CHAPTER ONE

The Nature of Political Economy

THE PARALLEL existence and mutual interaction of "state" and "market" in the modern world create "political economy"; without both state and market there could be no political economy. In the absence of the state, the price mechanism and market forces would determine the outcome of economic activities; this would be the pure world of the economist. In the absence of the market, the state or its equivalent would allocate economic resources; this would be the pure world of the political scientist. Although neither world can ever exist in a pure form, the relative influence of the state or the market changes over time and in different circumstances. Therefore, the conceptions of "state" and "market" in the following analysis are what Max Weber has called ideal types.

The very term "political economy" is fraught with ambiguity. Adam Smith and classical economists used it to mean what today is called the science of economics. More recently, a number of scholars, such as Gary Becker, Anthony Downs, and Bruno Frey, have defined political economy as the application of the *methodology* of formal economics, that is, the so-called rational actor model, to all types of human behavior. Others who use the term political economy mean employment of a specific economic *theory* to explain social behavior; game, collective action, and Marxist theories are three examples. The public choice approach to political economy draws upon both the methodology and theory of economics to explain behavior. Still other scholars use political economy to refer to a set of *questions* generated by the interaction of economic and political activities, questions that are to be explored with whatever theoretical and methodological means are readily available (Tooze, 1984).

Although the approaches to political economy based on the application of the method and theory of economic science are very helpful, they are as yet inadequate to provide a comprehensive and satisfactory framework for scholarly inquiry. Concepts, variables, and causal relations have not yet been systematically developed; political and other noneconomic factors are frequently slighted. In fact, a unified methodology or theory of political economy would require a general comprehension of the process of social change, including the ways in which

the social, economic, and political aspects of society interact. Therefore, I use the term "political economy" simply to indicate a set of questions to be examined by means of an eclectic mixture of analytic methods and theoretical perspectives.

These questions are generated by the interaction of the state and the market as the embodiment of politics and economics in the modern world. They ask how the state and its associated political processes affect the production and distribution of wealth and, in particular, how political decisions and interests influence the location of economic activities and the distribution of the costs and benefits of these activities. Conversely, these questions also inquire about the effect of markets and economic forces on the distribution of power and welfare among states and other political actors, and particularly about how these economic forces alter the international distribution of political and military power. Neither state nor market is primary; the causal relationships are interactive and indeed cyclical. Thus, the questions to be explored here focus on the mutual interactions of very different means for ordering and organizing human activities: the state and the market.

This formulation is certainly not an original one; it is at least as old as Georg Hegel's critical distinction in *Philosophy of Right* (1945 [1821]) between state and society (economy). Similar definitions have been offered by other scholars. Charles Lindblom (1977), for example, proposes "exchange" and "authority" as the central concepts of political economy. Peter Blau (1964) uses "exchange" and "coercion"; Charles Kindleberger (1970) and David Baldwin (1971) prefer "power" and "money"; and Klaus Knorr (1973) employs "power" and "wealth." Whereas Oliver Williamson (1975) contrasts "markets" and "hierarchies," Richard Rosecrance (1986) contrasts "market" and "territoriality"; both of these conceptualizations are close to the one chosen here. Each of these views of political economy has its respective merits.

Charles Kindleberger has noted (1970, p. 5) that both the state's budget and the market are mechanisms of product and resource allocation. In a purely political world in which the market did not exist, the state would allocate available resources on the basis of its social and political objectives; such state allocative decisions would take the form of the state's budget. In a purely "market" world in which state intervention did not occur, the market would allocate and operate on the basis of relative prices for goods and services; decisions would take the form of the individual pursuit of self-interest. Students of international political economy, therefore, must attempt to understand how these

contrasting modes of organizing human activities and of decision making affect one another and thereby determine social outcomes.

Although the state as the embodiment of politics and the market as the embodiment of economics are distinctive features of the modern world, they obviously cannot be totally separated; indeed, their interrelationship is a theme of this book. The state profoundly influences the outcome of market activities by determining the nature and distribution of property rights as well as the rules governing economic behavior (Gerth and Mills, 1946, pp. 181-82). People's growing realization that the state can and does influence market forces and thereby significantly determines their fate is a major factor in the emergence of political economy. The market itself is a source of power that influences political outcomes. Economic dependence establishes a power relationship that is a fundamental feature of the contemporary world economy. In brief, although it is possible to regard politics and economics as distinct forces creating the modern era, they do not operate independently of one another.

