The Decline of 'Embedded Liberalism' and the Rearticulation of the Keynesian Welfare State

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Introduction

In this paper we discuss the implications of globalisation and strategic trade and investment policies (STIPs) for the post-World War II politico-economic order based on 'embedded liberalism'—the marriage of free trade with domestic demand-side intervention. Theories about strategic trade suggest that state interventions in specific industries can improve the economic welfare of a country if the targeted industries generate sizeable positive externalities, show increasing returns to scale and are embedded in imperfect national and global markets. Imperfect markets create a potential for super-normal profits and well designed STIPs may shift these profits from foreign firms to domestic firms. Importantly, STIPs can enable countries to develop architectures of supply which are difficult to reproduce elsewhere. Such architectures of supply can become a major 'pull-factor' attracting investment from multinational corporations. Thus STIPs are an important element of state strategy to resist the de-nationalising impact of globalisation and to preserve the industrial base of the country. However, a widespread use of STIPs has two implications: at the international level, it undermines free trade, and at the domestic level, it refocuses allocations of state resources from demand-side social interventions to supply-side initiatives. For these reasons, STIPs help to undermine the political order based on embedded liberalism and hence create the basis for further domestic political resistance to the demands of economic globalisation.

1. The emergence of embedded liberalism

The Treaty of Westphalia in 1648 marked the end of the Holy Roman Empire and the beginning of the modern state system in Europe. The Westphalian nation-state, unlike its predecessors, exercised significant internal and external control.

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sovereignty over other sociopolitical institutions. Mercantilism helped to legitimize the authoritarian governments of nascent nation-states like Spain and France by emphasizing the importance of centralizing power to acquire, mainly by taxation, the wealth needed to pay for a military force that would generate more wealth through territorial expansion. Mercantilism provided a rationale for extensive and direct state interventions in markets, both domestic and international, assuming that domestic resources, particularly labor, were not fully employed. Since export employed such resources and imports did not international trade was viewed as a zero-sum game.4

Adam Smith attacked mercantilism by providing a different vision of the economic role of the Westphalian state. In Wealth of Nations, he argued for minimal state interventions in markets.5 Unlike the mercantilists, Smith assumed full employment of resources and thus focused on how to allocate these resources efficiently. He saw the market, the ‘invisible hand’, as being the most efficient allocator of resources—or at least more efficient than the state. The concept of the minimal state was challenged, in turn, by such prominent 18th and 19th century nationalists as Alexander Hamilton, Friedrich List and Gustav Schmoller. They argued for state support and temporary tariff protection for ‘infant industries’.6 In spite of this challenge from the nationalist thinkers, the minimalist view of the state inherent in Smithian economics remained dominant within political economy until the 1930s.7

In The General Theory of Employment, Interest, and Money, John Maynard Keynes challenged the three pillars of classical economics: Say’s Law, the Quantity Theory of Money and the assumption of perfect wage-price flexibility.8 Keynes questioned Say’s Law because he believed that during economic depression demand could create its own supply. He disagreed with the quantity theory of money because he believed that the money supply could affect real variables like the rate of growth and the level of unemployment. He also questioned the assumption of perfect wage markets and argued that market rigidities prevented perfect wage-price flexibility. According to Keynes, labour suffered from the ‘money illusion’ and thus resisted a downward revision of nominal wages even when real wages remained constant. Thus Keynes opposed the classicalists’ favourite remedy for balancing government budgets: deflating the economy. Deflation, he believed, decreased the price level and, in the absence of a decrease in nominal wages, increased real wages. A deflationary policy would reduce real wages if prices rose faster than the nominal wage. Thus Keynes differed in important ways from the classical economists in his theories about the relationships among labour markets, budget balances and the money supply.

