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Lawrence B. Krause
Editors

WORLD POLITICS AND INTERNATIONAL ECONOMICS

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Section I

International economics and international politics: a framework for analysis

C. Fred Bergsten, Robert O. Keohane, and Joseph S. Nye

Until August 1971, the United States categorically rejected any notion of devaluing the dollar and championed an international monetary system based on fixed but adjustable exchange rates. From August 1971 through February 1973, the United States aggressively sought massive devaluation of the dollar, and since early 1973, it has actively promoted the adoption of highly flexible exchange rates.

From 1962 until November 1967, the British government borrowed billions of dollars and adopted dozens of policy measures to avoid devaluing sterling. In June 1972, the British government floated sterling–to a sure depreciation–after just two days of speculative attack on the currency.

Until late 1971, Japan adamantly refused to consider revaluation of the yen and adopted numerous policy measures to avoid it. In 1973, Japan sold at least $6 billion from its reserves to keep the yen from depreciating back toward its earlier level.

Since the early 1960s, the United States pressed Europe and Japan to lower their barriers to US agricultural exports. In June 1973, the United States totally embargoed its exports to Europe and Japan (and everywhere else) of some of those very same agricultural products.

In the early 1960s, Brazil and other producing countries pleaded with consuming countries to negotiate the International Coffee Agreement to keep coffee prices from declining. By the middle 1970s, those coffee producers let the agreement lapse because they felt sufficiently strong to force prices up on their own.

What were the objectives of these international economic policies of some of the leading countries in the world economy? Did these objectives change as dramatically, over both longer and shorter periods of time, as appears to be the

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case? If so, was this because the countries' preferences changed? Or because the nature of the problem they faced changed? Or because their power to achieve ends they had sought all along changed? Or because they were forced to alter their views by other countries or by nonnational actors such as transnational enterprises? Or were the objectives relatively constant, with the changes only in the means used to pursue desired outcomes?

Indeed, why did the international order that had effectively structured world economic relationships for the first postwar generation begin to collapse in the late 1960s and early 1970s? Did it no longer address the issues most critical to its member countries? Did it no longer comport with the world economic environment it sought to order? Did it no longer accurately reflect the constellation of national power that must underpin any international system?

This volume seeks to answer such questions, and, in doing so, assist in the construction of a new international economic order. This introductory essay presents a conceptual framework for such analysis, and it examines the relationship between international economic policies and international politics more generally, discusses postwar United States predominance and its partial decline, and analyzes the economic goals sought by governments in international relations. Governmental economic policies and transnational behavior do not take place in a vacuum; the political order strongly affects national decisions about economic goals and the leeway given to transnational actors. It is appropriate, therefore, to begin with an analysis of the impact of world politics on the international economic order, rather than, as is too often done, introducing politics merely as a constraint on the attainment of independently determined economic goals.

The international political context of world economics

Politics and economics in the contemporary system

Politics and economics are interwoven strands in the fabric of world order. Two world wars, a depression, and the cold war have made us well aware of the important causal effects of each on the other. Unless definitions of *politics* and *economics* are arranged so that one category necessarily includes all fundamental phenomena, neither economic nor political determinism can explain events successfully.

Debates about the origins of imperialism or about postwar United States foreign policy, between analysts who stress security motivations and power competition and those who emphasize economic incentives, are inconclusive. The energetic globalism of United States policy can be explained by either a genuine fear of widespread totalitarian resurgence if it were not checked at all points, analogous to contemporary perceptions of the lessons of Munich, or by a desire to make the world safe for American commerce, or both. Indeed, the security and economic motives were inextricably linked: the breakdown of the international economy in the 1930s was widely viewed as a central element in the national economic catastrophes, especially in Europe, which led to the installation of totalitarian governments, which in turn produced World War II. Monocausal arguments founder on the fact that policymakers usually have more than one set of reasons for their actions and see intimate linkages between the different categories, which are often isolated in scholarly writing.[1]

On the motivational level, therefore, political and economic factors are frequently so closely intertwined that they cannot be disentangled. In addition, regardless of motivations, politics and economics are almost inevitably linked at the systemic level. An international economic system is affected by the international political system existing at the time, and vice versa. The behavior of governments on economic issues will be affected by their political calculations, which will in turn be determined in part by the structure of world politics. At the same time, political steps by governments must often rest on economic capabilities and, as we will see shortly, are increasingly taking economic form.