The state and the market have tended to displace other forms of political and economic organization in the modern world because of their efficiency in the production of power and/or wealth. Originating in early modern Europe, state and market have subsequently spread from that relatively small corner of the globe to embrace a substantial fraction of mankind. Very few peoples today are excluded from statehood; those who are regard the achievement of statehood as one of their highest goals, as is witnessed in the struggle of Jews, Palestinians, and others to acquire homelands. Following an ebb and flow pattern, the market form of economic exchange has also spread, gradually bringing more and more societies into the web of economic interdependence.[1]

The relationship of state and market, and especially the differences between these two organizing principles of social life, is a recurrent theme in scholarly discourse. On the one hand, the state is based on the concepts of territoriality, loyalty, and exclusivity, and it possesses a monopoly of the legitimate use of force. Although no state can long survive unless it assures the interests and gains the consent of the most powerful groups in society, states enjoy varying degrees of autonomy with respect to the societies of which they are a part. On the other hand, the market is based on the concepts of functional integration, contrac-

[1] The historical relationship of state and market is a matter of intense scholarly controversy. Whether each developed autonomously, the market gave rise to the state, or the state to the market are important historical issues whose resolution is not really relevant to the argument of this book. State and market, whatever their respective origins, have independent existences, have logics of their own, and interact with one another.

tual relationships, and expanding interdependence of buyers and sellers. It is a universe composed mainly of prices and quantities; the autonomous economic agent responding to price signals provides the basis of decision. For the state, territorial boundaries are a necessary basis of national autonomy and political unity. For the market, the elimination of all political and other obstacles to the operation of the price mechanism is imperative. The tension between these two fundamentally different ways of ordering human relationships has profoundly shaped the course of modern history and constitutes the crucial problem in the study of political economy.[2]

This conception of political economy differs in a subtle way from the definition employed in my earlier book on the subject, which defined political economy as "the reciprocal and dynamic interaction . . . of the pursuit of wealth and the pursuit of power" (Gilpin, 1975, p. 43). Although both are concerned with the effects of the relationship of "economics" and "politics," the formulation here stresses the organization of these activities in the modern era; the earlier work stressed the objective of the activity. Obviously, these conceptions cut across one another. As noted above, markets certainly constitute a means to achieve and exercise power, and the state can be and is used to obtain wealth. State and market interact to influence the distribution of power and wealth in international relations.

THE ISSUES OF POLITICAL ECONOMY

The conflict between the evolving economic and technical interdependence of the globe and the continuing compartmentalization of the world political system composed of sovereign states is a dominant motif of contemporary writings on international political economy.[3] Whereas powerful market forces in the form of trade, money, and foreign investment tend to jump national boundaries, to escape political control, and to integrate societies, the tendency of government is to restrict, to channel, and to make economic activities serve the perceived interests of the state and of powerful groups within it. The logic of the market is to locate economic activities where they are most productive and profitable; the logic of the state is to capture and control the process of economic growth and capital accumulation (Heilbroner, 1985, pp. 94-95).

[2] The concepts of state and market used in this book are derived primarily from Max Weber (1978, vol. 1, pp. 56, 82, and passim).

[3] Perhaps the first writer to address this theme systematically was Eugene Staley (1939).

Debate has raged for several centuries over the nature and consequences of the clash of the fundamentally opposed logic of the market and that of the state. From early modern writers such as David Hume, Adam Smith, and Alexander Hamilton to nineteenth-century luminaries such as David Ricardo, John Stuart Mill, and Karl Marx to contemporary scholars, opinion has been deeply divided over the interaction of economics and politics. The conflicting interpretations represent three fundamentally different ideologies of political economy, which the next chapter will discuss.