The Depression of the late 1920s and 1930s was both a cause and a consequence of trade, monetary and exchange-rate-related beggar-thy-neighbour policies. In his later role as international diplomat, Keynes helped to create the Bretton Woods institutions that were designed to prevent a repeat of such policies. His vision was predicated upon what John Ruggie called embedded liberalism—an international liberal trade order embedded in a system of domestically interventionist states. The exchange rate regime constrained the ability of states to manipulate exchange rates in the short run; states could intervene only
to protect the exchange rate of their own currency. In international trade, the GATT sought to encourage free trade through reductions in tariffs and to limit the erection of new trade barriers. Thus the Bretton Woods regime sought to prevent a repeat of the follies of the 1920s and 1930s—trade wars and competitive devaluations—in a manner that war consistent with Keynesian theories.

2. Globalisation: mobile capital and technologised production

Globalisation is a highly contested concept and we do not attempt here to summarise the literature on this subject. In this article, we focus on economic globalisation, paying particular attention to evidence that important economic actors increasingly treat the globe, and not any particular country or region, as the unit of analysis for key economic decisions. We assume that promoters of economic globalisation are primarily non-state actors, such as multinational corporations, although the actions of states to take advantage of or cope with globalisation may certainly affect the direction and rate of globalisation processes.

Economic globalisation is not demolishing the state. Rather, we believe, it is creating conditions for its rearticulation, particularly with respect to influencing market processes. States are not capitulating to denationalising processes of globalisation; rather they are employing a variety of strategies to protect their domestic industrial base and national well-being. As Boyer and Drache observe, even though specific Keynesian policies may not be useful in a globalised economy, Keynes’s larger vision that markets are not self-organising and state interventions may be necessary to pursue national goals remains valid.

The twin hallmarks of economic globalisation are mobile capital (fixed as well as portfolio) and the technologisation of trade—that is, the increasing salience of high-technology products in global trade. High technology could be embodied in final products or be used in producing them. In this article, we focus on the implications of the technologisation of traded products and the resulting incentives for states to use STIPS to develop domestic architectures of supply in critical technologies. By employing such policies, states attempt to maintain their domestic manufacturing base, high labour productivity levels, and the concomitant high standards of living of their domestic workforce. One could therefore interpret STIPS as a policy response of states to resist the homogenising and denationalising pressure of economic globalisation.

The performance of political leaders in advanced industrial countries is increasingly judged on the basis of economic indicators such as economic growth, unemployment and inflation rate. To deliver on these indicators, policy makers need to attract and retain capital investments. To do this successfully, they are required by globalised financial markets to control government expenditures and to reduce budgetary deficits so that public borrowing will not crowd out private investments in the capital market. Consequently, states are adopting two kinds of strategies. First, as Porter, Reich, Dunning and other, point out, states are undertaking supply-side initiatives such as creating physical infrastructure, lowering transaction costs, protecting intellectual and other property rights.
and investing in human capital. 12 States may also indulge in beggar-thy-neighbor policies (regulation arbitrage, as Cerny puts it), 13 for example, by competitively lowering economic, social and environmental regulations. 14 In this article we suggest that, along with these factors, states will use STIPs as supply-side initiatives to create and maintain domestic architectures of supply in critical technologies.

Second, states are downsizing their demand-side interventions, both social and economic, presumably on the grounds that the expanded scope of redistributive welfare policies and the agency costs of administering them have resulted in a fiscal crisis. 15 State interventions can be conceptualised as collective goods. Unlike Cerny, we do not consider all outputs of state interventions to be public goods. 16 Public goods are a subset of collective goods which are non-rival and non-excludable. Other collective goods: such as common-pool-resources and club/toll goods can also be created as a result of state interventions, and they are associated with a different set of governance issues than public goods. 17 For example, one can classify welfare support to individuals in distress as a sort of common-pool resource which is rival but non-excludable. It is not a pure public good. Such common-pool resources like welfare are bound to be 'over-grazed', resulting in the degradation of the resource (fiscal crisis in our context). More conventional explanations for the expansion of welfare payments—such as the temptation on the part of incumbent politicians to expand welfare programmes to assure re-election—are also valid explanations for the fiscal crisis. However, since corporate welfare is an excludable club-good or private good, its beneficiaries have much greater incentives than recipients of individual welfare payments to organise themselves to safeguard their privileges. The same can be said for the recipients of group-specific welfare payments, e.g. the elderly for what in US terminology is called Medicare and social security, or college students for college loans.

