the nineteenth century challenged many liberal assumptions about human beings, the market and the role of the state. This is often forgotten or not well understood by contemporary economic liberals.

Critics such as Polanyi highlighted the extent to which material self-gain in a market society was necessary for survival in an unregulated market society, rather than a reflection of the human condition in its natural state. It is therefore unwise for liberals to generalize from the specific case of market capitalism – to believe that behaviour enforced as a result of a new and presumably transient form of political economy was a true reflection of a human being's inner self (Polanyi 1944; Block and Somers 1984).

State intervention in the economic life of a society was in fact an act of community self-defence against the destructive power of unfettered markets which, according to Polanyi, if left unregulated, threatened to annihilate society. However, state intervention in the economy was also necessary for markets to function – free trade, commercial exchanges and liberal markets have always been policies of the state and have not emerged organically or independently of it.

As List and many since have explained, the state plays a crucial role in the economic development of industrial societies, protecting embryonic industries from external competition until they are ready to win global market shares on an equal footing. There are few, if any examples of states emerging as industrial powerhouses by initially adopting a policy of free trade. Protectionism and state coordinated economic development have been key early ingredients of economic success in the modern world, as the post-war experience of East Asia suggests.

Liberalism and globalization

To a significant extent, the globalization of the world economy coincided with a renaissance of neo-liberal thinking in the Western world. The political triumph of the 'New Right' in Britain and the United States in particular during the late 1970s and 1980s was achieved at the expense of Keynesianism, the first coherent philosophy of state intervention in economic life. According to the Keynesian formula, the state intervened in the economy to smooth out the business cycle, provide a degree of social equity and security and maintain full employment. Neo-liberals, who had always favoured the free play of 'market forces' and a minimal role for the state in economic life, wanted to 'roll back' the welfare state, in the process challenging the social-democratic consensus established in most Western states during the post-war period.

Just as the ideological predilection of Western governments became more concerned with efficiency and productivity and less concerned with welfare and social justice, the power of the state to regulate the market was eroded by the forces of globalization, in particular the de-regulation of finance and currency markets. The means by which domestic societies could be managed to reduce inequalities produced by inherited social structures and accentuated by the natural workings of the market, declined significantly. In addition, the disappearance of many traditional industries in Western economies, the effects of technological change, increased competition for investment and production and the mobility of capital, undermined the bargaining power of labour. The sovereignty of capital began to reign over both the interventionary behaviour of the state and the collective power of organized working people.

There is a considerable debate over globalization, between liberals who believe it constitutes a fundamentally new phase of capitalism and statists who are sceptical of such claims (Held *et al.* 1999; Held and McGrew 2000). Liberals point to the increasing irrelevance of national borders to the conduct and organization of economic activity. They focus on the growth of free trade, the capacity of transnational corporations (TNCs) to escape political regulation and national legal jurisdictions, and the liberation of capital from national and territorial constraints (Ohmae 1995; Friedman 2000; Micklewait and Wooldridge 2000). Sceptics, on the other hand, claim that the world was less open and globalized at the end of the twentieth century than it was in the nineteenth. They suggest that the volume of world trade relative to the size of the world economy is much the same as it was in 1914, though they concede that the enormous explosion of short-term speculative capital transfers since the collapse of the Bretton Woods system in the early 1970s has restricted the planning options for national governments. Significantly, sceptics want to distinguish between the idea of an international economy with growing links between separate national economies, which they concede, and a single global political economy without meaningful national borders or divisions, which they deny (Weiss 1998; Chomsky 1999b; Hirst and Thompson 1996; Hobsbawm 2000).

The next section will examine the claims made by liberals and the extent to which their ideas have shaped the current economic order. It will focus on the contemporary nature of world trade, the questions of sovereignty and foreign investment and the challenges to liberal ideas recently posed by Islamic terrorism.

The nature of 'free trade'

For neo-liberals, the principles of free trade first enunciated by Smith and Ricardo continue to have contemporary relevance. Commercial traders should be allowed to exchange money and goods without concern for national barriers. There should be few legal constraints on international commerce, and no artificial protection or subsidies constraining the freedom to exchange. An open global market, where goods and services can pass freely across national boundaries, should be the objective of policy makers in all nation-states. Only free trade will maximize economic growth and generate the competition that will promote the most efficient use of resources, people and capital.