The inevitable clash gives rise to three general and interrelated issues that pervade the historic controversies in the field of international political economy. Each is related to the impact of the rise of a world market economy on the nature and dynamics of international relations.[4] Each is found in the treatises of eighteenth-century mercantilists, in the theories of classical and neoclassical economists over the past two centuries, and in the tomes of nineteenth-century Marxists and contemporary radical critics of capitalism and the world market economy. This long tradition of theorizing and speculation is crucial to an understanding of contemporary problems in trade, finance, and monetary relations.

The first issue is concerned with the economic and political causes and effects of the rise of a market economy. Under what conditions does a highly interdependent world economy emerge? Does it promote harmony or cause conflict among nation-states? Is a hegemonic power required if cooperative relations among capitalist states are to be ensured, or can cooperation arise spontaneously from mutual interest? On this issue theorists of different schools of thought have profoundly conflicting views.

Economic liberals believe that the benefits of an international division of labor based on the principle of comparative advantage cause markets to arise spontaneously and foster harmony among states; they also believe that expanding webs of economic interdependence create a basis for peace and cooperation in the competitive and anarchical state

[4] Obviously, the choice of these three issues as the central ones will not meet with the approval of everyone in the field of international political economy. Many would quite rightly come up with another set. These issues exclude, for example, such topics as the making and substance of foreign economic policy. Although this subject is important, the principal focus of this book is on the structure, functioning, and interaction of the international economic and political systems. A parallel and not invidious distinction can be and usually is made between the study of the foreign policies of particular states and the study of the theory of international relations. Although these subjects are closely related, they ask different questions and are based on different assumptions. Gaddis (1982) and Waltz (1979) are respectively excellent examples of each approach.

system. Economic nationalists, on the other hand, stress the role of power in the rise of a market and the conflictual nature of international economic relations; they argue that economic interdependence must have a political foundation and that it creates yet another arena of interstate conflict, increases national vulnerability, and constitutes a mechanism that one society can employ to dominate another. Although all Marxists emphasize the role of capitalist imperialism in the creation of a world market economy, they divide between the followers of V. I. Lenin, who argue that relations among market economies are by nature conflictual, and those of Lenin's chief protagonist, Karl Kautsky, who believe that market economies (at least the dominant ones) cooperate in the joint exploitation of the weaker economies of the globe. The alleged responsibility of the market system for peace or war, order or disorder, imperialism or self-determination, is embedded in this important issue, as is the crucial question of whether the existence of a liberal international economy requires a hegemonic economy to govern the system. The challenge to the United States and Western Europe from Japan and other rising economic powers at the end of this century dramatically highlights the importance of these matters.

The second issue pervading the subject of international political economy is the relationship between economic change and political change. What are the effects on international political relations and what problems are associated with structural changes in the global locus of economic activities, leading economic sectors, and cyclical rates of economic growth? And, vice versa, how do political factors affect the nature and consequences of structural changes in economic affairs? For example, one may question whether or not major economic fluctuations (business cycles) and their political effects are endogenous (internal) to the operation of the market economy, or whether economic cycles are themselves due to the impact on the economic system of exogenous (external) factors such as major wars or other political developments. It is also necessary to ask whether or not economic instabilities are the cause of profound political upheavals such as imperialist expansion, political revolution, and the great wars of the past several centuries.

This book is thus concerned in part with the effects of economic changes on international political relations. These economic changes undermine the international status quo and raise profound political problems: What will be the new basis of economic order and political leadership? Can or will adjustment to the changed economic realities, for example, new trading and monetary relations, take place? How will the inevitable clash between the desire of states for domestic autonomy

and the need for international rules to govern change be reconciled? These issues of transition between historical epochs have again arisen with the global diffusion of economic activities and the profound shifts in the leading economic sectors taking place in the late twentieth century. It is important to probe the relationship between these structural changes and the crisis of the international political economy.

The third issue with which this book will deal is the significance of a world market economy for domestic economies. What are its consequences for the economic development, economic decline, and economic welfare of individual societies? How does the world market economy affect the economic development of the less developed countries and the economic decline of advanced economies? What is its effect on domestic welfare? How does it affect the distribution of wealth and power among national societies? Does the functioning of the world economy tend to concentrate wealth and power, or does it tend to diffuse it?