Although globalisation is leading to pressure for a downsizing of particularly unpopular welfare-state programmes, such as affirmative action programmes, free medical care for the indigent and corporate welfare for state enterprises (especially in Europe), there is little claqueur for downsizing middle-class entitlements like Medicare and social security, college student loans or corporate welfare for private firms. The welfare state, in short, is not on the verge of disappearing. Rather, it is treasuring and regrouping around a new set of slogans and rationales. Supporters of globalisation, like the world’s multinational corporations, have pushed hard for this reformulation of welfare-state policies. Some political actors in advanced industrial societies have concluded that the best defence of the residual welfare state, therefore, is to link welfare-state policies with international economic competitiveness (more on this later).

Globalised financial infrastructure and the increased economic power of the multinational corporations have limited the efficacy of traditional economic interventions. The globalised financial infrastructure is marked by internationally mobile capital, especially short-term capital. International capital mobility makes it more difficult for domestic monetary authorities to control inflation by manipulating the money supply. When credit is tightened in order to stem inflation, foreign capital will flow in to take advantage of higher interest rates.
When credit is loosened to promote economic growth and reduce unemployment, foreign capital will flow in. In theory at least, financial globalisation subtracts two items—control over the money supply and exchange rates—from the menu of policy instruments available to the state. As Tibetegen argued, the number of policy objectives can never exceed the number of policy instruments. Hence the state is presumably forced to shed some policy objectives just to grapple with internationally mobile capital. We observe simply that it is tempting to deal with this problem by removing social safety nets because the beneficiaries of such programmes are actors who, unlike multinational corporations, cannot “vote with their feet.” The expanded cost and scope of supply-side interventions, particularly those justified in terms of theories of strategic trade and investment, crowd out demand-side interventions. In sum, globalisation erodes the political support among financially powerful and internationally mobile domestic economic actors for Keynesian demand-side interventions and social safety nets at the same time as it creates new demands from them for supply-side spending to promote international competitiveness. States can resist these pressures for downsizing demand-side spending by reformulating welfare-state social policies and by defending item in terms of enhanced competitiveness, but they are likely to have to make concessions on increased supply-side spending as part of the overall shift in policies.

States vary in their willingness and capability to engage in supply-side interventions or to downsize demand-side interventions. Willingness and ability to intervene critically depends on the history of state–societal relationships as well as the state’s place in the international system. In the industrialised democratic societies with strong labour parties, states are likely to face considerable domestic opposition to reducing demand-side spending. In societies where organised labour is politically weak, the pressure to reduce demand-side spending will be harder to resist. It is not easy to predict a priori which type of state–societal arrangements (corporatist, pluralist, statist) will best equip a country to resist these pressures or to defend the welfare state with well designed demand-side and supply-side programmes aimed at fostering competitiveness.

A few scholars have argued that there are different forms of capitalism and that only some of these are consistent with well designed and well executed supply-side intervention. For example, the USA has rarely engaged in active supply-side interventions, partly because of the dominance of business interests in US society, the ideational and institutional grip of neoclassical economics, and possibly also the hegemonic role of the USA in setting up the postwar multilateral system (based on Keynesian embedded liberalism). Since both neoclassical and Keynesian ideas are less influential in Japan than in the USA, which is itself partly the result of power-sharing between the state and private business interests, the Japanese government faces less political opposition to its supply-side interventionist role. In this article we will not be able to analyse the various types of state–societal arrangements and their impact on a state’s capacity to confront economic globalisation. This is, however, a worthy topic for further examination. We also will not be able to analyse how a nation’s position in the international system may impede or facilitate its willingness or ability to cope with domestic pressures to accommodate or resist economic globalisation.
Instead, we will focus on how globalization creates incentives for states to adopt STIPs and how a widespread adoption of STIPs can undermine the postwar international economic order of embedded liberalism.