The fact that a particular economic activity is characterized by nonpolitical behavior (for instance, when transactions are carried on through a market system) does not imply that politics is unimportant. Indeed, politics may have been crucial in establishing the setting within which the activity took place, the *structure* of relations in the overall system. This second "face of power" is extremely important in determining what issues are raised for political decisions and what issues are not.[2]

The importance of this aspect of power leads us to distinguish between two levels of analysis: a process level, dealing with short-term behavior within a constant set of institutions, fundamental assumptions, and expectations; and a structure level, having to do with long-term political and economic determinants of the systemic incentives and constraints within which actors operate. At this structural level, we are interested in how the institutions, fundamental assumptions, and rules of the game are created and how they support or undermine different patterns of short-term economic activity.[3]

[1] For an attempt to argue that economic considerations were paramount in United States foreign policy after World War II, see Joyce and Gabriel Kolko, *The Limits of Power: The World and United States Foreign Policy, 1945-54* (New York: Random House, 1972). The authors choose references to economic purposes as indicating "real" motivations, and ignore or discount references to security purposes. The limitations of their analysis are most graphically revealed by their failure even to mention the psychic effects of Munich–in over 700 pages about the first postwar decade of US foreign policy! Conservative historians have taken the opposite approach of regarding economic motivation as simply derivative from security concerns. In our view this represents an artificial and ultimately fruitless search for the "essential" element in an inextricably intertwined set of reasons and rationalizations.

[2] See Peter Bachrach and Morton Baratz, "Decisions and Nondecisions: An Analytical Framework," *American Political Science Review* 57 (1963): 632-42.

[3] See Robert O. Keohane and Joseph S. Nye, "World Politics and the International Economic System," in C. Fred Bergsten, ed., *The Future of the International Economic Order: An Agenda for Research* (Lexington, Mass.: D.C. Heath, 1973). The following six pages draw heavily upon this essay.

In some systems at some times, the levels of structure and process are relatively well insulated from one another. Basic institutions and practices are accepted as legitimate by all major parties. Economic activity in these systems may involve very little direct political intervention. On the international level, only minor and infrequent attention may be paid to economic affairs by top government officials. At other times, however, the rules of the game themselves are called into question by major participants. The system becomes politicized as controversy increases. In highly politicized systems, attention of top-level decision makers is focused on the system, and nonroutine behavior dominates routine behavior. Insulation between the structure of the system and particular processes breaks down; specific quarrels become linked to arguments about appropriate institutions and permanent arrangements.

It is when accepted structures, with their associated rules of the game, are called into question that controversy, and therefore politicization, are likely to increase most rapidly. During these periods, questions of who will exercise political control, and how, become dominant. Thus one observes increasing disagreements between a larger number of important contenders, over a greater number of specific issues, with more direct linkage between immediate problems (e.g., the exchange rate of the yen) and systemic issues (e.g., fixed versus more flexible exchange rates), and an increase in the attention devoted to these issues by heads of government and cabinet ministers. In recent years, we have witnessed increased politicization of international economic affairs.

To some extent, this increased politicization is the result of secular trends towards more governmental intervention in the economy as governments accept responsibility for an increasing array of policy targets. The dramatic increase in international economic interpenetration heightens the external threat to successful pursuit of these government objectives, and thereby produces a tendency for countries to seek to shield themselves from it. But, at the same time, outside forces offer additional policy instruments, often of very high value, to governments that can harness them effectively, which produces a tendency for countries to welcome international exchange as long as they can assure that it points in desired directions.

Thus the increased policy role of national governments combines with the increased internationalization of the world economy to force a blurring of the lines between domestic and foreign policy, and an increase in the number of issues relevant to foreign policy. International economic issues rise toward the top of national policy agendas and become increasingly politicized in the process.

Economic power and military force

The increased politicization of international economics, however, is also a product of other long-term changes that have affected the relations among states, the effective means at their disposal, and other aspects of their political-economic milieu. One of these important long-run changes has been in the relative utility of force and economic power for major states.