Liberals and traditional Marxists alike consider the integration of a society into the world economy to be a positive factor in economic development and domestic welfare. Trade, most liberals argue, constitutes an "engine of growth"; although the domestic sources of growth are more important, the growth process is greatly assisted by international flows of trade, capital, and productive technology. Traditional Marxists believe that these external forces promote economic development by breaking the bonds of conservative social structures. On the other hand, economic nationalists in both advanced and less developed countries believe that the world market economy operates to the disadvantage of the economy and domestic welfare. Trade, in their view, is an engine of exploitation, of underdevelopment, and, for more advanced economies, of economic decline. This controversy over the role of the world market in the global distribution of wealth, power, and welfare constitutes one of the most intensely debated and divisive questions in political economy.

These three issues, then—the causes and effects of the world market economy, the relationship between economic and political change, and the significance of the world economy for domestic economies—constitute the major theoretical interests of this book. Not all aspects of these issues can be examined here in detail, of course. I shall be concerned with those specific matters that illuminate the problems of the contemporary world economy.

In the rest of this chapter the nature of the market, its economic, social and political consequences, and the political responses to these effects will be discussed. In subsequent chapters, the role of the state in

shaping and attempting to control market forces will be emphasized. However, prior to a consideration of the theoretical issues that arise out of this interaction and their relevance for understanding such areas as trade, money, and foreign investment, a question should be asked regarding this focus on the market. Why stress it as the crucial feature of modern economic life rather than, say, the rise of capitalism, the advent of industrialism, or the impact of scientific technology?

The Importance of the Market

This study of political economy focuses on the market and its relationship to the state because the world market economy is critical to international relations in the modern era; even in socialist societies the key issue in economic debates is the appropriate role for internal and external market forces. As Karl Polanyi said in his classic study of the transformation of modern society:

> the fount and matrix of the [modern economic and political] system was the self-regulating market. It was this innovation which gave rise to a specific civilization. The gold standard was merely an attempt to extend the domestic market system to the international field; the balance-of-power system was a superstructure erected upon and, partly, worked through the gold standard; the liberal state was itself a creation of the self-regulating market. The key to the institutional system of the nineteenth century [as well as our own] lay in the laws governing market economy (Polanyi, 1957, p. 3).

Karl Marx, on the other hand, stressed capitalism or the capitalist mode of production as the creator and unique feature of the modern world. The defining characteristics of capitalism, as defined by Marx and his collaborator, Friedrich Engels, and which I accept, are the private ownership of the means of production, the existence of free or wage labor, the profit motive, and the drive to amass capital. These features provide capitalism with its dynamism; the dynamic character of the capitalist system has in turn transformed all aspects of modern society. As Gordon Craig has pointed out, the revolutionary nature of capitalism lay in the fact that, for the first time, the instinct to accumulate wealth became incorporated in the productive process; it was this combination of the desire for wealth with the economic system that changed the face of the earth (Craig, 1982, pp. 105-106).

This characterization of the dynamic nature and impact of capitalism is certainly accurate; the aggressive spirit of acquisitive capitalism does animate the market system (Heilbroner, 1985). But it was the market that first released these forces of capitalism and that subsequently also

channeled them. Capitalism works its profound effects on social relations and the political system through the market mechanism. The market and exchange certainly tie the economic world together, yet one cannot really speak of an international mode of capitalist production. Despite the emergence of the multinational corporation and international finance, production and finance are still nationally based and, despite the increase in economic interdependence, few economies are tightly integrated into the world economy. Moreover, the socialist or nonmarket bloc is increasing its participation in the world market economy in the final decades of the century. The world market is far larger than but not identical with the capitalist system itself.

The dynamism of the capitalist system is due precisely to the fact that the capitalist, driven by the profit motive, must compete and survive in a competitive market economy. Competition weeds out the inefficient while rewarding efficiency and innovation; it encourages rationality. In the absence of a market, capitalism loses its creativity and essential vigor (McNeill, 1982). The distinctive features of the capitalistic mode of production, as defined by Marxists, would not have led to economic progress without the spur of market competition. In the presence of a market, however, even socialist or nationalized firms must strive to become profitable and competitive. The advent of socialism may not necessarily alter the underlying dynamics, provided that market competition or its functional equivalent survives. There is, as John Rawls reminds us, "no essential tie between the use of free markets and private ownership of the instruments of production" (Rawls, 1971, p. 271). Capitalism and the market exchange system are not necessarily connected.