3. Strategic trade and investment policies

Trade policies are policies that are supposed to encourage or inhibit trade (exports and imports). Tariffs and non-tariff barriers (of which there are hundreds of different kinds) are examples of trade policy instruments. Two questions that have been hotly debated since the time of Adam Smith are: should there be a trade policy at all and, if so, what kinds of trade policies can benefit a specific country?

Smith made a case for free trade based on absolute advantage. The Ricardian trade theory, also known as classical trade theory, argued for free trade based on comparative and not absolute advantage. The neoclassical trade theory, pioneered by Eli Heckscher and Bertil Ohlin, also identified comparative advantage as the basis of international trade. The Heckscher-Ohlin (H-O) model assumes declining or constant returns to scale (growth of output can never grow faster than the growth of inputs), perfect competition in product and factor markets (there are many producers and few barriers to entry for new producers) and perfectly mobile technology. Since in Smithian, Ricardian and H-O models free trade benefits all the participants, states are advised not to have trade policies but simply to open their economies to free trade.

New Trade Theories or Strategic Trade Theories (STTs) relax the assumptions of the H-O model. STTs assume imperfectly competitive markets and increasing returns to scale. They then deduce that domestic firms can benefit asymmetrically from its presence. But if the state intervenes on behalf. By doing so, the state can shift the supernormal profits associated with industries in imperfectly competitive markets, and eventually jobs, from one country to another. Given the primacy of economic issues on political agendas, states are tempted to adopt the strategic trade policies that STTs suggest will do this.

Industrial policies, i.e. state intervention in the domestic economy to promote critical industries, also have a long history of intellectual discourse—starting with the earliest defences of infant industry policies and including the vigorous defence of import substitution policies by Latin American economists like Raúl Prebisch. Industrial policies differ from macroeconomic policies in that they target only a subset of the economy. Whereas macroeconomic policies (such as tax rates, levels of government spending and interest-rate policies) generally do not discriminate among types of firms or industries, industrial policies (such as R&D subsidies, tax subsidies, preferential loans and preferential credit allocations) can be granted to some firms or industries and not others.

Industrial policy theories (IPTs) fall into three broad categories: technological trajectory theories, structuralist theories and institutionalist theories. Although these categories overlap, they provide different rationales for industrial policies. The technological trajectory theories argue that technological flows across national boundaries are imperfect even when capital is highly mobile. State intervention may be needed to secure “first-mover advantages” for
domestic firms in high-technology industries for which initial investments are large, learning curves are steep and architectures of supply are difficult to reproduce. In this case, it is extremely risky for firms to make the necessary investments without government support of some kind. However, if they fail to do so, the country loses the chance to earn revenues and generate employment in that particular industry for a reasonably long time. Such industries are often designated as 'strategic' for this reason and have a larger claim on government resources than other industries. It helps, of course, if they involve technologies which also have military applications. Examples in recent years would include the computer, semiconductor and aerospace industries.

The structuralists, for their part, argue that industrial policies are one way that non-hegemonic countries can challenge the power of the hegemon, by promoting exports of domestically produced goods and capital to the rest of the world while protecting domestic firms from international competition by restricting imports and capital inflows—in short, by free riding on the liberal trade and monetary institutions established by liberal hegemons like the USA. Institutionalist theorists, in turn, focus on the historically rooted differences in state—societal arrangements and their impact on the competitiveness of domestic firms. Some institutional configurations systematically create barriers to imports and inward investments and thereby shelter domestic firms from international competition. Contrast, for example, the relatively open nature of the US system, marked by low government—industry collaboration, with the relatively closed Japanese system, marked by significant business—government collaboration. Institutionallists argue that these differences create advantages for Japanese firms to compete in global markets.30