Political scientists for the past three decades have generally emphasized the role of force, particularly organized military force, in international politics. Force dominates other means of power in the sense that *if* there are no constraints on one's choice of instruments (a hypothetical situation that has only been approximated in the two world wars), the state or states with superior military force will prevail. Thus, American economic sanctions against Japan in 1940-41 were countered by Japanese military action; to the military challenge, the United States had to answer in military terms. If the security dilemma for all states were extremely acute, military force and its supporting components, which, of course, include a large economic dimension, would clearly be the dominant source of power. Survival is the primary goal of all states, and in the most adverse situations, force is ultimately necessary to guarantee survival. Thus military force is always a central component of national power.

But insofar as the perceived margin of safety for states widens, other goals—such as economic welfare, political autonomy, and status—become relatively more important. This is in fact the situation at present, as widespread perceptions of détente have rendered quite low most countries' fear of any use of force by the major military powers. This situation is not necessarily permanent: the cold war could reappear, or nuclear proliferation could again raise deep national insecurities. But, at least for now, economic issues have become far more salient in international affairs than at any point since the beginning of World War II, both because of their increased importance in their own right and because of the decline in concerns about survival and the traditional forms of security.

It is unlikely that military force will be an appropriate tool to achieve these nonmilitary goals. Furthermore, as the nature of military force and the consequence of its use change, it has become less efficacious even for achieving the goals that it formerly served. The disproportionate destructiveness of nuclear weapons limits the utility of this type of force for achieving positive goals, as opposed to deterrent objectives. In addition, prevailing norms and the costliness of ruling alien populations that have become socially mobilized increase the cost of using conventional force.[4] As these changes in goals and in the nature of force take place, the roles of other instruments of power and influence tend to increase.

It is important to notice, however, that the effects of these increasing constraints on the use of force are not felt equally by all actors in world politics, nor are the constraints the same for all potential uses of force by the same actors. It may be useful briefly to discuss the effects on three sets of actors: (1) the superpowers—the US and the USSR, (2) other developed countries, and (3) other actors, particularly Third World states and transnational organizations.

The superpowers have continued to use force or the threat of force to control events within certain other states. The threat of force is probably most effective

[4] See Stanley Hoffmann, *Gulliver's Troubles, or The Setting of American Foreign Policy* (New York: McGraw Hill, 1968).

where it remains in the background. Military power based on undeterred local preponderance and occasional military intervention helps to explain the high degree of conformity of the economic systems of the states in the Council for Mutual Economic Cooperation (COMECON) to that of the Soviet Union, and the substantial trade preferences between those states. Similarly, the threat of open or covert US military intervention has played a role in limiting revolutionary regime changes in Latin American countries over the past three decades, and has therefore tended to keep their economies more closely tied to that of the United States than might otherwise have been the case. In some cases the *use* of force has been effective, as in the United States intervention in the Dominican Republic in 1965 and the Soviet intervention in Czechoslovakia three years later. In others, such as the United States support of the Bay of Pigs invasion in 1961 or the American intervention in Indochina, the policy of force led to disastrous results. On some disputes on which force might have been used in the past, such as the Arab oil embargo against the United States in 1973-74 or the Chilean expropriation, without significant compensation, of American-owned enterprises under the Allende government in 1971, the United States has resorted to other means of influence. "Gunboat diplomacy" is widely regarded as dangerous and often counterproductive; force is seen as an undesirable means of intervention, except as a last resort.

Force, however, can be used not only for intervention but for deterrence, and here its utility does not seem to have diminished so sharply. Since each superpower continues to use the threat of force to deter attacks by the other superpower on itself or on its allies, the importance of these nuclear weapons for deterrence remains a valuable resource that can be used by alliance leaders in their own bargaining on other issues with their allies. This is particularly important for the United States, whose allies are concerned about potential Soviet threats, and which has fewer other means of influence over its allies than does the Soviet Union over its Eastern European partners. The United States has, accordingly, taken advantage of the Europeans' (particularly the Germans') desire for American protection with regard to the issue of troop levels in Europe and their links to trade and monetary negotiations. Sometimes this has taken place through calculated executive actions, sometimes through congressional initiatives contrary to executive preference. Thus, although the first-order effect of deterrent force is essentially negative—to deny effective offensive power to a superpower opponent—the state within the alliance controlling this force can gain positive political influence from its possession. Since neither Europe nor Japan seems willing to undertake the expense and risk of developing a major nuclear second-strike capability in the immediate future, this form of militarily based power remains significant for the United States.