Conversely, 'protectionism' is seen as a pernicious influence on the body politic. Policies which protect uncompetitive industries from market principles corrupt international trade, distort market demand, artificially lower prices and encourage inefficiency, while penalizing fair traders. Protection is the cry of 'special' or 'vested' interests in society and should be resisted by government in 'the national interest'. It penalizes developing nations by excluding them from entry into the global marketplace where they can exploit their domestic advantage in cheap labour.

The cornerstone of the free trade argument is the theory of 'comparative advantage', which discourages national self-sufficiency by advising states to specialize in goods and services they can produce most cheaply – their 'factor endowments'. They can then exchange their goods for what is produced more cheaply elsewhere. As everything is then produced most efficiently according to the price mechanism, the production of wealth is maximized and everyone is better off. For Smith, the 'invisible hand' of market forces directs every member of society in every state to the most advantageous position in the global economy. The self-interest of one becomes the general interest of all.

The relevance of the theory of comparative advantage in the era of globalization has recently come under question (Strange 1985; Bairoch 1993; Daly and Cobb 1994; Clairmont 1996). The first difficulty is that it was devised at a time when there were national controls on capital movements. Ricardo and Smith assumed that capital was immobile and available only for national investment. They also assumed that the capitalist was first and foremost a member of a national political community, which was the context in which he established his commercial identity: Smith's 'invisible hand' presupposed the internal bondings of community, so that the capitalist felt a 'natural disinclination' to invest abroad. Smith and Ricardo could not have foreseen 'a world of cosmopolitan money managers and TNCs which, in addition to having limited liability and immorality conferred on them by national governments, have now transcended those very governments and no longer see the national community as their context' (Daly and Cobb 1994: 215). The emergence of capitalists who freed themselves from community obligations and loyalties, and who had no 'natural disinclination' to invest abroad, would have appeared absurd. Highly mobile and volatile capital markets are a major challenge for the theory of comparative advantage.

The second problem is that the forms of international trade have changed dramatically over recent decades. The idea of national, sovereign states trading with each other as discrete economic units is becoming an anachronism. Intra-industry or intra-firm trade dominates the manufacturing sector of the world economy. Over 40 per cent of all trade now comprises intra-firm transactions, which are centrally managed interchanges within TNCs (that cross international borders) guided by a highly 'visible hand'. Intra-firm trade runs counter to the theory of comparative advantage which advises nations to specialize in products where factor endowments provide a comparative cost advantage. The mobility of capital and technology, and the extent to which firms trade with each other, means that 'governments in virtually all industrial societies now take an active interest in trying to facilitate links between their own domestic firms – including offshoots of multinationals – and the global networks' in the strategic industries. They can no longer remain at arm's length from business as neo-liberal economic theory demands (Emy 1993: 173).

Similarly, the globalization of the world economy has seen the spread of manufacturing industries to many developing countries and the relocation of transnational manufacturing centres to what are often low-wage, high-repression areas – regions with low health and safety standards where organized labour is frequently suppressed or illegal. TNCs are becoming increasingly adept at circumventing national borders in their search for cheap labour and access to raw materials, and few states can refuse to play host to them. The creation of new centres of production occurs wherever profit opportunities can be maximized because investment decisions are governed by absolute profitability rather than comparative advantage. For liberals, this is nevertheless the best way of encouraging much-needed foreign investment in the developing world and establishing a trade profile for countries which might otherwise be excluded from world trade altogether.

Modern trading conditions have diverged significantly from the assumptions which underpin the neo-liberal analysis of how markets and trade actually work. The internationalization of production, the mobility of capital and the dominance of transnational corporations are just three developments which render theories of comparative advantage somewhat anachronistic. The idea of national sovereign states trading with each other as discrete economic units is steadily becoming the exception rather than the rule. Neo-mercantilist theory, which stresses the maximization of national wealth, also fails to explain contemporary trade realities. A more accurate description is 'corporate mercantilism', with 'managed commercial interactions within and among huge corporate groupings, and regular state intervention in the three major Northern blocs to subsidise and protect domestically-based international corporations and financial institutions' (Chomsky 1994: 95). If there is such a thing as a nation's comparative advantage it is clearly a human achievement and certainly not a gift of nature, though this view remains unorthodox within powerful economic circles.