This article focuses on the technological trajectory version of industrial policy theorising and links it to theories of strategic trade. As suggested earlier, we identify two distinguishing characteristics of globalisation—greater mobility of capital and the technologisation of traded products. To be globally competitive in high technology products, firms must have adequate and timely access to related technologies (e.g. for materials, components and manufacturing equipment). This can only be ensured by a well developed architecture of supply in those products and technologies. In high technology industries, it is important for suppliers to be located near producers because suppliers and producers must often collaborate on designing both products and production processes. Even if the suppliers are not locally owned, they must have a local presence for this sort of collaboration to be practical.31

A good example of this can be found in the relationship between semiconductor producers and the makers of tools used in semiconductor manufacturing—e.g. photolithography equipment, chemical vapour deposition devices, steppers and so on. It is often difficult for US semiconductor manufacturers to obtain access to state-of-the-art tools from Japanese equipment manufacturers, because the main customers of the latter are in Japan and the tool makers do not have sufficient resources to locate a subsidiary near their potential US customers. A similar problem exists currently for US liquid crystal display (LCD) firms, since most of the suppliers are currently in Japan servicing Japanese customers (even if they are not Japanese firms). The Japanese semiconductor industry faced the
same problem when it tried to compete with the US industry in the 1960s and early 1970s. It succeeded only after it received fairly substantial assistance from the Japanese government during the mid and late 1970s to create its own set of supplies.

This suggests that countries having appropriate architectures of supply will have an easier time than those without them in keeping domestic firms internationally competitive and in attracting inward investments by foreign multinationals. An example of this would be IBM’s decision in 1986 to work with Toshiba in a joint venture in Japan to manufacture active matrix LCDs. Similarly, Hewlett-Packard works with Canon in Japan via its Japanese subsidiary to manufacture engines for laser printers. The technological trajectory version of industrial policy theorising, in our view, best frames the challenge which globalisation poses to the territorially based nation-state system and to the international regimes founded on the idea of embedded liberalism.

4. Erosion of distinction between trade and industrial policies

How are industrial policies related to trade policies? Trade and industrial policies overlap if promoting exports or restricting imports affects the international competitiveness of domestic firms. Economic globalisation blurs the boundaries between domestic and international markets. Domestic firms can tap international markets either through exports, foreign direct investment, or international cooperative arrangements with foreign firms. The essence of industrial policy, as supported by strategic trade and industrial policy theories, is to keep foreign competition at bay for a period of time while government subsidies combined with private sector investments create an internationally competitive domestic industry and a viable local architecture of supply. Keeping the foreign competition at bay may require a combination of import restrictions and restrictions on inflows of foreign investment, while at the same time encouraging foreign firms to share needed technologies at the lowest possible price.

So it is clear that two key components of industrial policy, especially as practised in Asia, are trade policy in the form of import restrictions and investment policy in the form of restrictions on the inflow of foreign direct investment (FDI). What are the implications of restricting inward foreign investment? First, at a general level, impediments to inward FDI are similar to tariffs in that they reduce the amount of competition that domestic firms face in servicing the domestic market. Unlike tariffs, such impediments do not generate revenues for the state in the form of customs receipts, but, like tariffs, they generally increase the prices of goods that might have been imported or produced locally by foreign investors in the absence of FDI restrictions.

Second, restrictions on inflows of FDI can be used to bar foreign supplier firms from participating in local architectures of supply. This is what happened, for example, after the Japanese government and semiconductor industry were successful in fostering the growth of a domestic semiconductor tool-making industry. It became much more difficult for US suppliers of lithography equipment, for example, to sell machines to Japanese semiconductor firms.

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Third, the combination of import and inward investment barriers encourages foreign firms to set up joint ventures or licensing arrangements with domestic firms as a last resort for getting some foothold in the domestic market. This tends to give domestic firms greater bargaining power to obtain access to needed foreign technology without paying exorbitant prices. This only occurs, it should be noted, if the combination of public and private resources actually creates an internationally competitive industry. Otherwise, foreign firms will not be so desperate to get a piece of the market by sharing or licensing technology.