For other developed countries, in general, force is of less utility than for the superpowers. Indeed, in relations between many developed countries, force is of negligible importance, for instance, between Germany and Japan, Italy and Holland, or New Zealand and the United Kingdom. Intense relationships of mutual influence are developing in which force is irrelevant as an instrument of policy, and these are not limited to common markets or members of a close-knit politicomilitary bloc. Since economic instruments have largely supplanted the use or threat of force in these relationships, the implications for the political relevance of economic ties between these countries are considerable.

For the superpowers and developed countries generally, we have stressed the declining role of force. For other actors in world politics, however, force remains valuable. Indeed, in areas such as the Persian Gulf from which British or American force has been partially withdrawn, force may be becoming more important than formerly as a means of influence for small or middle powers. It is clear that force remains important on the Indian subcontinent, in southeast Asia, and in the eastern Mediterranean. National liberation movements, sometimes operating transnationally, often rely heavily on force; witness the recently successful movement in Mozambique and the various Palestinian paramilitary operations.

Yet limits on the use of force, although they operate unevenly, are frequently important. To some extent, economic instruments are used in reaction to this situation as a substitute for force, to achieve similar purposes when force is unavailable or its use is deemed too costly. Using economic instruments in this way is a well-established practice in world politics. Examples include the Allied blockade against Napoleon, the League of Nations oil embargo against Italy, the near total US embargo of exports to Cuba, and United Nations sanctions against Rhodesia, as well as the recent embargo of oil sales to the United States and the Netherlands by Arab states in 1973-74 in pursuit of a favorable political settlement in the Middle East. The most sustained effort in this direction in the postwar period has been the US effort to restrict trade in some strategic materials, and to limit Soviet access to advanced technology. Here economic sources of power allow governments to carry on "war by other means."

But there is a more straightforward function served by economic instruments: to exercise influence on questions arising out of patterns of economic interdependence, for the sake of affecting economic transactions and benefits to be derived from them. The monetary negotiations of the last decade, as well as negotiations on trade and on foreign investment, have primarily reflected competition for economic benefits, as well as to some extent for political influence or status within the context of relatively intense economic intercourse. Where transactions are economic, economic instruments are likely to be used first. They can be wielded by the same bureaucracies that deal with the economic transactions, and they often appear more legitimate to other governments than instruments that appear to "escalate" the controversy to the political-military plane.

Yet much of the complexity, as well as much of the interest, in international political-economic relations derives from the fact that linkages between issue areas, both within the broad arena of economics itself and between economic and security concerns, frequently do take place. In 1971, for instance, the United States linked trade and monetary negotiations together for the sake of getting a better monetary agreement, and there were also references to the need to attain a trade surplus to permit the United States to maintain its worldwide political and military position. About the same time, the United States linked the reversion of Okinawa to Japan to Japanese agreement to limit its textile exports to the United States; and US troop levels in Germany have for fifteen years been linked, at least implicitly, to German willingness to offset the costs of those troops to the US balance of payments. The Arab oil producers' actions on behalf of their political goals of a favorable Middle East settlement have often been almost indistinguishable from their economic goals of increasing revenue from their petroleum resources. Within the European Common Market, complex linkages and trade-offs between issues are commonplace.

In general, whenever there is less than perfect congruity between various sources of power for states involved in close and complex relations with one another (for instance, where one set of states is stronger militarily, but the other controls a valuable economic resource that is at issue), linkages between issue areas are likely to be drawn. Arab oil producers used economic power–their only source of major international leverage–to pursue their most urgent national security objectives in 1973-74; and the United States has attempted to counter this by implicitly threatening military force, and by linking high petroleum prices to the world food issue, where it is *American* resources (food surpluses for export) that are sought by other governments.