The concept of "market" is thus broader than that of "capitalism." The essence of a market, defined in greater detail below, is the central role of relative prices in allocative decisions. The essence of capitalism, as noted above, is the private ownership of the means of production and the existence of free labor. Theoretically, a market system could be composed of public actors and unfree labor as envisioned in the concept of market socialism. The increasing role of the state and public actors in the market has recently led to a mixed economy of public and private enterprise. In practice, however, the market system has tended to be associated with international capitalism.

In summary, although the connection between the market exchange system and the capitalist mode of production is close, these terms are not the same—even though they will sometimes be used interchangeably in this book. Capitalism is too ambiguous a label to be used as an analytical category. There are in fact many varieties of capitalism that

function differently. Is France truly capitalist, with 90 percent of its financial sector and much of its heavy industry nationalized and in state hands? How is one to categorize Japanese capitalism, with the central role of its state in guiding the economy? The contemporary world is composed largely of mixed economies that at the international level are forced to compete with one another.

Other scholars have identified industrialism, industrial society, and/or the development of scientific technology as the defining characteristics of modern economic life.[5] The development of both industrial technology and modern science are obviously important for the prosperity and character of the modern world. One cannot account for the Industrial Revolution and the advent of modern science simply as a response to market forces; without science-based technology the modern market economy could not have progressed very far.

The scientific breakthroughs of the seventeenth and eighteenth centuries that laid the foundations for modern industry and technology are not reducible to the operation of economic motives. Science is an intellectual creation resulting from human curiosity and the search for understanding of the universe. Yet without market demand for greater efficiencies and new products, the incentive to exploit science and develop innovations in technology would be greatly reduced. Although the advance of science increases the potential supply of new industries and technology, the market creates the demand necessary to bring the technologies into existence. Thus the crucial role of the market in propelling and organizing economic life is the reason for our focus here on the market and the implications of economic interdependence for international relations.

The concept of market or economic interdependence is a highly ambiguous term, and many different definitions exist.[6] In this book the *Oxford English Dictionary* definition of economic interdependence favored by Richard Cooper will be used; it defines interdependence as "the fact or condition of depending each upon the other; mutual dependence" (Cooper, 1985, p. 1196). In addition, as Robert Keohane and Joseph Nye (1977) have noted, economic interdependence can refer to a power relationship, that is, to what Albert Hirschman (1945) calls vulnerability interdependence. Economic interdependence can also mean sensitivity interdependence, that is, changes in prices and quantities in different national markets respond readily to one another.

[5] Goldthorpe (1984, ch. 13), Giddens (1985), and Rostow (1975) are representative of these positions.

[6] An excellent analysis of these various meanings is Cooper (1985, pp. 1196-1200).

Although these different meanings of the term can in theory be easily distinguished from one another, this is not always the case in reality. Unless otherwise noted, I use "interdependence" to mean "mutual albeit not equal dependence." I thus accept economic interdependence as a "fact" or "condition," but do not accept many of its alleged economic and political consequences.

If by increasing economic interdependence one means the operation of the "law of one price," that is, that identical goods will tend to have the same price, then global interdependence has reached an unprecedented level. The conclusions to be drawn from this fact, however, are not readily obvious. Although this book will discuss the integration of national markets into an expanding interdependent global economy, it will also question a number of the effects that this growing interdependence is alleged to have upon international relations. Interdependence is a phenomenon to be studied, not a ready-made set of conclusions regarding the nature and dynamics of international relations.