5. STIPS and 'embedded liberalism'

Ruggie’s notion of ‘embedded liberalism’ links the rise of the Keynesian welfare state to an agreement among the major industrialised nations to keep the global trading system as open as possible. The Keynesian state frequently employs two categories of demand-side interventions—social safety-net interventions, such as unemployment benefits, medical benefits and old age pensions, and macroeconomic interventions to stabilise the economy. The Keynesian state is under attack on both these counts.

The logic of embedded liberalism depended on a broad social consensus on the value of preserving free trade. Maintaining this broad consensus on free trade was always somewhat problematic, but since the end of the 1970s that task has become substantially more difficult. Samuelson’s factor price equalisation theorem, an important side product of the H-O trade model, explains why foreign trade creates asymmetrical benefits across domestic factors of production: greater foreign trade tends to benefit the relatively abundant factor of production disproportionately. 13 Free trade increases a country’s exports as well as imports. A country has a comparative advantage in products which use the abundant factor intensively. Since the abundant factor is intensively used in exports, free trade increases its earnings. On the other hand, since the scarce factor is intensively used in products which compete with the imports, its earnings fall. Then why should the scarce factor accept free trade? Clearly, some sort of side-payments to the scarce factor are required to make free trade Hicks-Kaldor superior for all the factors of production. 14

Keynesian social interventions can therefore be interpreted as side-payments to domestic actors hurt by the multilateral trade regime established at Bretton Woods. The popular perception is that imports into industrialised countries typically consist of low-technology products produced in low-wage countries which hurt the domestic sunset industries. Some sort of side-payments are therefore made to the constituencies dependent on such industries. Since the fiscal crisis confronting most of the industrialised countries is generating political pressures to downsize such side-payments, actors hurt by free trade are increasingly demanding protection from imports—classical protectionism. Thus further movement towards globalisation and free trade is being most vigorously opposed by nationalists in alliance with organised labour in sunset industries, as well as by other constituencies which hitherto were beneficiaries of the Keynesian welfare state. 

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Social interventions may also be justified as tools of counter-cyclical demand management. Keynesians view such payments as built-in stabilisers—they deflate the economy during recessions and deflate it during booms. However, such side-payments have exhibited a kind of ratchet effect and have kept on increasing without regard to the willingness of taxpayers to be taxed further. As long as there is some faith in the efficacy of Keynesian demand-management policies to smooth out economic cycles, Keynesian free traders can justify social interventions on purely economic grounds. The assumption is that taxpayers will go along with changes in spending and tax levels that are designed to reduce economic cyclicalties. As Keynesian demand management becomes more difficult because of economic globalisation, however, the advocates of counter cyclical macroeconomic and social policies find it more and more difficult to justify them politically.

We have argued that STIPs are attractive to cope with economic globalisation, particularly the technologisation of traded products. Because access to critical technologies has become one of the primary considerations for locating new investments by multinational corporations, they have a strong incentive for supply are vital to international economic success. Firms with access to such architectures of supply are more likely to be able to develop and commercialize high technology products and to be 'first movers' in global markets. Since first movers often earn super-normal profits, a substantial portion of which can be transferred to subsequent research and development to preserve first-mover advantages, countries with more such firms will be better able to create jobs and prosperity in the domestic economy. The resemblance with the Schumpeterian idea of monopoly profits financing the 'perennial gales of creative destruction' is not coincidental.18

As the technologisation of traded products proceeds, market imperfections (particularly the rise of giant firms capable of enjoying a monopoly or quasi-monopoly status) may be accentuated. Since technology development and commercialisation is expensive, markets cannot support a large number of players in high technology sectors. Hence the technologised global markets will tend to be oligopolistic or monopolistic. The resulting growth in super-normal profits will create further incentives for state interventions, leading to a further undermining of the international regimes that were established under embedded liberalism.