In a period such as the present, with interdependence high, rapid shifts taking place in governmental policies, and vast asymmetries between the economic and military power of numerous states, linkages between issue areas are likely to become particularly pronounced. One linkage breeds another, as the states disadvantaged by the first linkage seek to bring their sources of strength to bear upon the problem at hand. In the immediate future, world economics will be increasingly politicized, and vice versa.

New actors

In addition to changes in the relative utility of force and economic power as instruments for major states, the international economic order must now encompass two new sets of major actors that have emerged because of their economic power: a number of countries that were unimportant to world economics when the postwar world was organized, or even ten years ago; and transnational economic actors, of which multinational enterprises are the most important and well known.

The postwar economic system was organized primarily by, and for, the United States, Canada, and Western Europe, with some participation from Latin America (and the Soviet Union, which soon dropped out). Many countries that play a central role in today's world, including some of the oil-exporting countries, were not even independent at that time.

But Japan, which entered the core group of international economic decision makers in the early 1960s, and the oil countries have made the set of major economic powers more heterogeneous. In addition, other states, largely from the Third World, have become more important and more active. The participation, or at least acquiescence, of many of these countries is necessary in at least some aspects of any new international economic structure, not only because of their possession of many key primary products but also because of their new awareness of their needs and opportunities, which will prompt them to attempt to block international economic reform unless their interests are taken into account.[5] Indeed, this new "middle class" has left behind a "Fourth World," which remains the hard-core international welfare problem of the 1970s and beyond.

With regard to multinational enterprises, some incautious or enthusiastic observers have gone too far in proclaiming the death of the nation state in a world of interdependence.[6] The nonstate actors do not supersede states, although they do affect the system–particularly the monetary and trading systems, via the growth of the Eurocurrency market and intracorporate trade–and create new problems for governments. Outcomes in these issue areas can no longer be understood solely as results of state action and policy.

It is clear that, at a minimum, these transnational actors have greatly speeded the transmission of economic events from one country to another. The Eurocurrency and Eurobond markets provide a truly international center for financial and capital transactions. Multinational firms increasingly scan the globe for production and marketing opportunities and hence speed shifts in national comparative advantage. As a result of this acceleration of the pace of international economic change, the threats and opportunities generated for national policies by external events have become much more acute. Questions arise as to whether the pace should be deliberately slowed, perhaps by placing restraints on the growing economic interdependence of nations, including these very transnational forces that have promoted its acceleration.

The emergence of new international economic issues

Reference to these transnational actors leads us to the final key change in the political milieu for international economic relations: the emergence of important

[5] For one of the coauthors' views on these issues, see C. Fred Bergsten, "The Threat from the Third World," *Foreign Policy*, no. 11 (Summer 1973): 102-24; and Bergsten, "The Response to the Third World," *Foreign Policy*, no. 17 (Winter 1974-75).

[6] In 1969 Charles Kindleberger argued in a much-quoted (and probably much-regretted) phrase that "the nation-state is just about through as an economic unit" (*American Business Abroad* [New Haven, Conn.: Yale University Press, 1969], p. 207). The most trenchant criticisms of this view can be found in the works of Kenneth N. Waltz, particularly, "The Myth of National Interdependence," in Charles Kindleberger, ed., *The International Corporation* (Cambridge, Mass.: Harvard University Press, 1970); and Robert Gilpin, particularly, "The Politics of Transnational Economic Relations," in Robert O. Keohane and Joseph S. Nye, eds., *Transnational Relations and World Politics* (Cambridge, Mass.: Harvard University Press, 1972). For an assessment of the controversy, see the essay by Keohane and Ooms in this volume, and Robert O. Keohane and Joseph S. Nye, "International Interdependence and Integration," in Nelson Polsby and Fred Greenstein, eds., *Handbook of Political Science*, vol. 7 (forthcoming in 1975).

new international economic issues that were ignored, or inadequately covered, in the postwar structure, such as nontariff barriers to trade, agriculture, business and government cartels, the variety of issues relating to multinational enterprises, and adjustment assistance to domestic groups adversely affected by international transactions.

