-war economic policy-making and the international economic regimes were conceived, has been rendered obsolete. In that picture, production was national, and countries were linked into an international division of labour by arm's length trade, portfolio investment, and direct investment in raw materials sectors or to secure local market access. Today, in significant measure the international division of labour is becoming *internalised* at the level of firms. Integrated administrative structures that span the globe increasingly manage the design, production, and exchange of parts, components, and finished products; the allocation of strategic resources, including funds and skills; and the synoptic plans that rationalise these processes, including their location, for success in a competitive environment that is itself increasingly global. In short, for virtually every major industry, whether manufactures or services, the primary mode for the international organisation of economic transactions has shifted away from reliance on international markets towards global administrative hierarchies.[42] Thus, even as borders everywhere have become more open, in this specifically institutional sense, global production and exchange may be said to have become more 'closed'. Even though states are actively involved in bargaining with firms about conditions of access, for example, nowhere is economic policy-making remotely equipped to deal with the systemic policy consequences of this shift.

One direct consequence is the growth of intra-firm trade: trade among subsidiaries or otherwise related parties. At the moment, few official and uniform intra-firm trade statistics are collected. Episodic studies show that it is growing at a rate considerably more rapid than conventional trade, and they indicate that intra-firm trade is far less sensitive than conventional trade to such policy

40. Stephen J. Kobrin, 'An Empirical Analysis of the Determinants of Global Integration', *Strategic Management Journal* (Vol. 12, 1991), p. 20.
41. Joseph Grunwald and Kenneth Flamm, *The Global Factory: Foreign Assembly in International Trade* (Washington, DC: The Brookings Institution, 1985).
42. Kobrin's work is particularly helpful in conceptualizing this transformation. See, Kobrin, *op. cit.*, in notes 34 and 40. For a critical account of its consequences, in the industrialized countries as well as the third world, see Richard J. Barnet and John Cavanagh, *Global Dreams: Imperial Corporations and the New World Order* (New York, NY: Simon & Schuster, 1994).

instruments as exchange rates.[43] Other policy-related concerns include transfer pricing for the purposes of cross-subsidisation and to minimise tax obligations.

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

Finally, this institutional transformation challenges what was perhaps the central relationship in the entire post-war American political economy. As Cowhey and Aronson depict its prevailing model of industrial organisation, the federal government assumed that its primary role was to manage levels of consumer spending, provide R&D funding, and otherwise help socialise the costs of technological innovation via military procurement and civilian science programs. The major US companies would take it from there.[47] Today, it is getting harder to determine not only whether something is a US product, as Reich observes, but more importantly, whether the legal designation, 'an American corporation', describes the same economic entity, with the same consequences for domestic employment and economic growth, that it did in the 1950s and 1960s.[48] The NAFTA debate about how many US jobs would be lost

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43. See Janè Sneddon Little, 'Intra-Firm Trade: An Update', *New England Economic Review* (May/June 1987), pp. 46-51; Mark Cassons, *Multinationals and World Trade* (London: Allen and Unwin, 1986); and the earlier but still useful study by Gerald C. Helleiner, *Intra-Firm Trade and the Developing Countries* (London: Macmillan, 1981).

44. Robert Reich, *The Work of Nations* (New York, NY: Knopf, 1991), Chapter 25.

45. The case involved Brothers Industries Ltd., a Japanese concern assembling typewriters in Bartlett, Tennessee; and Smith Corona, a US concern doing the same off-shore. Adding another element of complexity, Hanson PLC., a British group, owned 48 per cent of Smith Corona. See Robert Reich, 'Dumpsters', *The New Republic* (10 June 1991), p. 9; and David E. Sanger, 'A Twist in Fair Trade Case: Japanese Charge a U.S. Rival', *New York Times* (12 August 1991), p. D-1. Sanger's story also recounts that Chrysler almost inadvertently filed an ITC claim against *itself* when it charged Japanese firms with dumping minivans in the US market—one of the vehicles covered by the definition was made for Chrysler by Mitsubishi. The Brothers request was subsequently denied, the ITC concluding that the firm was not enough of a domestic producer to claim injury.

46. Andrew Pollack, 'Technology Without Borders Raises Big Questions for US', *New York Times* (1 January 1992), p. 1.

47. Cowhey and Aronson, *op. cit.*, in note 23, pp. 16-17.

48. Reich points out that of the $20,000 an American consumer paid in 1991 for a Pontiac Le Mans, about $6,000 went to South Korea for parts and operations, $3,500 to Japan, $1,500 to Germany, and an additional $1,400 to various suppliers of products and services in these and other countries. Less than $8,000 of the total was paid for goods and services that were produced in the United States. See Reich, *op. cit.*, in note 44, p. 113.

or gained made it clear how little is known about the links between transnationalised production and trade policy, on the one hand, and domestic employment and economic growth, on the other. It also demonstrated that previous premises about the nature of economic entities and relationships no longer fully capture essential features of the US political economy.