The third challenge to the relevance of the theory of comparative advantage is the steady erosion of the rules which have underpinned multilateral trade in the post-war era. While there has been a reduction in barriers to trade *within* blocs such as the European Union and the North American Free Trade Agreement (NAFTA), they have been raised *between* blocs. Tariffs have come down but they have been replaced by a wide assortment of non-tariff barriers (NTBs), including import quotas and voluntary restraint agreements. This is a concern to small, 'fair' traders which are incapable of matching the subsidies provided by Europeans and North Americans. States which unilaterally adopt free market doctrines while leading industrial societies head in the opposite direction place themselves in a vulnerable position in the world economy. But regardless of whether tariff barriers and NTBs are dismantled, the world market would not be 'free' in any meaningful sense, because of the power of the TNCs to control and distort markets through transfer pricing and other devices.

The proliferation of free trade agreements and organizations such as NAFTA, Asia Pacific Economic Cooperation (APEC) and the WTO and the growing importance of international organizations such as the G8, the International Monetary Fund (IMF) and World Bank is indicative of the influence of neo-liberalism in the post-Cold War period. These are powerful transnational bodies which embody free trade as their governing ideology. To their supporters, they provide developing societies with the only opportunity to overcome financial hardship and modernize their economies. To their critics, however, they impose free market strictures on developing societies. They are primarily organizations which formalize and institutionalize market relationships between states. By locking the developing world into agreements which force them to lower their protective barriers, NAFTA and the WTO, for example, prevent the South from developing trade profiles which diverge from the model dictated by their supposed 'comparative advantage'. The IMF and the World Bank, on the other hand, make the provision of finance (or, more accurately, 'debt') to developing societies conditional on their unilateral acceptance of free market rules for their economies – the 'conditionality' of the so-called 'structural adjustment policies' or SAPs.

Critics attack these institutions for legitimizing only one kind of global order, based on unequal market relations. Specifically, the institutions are criticized for imposing identical prescriptions for economic development on all countries, regardless of what conditions prevail locally. Developing societies are expected to adopt the free market blueprint (sometimes called the 'Washington Consensus') – opening their economies up to foreign investment, financial de-regulation, reductions in government expenditure and budgetary deficits, the privatization of government-owned enterprises, the abolition of protection and subsidies, developing export orientated economies – or risk the withholding of much needed aid and finance. And because they are required to remove national controls on capital movements – which make it possible for states to reach their own conclusions about investment and spending priorities – the direction of their economic development is increasingly set by amorphous financial markets which act on profit opportunities rather than out of any consideration of national or community interest.

Arguments for free trade are still powerfully made on the grounds of economic efficiency and as the only way of integrating the developing world into the wider global economy. Protectionism within the North is said primarily to hurt the South by pricing their economies out of markets in the industrialized world, thus denying them the opportunity to modernize their economies.

For leading players, however, free trade is often non-reciprocal and an ideological weapon used to regulate the economic development of subordinate societies. Their rhetoric supporting the sanctity of market principles is rarely matched by their own economic behaviour. This tendency, together with fundamental changes to the structure of the world economy and the forms of international trade, casts some doubt on the extent to which liberals can explain the globalization of the world economy solely on their own terms.

Sovereignty and foreign investment

The enormous volumes of unregulated capital liberated by the collapse of the Bretton Woods system in the early 1970s, have transformed the relationships between states and markets. Credit (bonds and loans), investment (Foreign Direct Investment, or FDI) and money (foreign exchange) now flow more freely across the world than commodities. The resulting increase in the power of transnational capital and the diminution of national economic sovereignty is perhaps the most dramatic realization of liberal economic ideas (Strange 1996, 1998).

The relationship between a nation's economic prosperity and the world's money markets is decisive. Because most states are incapable of generating sufficient endogenous wealth to finance their economic development, governments need to provide domestic economic conditions