The Economic Consequences of a Market

Although a market is an abstract concept, a market economy can be defined as one in which goods and services are exchanged on the basis of relative prices; it is where transactions are negotiated and prices are determined. Its essence, as one economist has put it, is "the making of a price by higgling between buyers and sellers" (Condliffe, 1950, p. 301). Phrased in more formal terms, a market is "the whole of any region in which buyers and sellers are in such free intercourse with one another that the prices of the same goods tend to equality easily and quickly" (Cournot, quoted in Cooper, 1985, p. 1199). Its specific characteristics are dependent upon its degree of openness and the intensity of the competition among producers and sellers. Markets differ with respect to the freedom of participants to enter the market and also the extent to which individual buyers or sellers can influence the terms of the exchange. Thus, a perfect or self-regulating market is one that is open to all potential buyers or sellers and one in which no buyer or seller can determine the terms of the exchange. Although such a perfect market has never existed, it is the model of the world implicit in the development of economic theory.

A market economy is a significant departure from the three more traditional types of economic exchange. Although none of these forms of exchange has ever existed to the exclusion of the others, one type or another has tended to predominate. The most prevalent economic system throughout history, one that is still characteristic of many less de-

veloped economies, is localized exchange, which is highly restricted in terms of available goods and geographic scope. The second type of exchange is that of command economies, such as those of the great historic empires of Assyria and, to much lesser extent, Rome, or of the socialist bloc today; in these planned economies, the production, distribution, and prices of commodities tend to be controlled by the state bureaucracy. Third, there is, or rather there was, long-distance trade in high-value goods. The caravan routes of Asia and Africa were the principal loci of this trade. Although this trade was geographically extensive, it involved only a narrow range of goods (spices, silks, slaves, precious metals, etc.). For a number of reasons, markets tend to displace more traditional forms of economic exchange.

One reason for the primacy of the market in shaping the modern world is that it forces a reorganization of society in order to make the market work properly. When a market comes into existence, as Marx fully appreciated, it becomes a potent force driving social change. As one authority has put it, "once economic power is redistributed to those who embrace the productive ideal, their leverage as buyers, investors, and employers is seen as moving the rest of society. The critical step in establishing a market momentum is the alienation of land and labor. When these fundamental components of social existence come under the influence of the price mechanism, social direction itself passes to economic determinants" (Appleby, 1978, pp. 14-15).

In the absence of social, physical, and other constraints, a market economy has an expansive and dynamic quality. It tends to cause economic growth, to expand territorially, and to bring all segments of society into its embrace. Groups and states seek to restrain the operation of a market because it has the potential to exert a considerable force on society; efforts to control markets give rise to the political economy of international relations.

Three characteristics of a market economy are responsible for its dynamic nature: (1) the critical role of relative prices in the exchange of goods and services, (2) the centrality of competition as a determinant of individual and institutional behavior, and (3) the importance of efficiency in determining the survivability of economic actors. From these flow the profound consequences of a market for economic, social, and political life.

A market economy encourages growth for both static and dynamic reasons. A market increases the efficient allocation of existing resources. Economic growth occurs because the market fosters a reallocation of land, labor, and capital to those activities in which they are most productive. Also, since market competition forces the producer (if

it is to prosper or even merely survive) to innovate and move the economy to higher levels of productive efficiency and technology, the market dynamically promotes technological and other types of innovation, thus increasing the power and capabilities of an economy. Although both the static and dynamic aspects of markets have encouraged economic growth throughout history, the dynamic factor has become of decisive importance since the advent of modern science as the basis of productive technology.

A market economy tends to expand geographically, spilling over political boundaries and encompassing an ever-increasing fraction of the human race (Kuznets, 1953, p. 308). The demand for less expensive labor and resources causes economic development to spread (H. Johnson, 1965b, pp. 11-12). Over time, more and more of the nonmarket economic periphery is brought within the orbit of the market mechanism. The reasons for this expansionist tendency include efficiencies of scale, improvements in transportation, and growth of demand. Adam Smith had this in mind when he stated that both the division of labor and economic growth are dependent on the scale of the market (Smith, 1937 [1776], p. 17). In order to take advantage of increased efficiencies and to reduce costs, economic actors try to expand the extent and scale of the market.

Yet another characteristic of a market economy is a tendency to incorporate every aspect of society into the nexus of market relations. Through such "commercialization," the market generally brings all facets of traditional society into the orbit of the price mechanism. Land, labor, and other so-called factors of production become commodities to be exchanged; they are subject to the interplay of market forces (Heilbroner, 1985, p. 117). Stated more crudely, everything has its price and, as an economist friend is fond of saying, "its value *is* its price." As a consequence, markets have a profound and destabilizing impact on a society because they dissolve traditional structures and social relations (Goldthorpe, 1978, p. 194).