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

Networks

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

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

In addition, the sheer size of investments and magnitudes of risks in many rapidly changing areas of high technology are increasingly beyond the capacity of even the largest firms, driving them to establish alliances.[51]

Paraphrasing Walter Powell's typology, networks are a collaborative form of organisation, based on complementary strengths, characterised by relational modes of interaction, exhibiting interdependent preferences, stressing mutual benefits, and bonded by considerations of reputation. The field of strategic

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49. See Powell, *op. cit.*, in note 34, and Kobrin, *op. cit.*, in note 34. The most extensive discussion to date of the policy implications of strategic alliances is Cowhey and Aronson, *op. cit.*, in note 23.
50. Powell, *op. cit.*, in note 34, p. 304.
51. Kobrin, *op. cit.*, in note 34, stresses this particular causal factor.

alliances is dominated by technology-intensive industries, such as semi-conductors, telecommunications, commercial aircraft, and automobiles. Themajor home bases of firms entering into alliances are the United States, the European Union (especially Germany), Japan, and Korea. Finally, Powell suggests that, as the globally integrated finn is discovering strategic alliances at the high end of R&D and in some instances production, it is also rediscovering the market at the low end of standardised components" ,

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

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

Welfare Capitalism

In the autumn of 1993,'the editors of the *Economist* thought they had detected, and vigorously applauded, a new grand economic strategy on the part of the Clinton administration. This purported to offer Americans what the journal described as a 'new deal': 'lilts outlines are simple: you accept change (such as the North American Free Trade Agreement) and we'll help to give you [occupational, health care, and personal] security'." The *Financial Times* later that year, even while editorially basking in 'the most capitalist Christmas in history', reflected on the pressing need for a new deal for the entire capitalist world:

52,_Powell, *op. cit.,* in note 34." ..,',

53. *The ,Economist, op. cit.,* in note 37, p. 66, and ~Doesit Matter Where You Are?' *The Economist* (30 July 1994), p. 13.

54. ~owhey and Arons~n., *op. cit.,* in note 23, Chapters '8-10.

55. In Search of Security. *The Economist* (16 October 1993), p. 25.

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

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

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

In Western Europe, the social safety net has held up more firmly than in the United States, but at the cost of eroding competitiveness and an anaemic rate of job creation. Production costs are among the highest in the world, thanks to generous benefits and high payroll taxes, and the work force is immobile and inflexible. As a result, unemployment is at a post-war high, averaging eleven

56. 'Capitalism at Christmas', *Financial Times* (24 December 1993), p. 6.
57. OECD, *The Future of Social Protection* (Paris: Organization for Economic Cooperation and Development, 1988), Table 1, p. 10.
58. As the senior economist of the National Association of Manufacturers—which is not usually closely allied with labour—recently stated: '[t]here are large numbers of temporary, part-time and contract workers out there who are counted as employed but are in reality competing for permanent jobs'. Cited in Louis Uchitelle, 'A Matter of Timing—Debate on the Fed's Latest Rate Increase Focuses on Capacity and Wage Demands', *New York Times* (18 August 1994), p. D-16.

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59. William Drozdiak, 'New Global Markets Mean Grim Trade-Offs: Europe's Welfare Benefits ~aQ.~ in Balance', *Washington Post* (8 August 1994), p. A-I. ,

60. See Ferdinand Protzman, <Rewriting the Contract for Germany's Vaunted Workers', *New York Times* (13 February 1994), p. E-5; and 'Europe and the Underclass', *The Econom,s!* (30 July 1994), pp. 21-23; and Steve Call, 'Economic Change; Social Upheaval, *Washington Post* (7 August 1994), p. A-I. .

,61. .Paul, McCracken., 'Costlier Labor, Fewer Jobs, Unemployment-The Crisis Contu~ues! *Wall Street Journal* (7 January 1994), p, A-lO.

62: Cited ııı Frank Swoboda, 'Reich Targets Several Job Programs' *WashingtonPost(28* January 1994), p.A-!. ."" "' .

63..Cited in Geoffrey York.v'Grits Vow Radical Social Reform' (Toronto) *Globe and Mall* (I February 1994), p. A-7. •

64. Ci;ted i,n 'Mr. Clarke's Ma~ifesto'l Editorial, *Financial Times* (5 May 1994), p. 17.

65. Cited ııı EJ. DIOnne, Jr., Europe's Preoccupation', *Washington Post* (11 January 1994), p. A-I!.

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

Conclusion

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

Constructing a contemporary analogue to the embedded liberalism compromise will be a Herculean task. Last time around, the most decisive negotiations took **place, in essence, between two countries, the United States and Britain. This** time, partly because of the diffusion of economic power but also due to the nature of the issues themselves, the relevant parties must include all leading **capitalist nations, in many instances the newly industrialising countries, and in some cases, members of the poorer developing world. What is more, last time** around there was widespread consensus about what needed to be done and how to do it in the professional circles on which policy-makers drew-in the relevant 'epistemic communities', as I have called them elsewhere." Today, it is more appropriate to speak of epistemic disarray in the community of scholars and policy analysts: Finally, the overall international geostrategic situation is very different today, requiring more precise and balanced *quids-pro-quos* in international economic relations.

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

John Gerard Ruggie is Dean of the School of International and Public Affairs at Columbia University, New York

66. Joh~ Gerard Ru~gie! 'International Responses to Technology: Concepts and Trends', *International Organization* 0101. 29, No.3, 1975), pp. 569-70. For an application to the post-war econonuc negotiations, see q. John Ikenberry, 'A World Economy Restored: Expert Consensus and the Anglo-Amencan Settlement'. *International Organization* (Vol. 46, No. I, Wmter 1992), pp. 289-321.