We have argued above that a separation of trade and industrial policy in international regimes has become increasingly difficult. The GATT, with its emphasis on reducing trade barriers, was useful when manufacturing industries dominated world trade. The compartmentalisation of trade policy and industrial policies was also legitimate at that time. However, with the rising share of the service industries in world trade, the technologisation of trade, and the growing subsidies and restrictions on foreign investment flows in high technology industries, the premises under which the GATT (now the World Trade Organization) operated have changed. The failure of the GATT to address investment issues along with trade issues has become, in the age of strategic trade and industrial policies, a major deficiency. The same can be said for the Bretton
Woods regime’s failures to adequately address trade in services, intellectual property protection and R&D subsidies.

In sum, we see strategic trade and industrial policies as challenging the order based on embedded liberalism on two grounds. At the domestic level, they crowd out demand-side social interventions. At the international level, they undermine free trade. Yet STIPs are attractive for two reasons. First, they help to create internationally competitive domestic firms with local architectures of supply, a key factor for attracting the investment of multinational corporations in a globalised world economy. Second, they become a bargaining chip to ensure that domestic firms are not discriminated against in foreign markets, especially those where STIPs are already being used to discriminate against foreign firms.

In this way, globalisation is undermining the multilateralism that was based on embedded liberalism by encouraging the wider adoption of STIPs.

Conclusion

STIPs can be viewed as policy instruments to harmonise national political economy to the demands of the globalised economy as strategies of states to resist the denationalising tendencies of globalisation by emphasising the local aspects of technology generation and diffusion. Though both STIPs and Keynesian economics recommend state interventions in the economy, they provide different rationales and distinctive visions for them. STIPs are selective supply-side sectoral interventions to enhance the competitiveness of specific domestic industries by facilitating the emergence of local architectures of supply. Keynesian interventions are macroeconomic in focus and operate mainly from the demand side to reduce the potentially negative impact of business cycles. In an increasingly globalised economy, there is a significant overlap between trade and industrial policies. They can be used in tandem to enhance the competitiveness of domestic firms and/or to increase the likelihood that foreign multinationals will locate major activities inside that country. To cope with globalisation, states are tempted to adopt supply-side interventions which tend to crowd out previous demand-side interventions because of budgetary constraints. Globalisation challenges embedded liberalism mainly for this reason and is resisted by the constituencies which benefited from the embedded liberalism compromise.

The use of STIPs to gain national advantage has been criticised (mainly by neoclassical economists) because of the problems inherent in measuring externalities, differentiating normal from super-normal profits, differentiating domestic from foreign firms in a globalising world economy, and preventing public officials and/or private interest groups using STIPs for rent seeking. Even though these criticisms are quite reasonable, STIPs remain attractive for governments trying to cope with the increasing technological change in the global economy. The political attractiveness of the idea of emulating the success stories of Asia is difficult to resist. It is also clear that a widespread adoption of STIPs may lead to increasing allocative inefficiencies in the world economy, if not massive trade wars, by undermining the multilateral norms of the GATT and other postwar international economic regimes. Thus the debate on STIPs provides a powerful stimulus to rethinking how the institutions
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linking states and markets within and across countries may be restructured. Further, the debate on STIPs challenges us to consider how likely it is that states and other social actors will resist the impact of economic globalisation and how likely it is that they will succeed in doing so. Globalisation is clearly forcing a rearrangement of the state in industrialised countries. However, states in those countries still retain a considerable ability to resist the denationalising tendencies of globalisation by protecting and building upon the domestic technological and industrial base. The crucial problem is how they will do this without alienating the social forces that have, in the past, supported liberal international economic regimes.

Notes

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3. Kraemer, however, argues that the notion of sovereign nations predates the Peace of Westphalia: the Holy Roman Empire ended only in 1806, even in contemporary times states have seldom exercised absolute sovereignty over their territory. See Stephen D. Krasner, 'Westphalia and All that', in Judith Goldstein & Robert O. Keohane (Eds), Ideas and Foreign Policy (Cornell University Press, 1990), pp. 234-64.