At both the domestic and international levels a market system also tends to create a hierarchical division of labor among producers, a division based principally on specialization and what economists call the law of comparative advantage (or costs). As a consequence of market forces, society (domestic or international) becomes reordered into a dynamic core and a dependent periphery. The core is characterized principally by its more advanced levels of technology and economic development; the periphery is, at least initially, dependent on the core as a market for its commodity exports and as a source of productive techniques. In the short term, as the core of a market economy grows, it

incorporates into its orbit a larger and larger periphery; in the long term, however, due to the diffusion of productive technology and the growth process, new cores tend to form in the periphery and then to become growth centers in their own right. These tendencies for the core to expand and stimulate the rise of new cores have profound consequences for economic and political affairs (Friedmann, 1972).

The market economy also tends to redistribute wealth and economic activities within and among societies. Although everyone benefits in absolute terms as each gains wealth from participation in a market economy, some do gain more than others. The tendency is for markets, at least initially, to concentrate wealth in particular groups, classes, or regions. The reasons for this tendency are numerous: the achievement of economies of scale, the existence of monopoly rents, the effects of positive externalities (spillovers from one economic activity to another) and feedbacks, the benefits of learning and experience, and a host of other efficiencies that produce a cycle of "they who have get." Subsequently, however, markets tend to diffuse wealth throughout the system due to technology transfer, changes in comparative advantage, and other factors. It may also produce in certain societies a vicious cycle of decline, depending on their flexibility and capacity to adapt to changes. A diffusion of wealth and growth, however, does not take place evenly throughout the system; it tends to concentrate in those new cores or centers of growth where conditions are most favorable. As a consequence, a market economy tends to result in a process of uneven development in both domestic and international systems.

A market economy, if left to its own devices, has profound effects on the nature and organization of societies as well as on the political relations among them. Although many of these consequences may be beneficial and much desired by a society, others are detrimental to the desires and interests of powerful groups and states. The resulting tendency, therefore, is for states to intervene in economic activities in order to advance the effects of markets beneficial to themselves and to counter those that are detrimental.

Market Effects and Political Responses

In the abstract world of economists, the economy and other aspects of society exist in separate and distinct spheres. Economists hypothesize a theoretical universe composed of autonomous, homogeneous, and maximizing individuals who are free and able to respond to market forces in terms of their perceived self-interest. They assume that economic structures are flexible and behaviors change automatically and

predictably in response to price signals (Little, 1982, ch. 2). Social classes, ethnic loyalties, and national boundaries are assumed not to exist. When once asked what was missing from his classic textbook, Nobel laureate Paul Samuelson is reported to have responded, "the class struggle." This puts the point well, although he could have added, without undue exaggeration or violation of the spirit of the text, "races, nation-states, and all the other social and political divisions."

The essence of economics and its implications for social and political organization, as viewed by economists, are contained in what Samuelson has called "the most beautiful idea" in economic theory, namely, David Ricardo's law of comparative advantage. The implication of this simple concept is that domestic and international society should be organized in terms of relative efficiencies. It implies a universal division of labor based on specialization, in which each participant benefits absolutely in accordance with his or her contribution to the whole. It is a world in which the most humble person and the most resource-poor nation can find a niche and eventually prosper. A fundamental harmony of interest among individuals, groups, and states is assumed to underlie the growth and expansion of the market and of economic interdependence.

In the real world, divided among many different and frequently conflicting groups and states, markets have an impact vastly different from that envisaged by economic theory, and they give rise to powerful political reactions. Economic activities affect the political, social, and economic well-being of various groups and states differentially. The real world is a universe of exclusive and frequently conflicting loyalties and political boundaries in which the division of labor and the distribution of its benefits are determined as much by power and good fortune as they are by the laws of the market and the operation of the price mechanism. The assumption of a fundamental harmony of interest is most frequently invalid, and the growth and expansion of markets in a socially and politically fragmented globe have profound consequences for the nature and functioning of international politics. What then are these consequences that give rise to political responses?