The most important new issue is access to supplies. When the postwar economic order was constructed, the attention of virtually all countries was riveted on the fear of unemployment. Hence, the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade (GATT), and the World Bank systems aimed to avoid national efforts to export unemployment (through competitive depreciations of exchange rates, import controls, and export subsidies), as had occurred with such devastating effect in the 1930s, and in fact to maximize national opportunities to expand production and to sell to other countries.

In the 1970s, however, inflation has emerged in virtually all countries as an economic (and hence political) problem at least as severe as unemployment, if not more so. Indeed, in recent years numerous countries have been seeking to insulate their economies against imported inflation and even export their inflation to others by *up*valuing their exchange rates, unilaterally *liberalizing* their import controls, and instituting *export* controls. Access to supplies has come to rival, if not surpass, access to markets as a major issue of international economics. But because of the previous focus on unemployment, by both governments and outside analysts, there exist no effective international rules and arrangements to govern these new policy approaches and few ideas for developing them.[7] Thus the international economic agenda has broadened at the same time that it has become more complex due to underlying political and economic changes.

United States predominance and the distribution of power

A number of essays in this volume refer loosely to shifts in the distribution of power among states. Positing that power abhors a free market, Díaz-Alejandro argues that multipolar deterrence has now made free markets more plausible than before. Gilpin speaks of the need for the United States to adjust to "the shifting balance of power." Clearly, there is a relationship between the distribution of states' military power and international economic order, but the discussion of this relationship is often marked by confusion resulting from failure to make necessary distinctions.

A simple reductionist theory of international economic affairs could hold that they are merely reflections of political-military developments. Changes in international economic relations would therefore be explained by shifts in military

[7] For one effort, see C. Fred Bergsten, *Completing the GATT: Toward New International Rules to Govern Export Controls* (Washington, D.C.: British–North American Committee, November 1974).

power. This explanation, however, does not hold up well against the pattern of recent events. The United States position in the world economy and its dominance in policymaking have clearly declined since 1944. At Bretton Woods the United States could construct the system largely according to its specifications; now it can only veto proposals it dislikes. Yet during this period, the United States has remained, militarily, the most powerful state in the world, and its lead in this respect over its major economic partners, Japan and Europe, has been maintained. Although it has become more costly for the United States to intervene effectively in other countries over the past 30 years, American deterrent power has remained intact.

Thus, although the distribution of military power is an important underlying factor affecting the international economic order, by itself it provides only a partial explanation. Two other major factors particularly must be taken into account to explain changes in international economic relations: changes in perceptions of the threat of military aggression, and changes in the relative economic strength of countries within US-led alliances.

Perceptions of threat are important. Many of the major advances in international economic relations came during the long period of maximum cold-war tension, between 1947 (Truman Doctrine) and 1963 (Test Ban Treaty). In these years, the IMF, the World Bank, the GATT, and the Organization for Economic Cooperation and Development (OECD) began to function, currency convertibility was achieved and major tariff cuts were implemented, and the Common Market was established. United States security leadership was prized by its allies, and the American perception of high threat from the Soviet Union encouraged United States policymakers to grant a variety of economic concessions to the Europeans and to the Japanese in the interest of systemic progress. The sharp reductions in perceived threats in recent years have reduced the ability of the United States to translate its military leadership of the alliance into economic leaderhip without resorting to overt and highly resented linkages between economic and military issues. American allies became less inclined to accept the roles of junior partners once they had perceived the external threat as diminished.[8] At the same time, United States willingness to accept trade barriers against American goods, or exchange rates that had similar effects, was also declining.

These changes in perceptions were reinforced by increases in European and Japanese economic capabilities relative to those of the United States. In the early postwar period, Europe was largely supine, and, although it was able to bargain and resist on particular issues, it usually complied with US leadership, particularly on the overall economic structure. In later years, the European economies had recov-

[8] For evidence of this in the case of Canada, see Joseph S. Nye, "Transnational Relations and Interstate Conflicts: An Empirical Analysis," *International Organization* 28 (Autumn 1974): 961-96. It should be noted that a serious future threat–not necessarily from the Soviet Union and not necessarily military–could restore greater cohesion. The steps taken in late 1974 toward an oil consumers organization provide an indication that events might move in this direction.