9. Is globalisation a myth? Some critics argue that the proportion of foreign trade to national income or the proportion of capital flows to current account flows for industrialised countries was actually higher before World War I than it is today. We share the views of a growing number of business scholars who believe that economic links are more pervasive today than ever before, and that firms are increasingly treating the whole globe as the basis for their economic decisions. See Michael E. Porter, The Competitive Advantage of Nations (The Free Press, 1990); Walter B. Wriston, 'Agents of change are rarely welcome', in Jeffrey A. Frieden & David A. Lake (Eds), International Political Economy: Perspectives on Global Power and Prosperity (St Martin's Press, 1986); John M. Henderson & Susan Strange, Real States, Real Firms (Cambridge University Press, 1991); Robert Reich, The Work of Nations (Vintage, 1992); John L. Daniels & N. Carstnie Daniels, Global Values: Building New Models for the Corporation of the Future (McGraw Hill, 1993); and John H. Dunning The Globalisation of Business: The Challenges of the 1990s (Hodder, 1993); and Stephen J. Kohlin, 'Regional Integration in a Globally Networked Economy', Transnational Corporations, Vol. 4, No. 2 (1995), pp. 11-33. But we also believe that the concept of globalisation has taken on mystic proportions and is being harnessed for political ends. On this question, see Ian Douglas, 76
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17. For an extended discussion, see: Ewige Osnos, Roy Gardner and James Walker, Rules, Games and Common-Pool Resources (University of Michigan Press, 1996).


20. For an ambitious attempt to combine domestic (soft versus hard states) and international factors (weak versus powerful states), see: Michael Aleschiano, David A. Lue & G. John Breyer, 'Towards a Realist Theory of State Action', International Studies Quarterly, Vol. 33 (1988), pp. 457-74. Yet the soft-hard distinction is problematic as sofies is specific to the issue area in as well as the non-state actor.


22. David Riesbl, Principles of Political Economy and Taxation (Boston, 1781 [1810]).


30. For a review of Japan's industrial policies, see Ronald Dore, Structural Rigidity (Stanford University Press, 1986); David Friedman, The Misunderstood Miracle (Cornell University Press, 1988); Johnson, MITI and the Japanese Miracle; Chalmers Johnson, Laura D'Andrea Tyson & John Zysman (Eds.), Politics and Productivity (Ballinger, 1989); Iku Takahashi, The Japanese Economy (MIT Press, 1992); Shigeto Tsutsui, Japanese Capitalism (Cambridge University Press, 1991); and Kent Calder, Strategic Capitalism (Princeton University Press, 1993). Boyer and Drake also note that 'the very process of internationalization reveals the persistence of national systems of innovation which are deeply embedded in a web of interrelated political, educational and financial institutions which cannot be copied or adapted'. Boyer & Drake, States against Markets, p. 14.

32. DeAnne Julius, Global Companies and Public Policy: The Growing Challenge of Foreign Direct Investment (Council on Foreign Relations Press, 1990); and James R. Markusen, 'The Boundaries of Multinational Enterprises and the Theory of International Trade', Journal of Economic Perspectives, Vol. 9 (1995), pp. 109-80. Multinational corporations are not synonymous with foreign direct investment. FDI is just one of the ways MNCs can finance their overseas operations. They can also use (local capital) FDI flows and stocks, however, are often used to measure the extent of MNC activity.


34. A charge is Pinto superior if no actor is worse off in the new situation versus the status quo. However, if some actors lose and some others gain, the new situation is Pinto non-comparable. If the aggregate gains of the winners exceed the aggregate losses of the losers (the net benefit is positive), then the change is Hicks-Kaldor superior in that the winners can potentially compensate the losers and still be left with a surplus.


36. Joseph A. Schumpeter, Capitalism, Socialism, and Democracy (Alten and Unwin, 1943),