One consequence of a market economy for domestic and international politics is that it has highly disruptive effects on a society; the introduction of market forces and the price mechanism into a society tends to overwhelm and even dissolve traditional social relations and institutions. The competition of the efficient drives out the inefficient and forces all to adapt to new ways. As noted earlier, markets have an inherent tendency to expand and bring everything into their orbit. New demands are constantly stimulated and new sources of supply sought.

Further, markets are subject to cyclical fluctuations and disturbances over which the society may have little control; specialization and its resulting dependencies increase vulnerabilities to untoward events. In short, markets constitute a powerful source of sociopolitical change and produce equally powerful responses as societies attempt to protect themselves against market forces (Polanyi, 1957). Therefore, no state, however liberal its predilections, permits the full and unregulated development of market forces.

Another consequence of a market economy is that it significantly affects the distribution of wealth and power within and among societies. In theory, all can take advantage of market opportunities to better themselves. In practice, however, individuals, groups, or states are differently endowed and situated to take advantage of these opportunities and therefore the growth of wealth and the spread of economic activities in a market system tends to be uneven, favoring one state or another. Thus, states attempt to guide market forces to benefit their own citizens, resulting, at least in the short run, in the unequal distribution of wealth and power among the participants in the market and the stratification of societies in the international political economy (Hawtrey, 1952).

Another important consequence of a market economy for states is due to the fact that economic interdependence establishes a power relationship among groups and societies. A market is not politically neutral; its existence creates economic power which one actor can use against another. Economic interdependence creates vulnerabilities that can be exploited and manipulated. In the words of Albert Hirschman, "the power to interrupt commercial or financial relations with any country . . . is the root cause of the influence or power position which a country acquires in other countries" through its market relations (Hirschman, 1945, p. 16). In varying degrees, then, economic interdependence establishes hierarchical, dependency, and power relations among groups and national societies. In response to this situation, states attempt to enhance their own independence and to increase the dependence of other states.

A market economy confers both benefits and costs on groups and societies. On the one hand, economic specialization and a division of labor foster economic growth and an increase in the wealth of market participants. Although gains are unevenly distributed, in general everyone benefits in absolute terms. Therefore few societies choose to absent themselves from participation in the world economic system. Yet, on the other hand, a market economy also imposes economic, social, and political costs on particular groups and societies, so that in relative

terms, some benefit more than others. Thus, states seek to protect themselves and limit the costs to themselves and their citizens. The struggle among groups and states over the distribution of benefits and costs has become a major feature of international relations in the modern world.

Conclusion

The central concerns of this book, then, are the impact of the world market economy on the relations of states and the ways in which states seek to influence market forces for their own advantage. Embedded in this relationship of state and market are three closely related issues of importance to the student of politics. The first is the way in which market interdependence affects and is affected by international politics and in particular by the presence or absence of political leadership. The second is the interaction of economic and political change that gives rise to an intense competition among states over the global location of economic activities, especially the so-called commanding heights of modern industry. The third is the effect of the world market on economic development and the consequent effort of states to control or at least to be in a position to influence the rules or regimes governing trade, foreign investment, and the international monetary system as well as other aspects of the international political economy.

Behind seemingly technical issues of trade or international money lurk significant political issues that profoundly influence the power, independence, and well-being of individual states. Thus, although trade may well be of mutual benefit, every state wants its own gains to be disproportionately to its advantage; it wants to move up the technological ladder to reap the highest value-added return from its own contribution to the international division of labor. Similarly, every state wants to have its say in decision making about the rules of the international monetary system. In every area of international economic affairs, economic and political issues are deeply entwined.

Scholars and other individuals differ, however, on the nature of the relationship between economic and political affairs. Although many positions can be identified, almost everyone tends to fall into one of three contrasting perspectives, ideologies, or schools of thought. They are liberalism, nationalism, and Marxism, and the next chapter will evaluate their strengths and limitations. In particular, the fundamental challenge raised by nationalism and especially Marxism with respect to the prospects for the continuation of the postwar liberal international economy will be considered.