PART II

Politics, Economics, and Stability

Chapter 8

STATES, MARKETS, AND GREAT POWER RELATIONS IN THE PACIFIC

Some Realist Expectations

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What will explain the emerging pattern of economic relations among the great powers in the Pacific? This essay applies a realist political economy framework to deduce expectations regarding the trade, monetary, and financial relations in the region with an emphasis on the United States, China, and Japan. It will consider the expectations of specific realist *theories*, not realism itself. Realist theories of political economy, some of which may in fact deduce competing predictions, derive from a common framework. The first section of this essay will establish that framework, which, it should be emphasized, is an approach, not a theory, and as such can not be falsified. Successive sections will then derive or review specific realist theories regarding trade, money, and finance and apply them to contemporary politics. These issue areas are addressed in increasing order of their practical significance. This underscores an implicit argument that trade issues have attracted a disproportionate amount of attention in debates surrounding realist analysis, at the expense of more consequential developments in the monetary and financial spheres.

THE POLITICAL ECONOMY OF REALISM[1]

Realist theories of political economy share three foundations, regarding the relationship between wealth and power, expectations of war, and the nature of the state. The first foundation—that *economic growth and capacity are the underlying source of power; economic and political goals are complementary in the long run*—is not unique to realism. It is clearly associated with Adam Smith, and most aspects of realist political economy can be traced to the neomercantilist response to Smith's devastating critique of classical mercantilism. Those neomercantilists, however, did not refute Smith's arguments. Rather, they integrated parts of his doctrine into the reformulation of their own.[2] Thus, while liberals and realists have always shared the view that both power and plenty were crucial and complementary aims of state action,[3] modern realists have integrated the liberal argument that power flows from productive capability and productive capability from economic growth. These are core assumptions upon which realism draws, but they are not uniquely realist positions.

What distinguishes realism from other schools of thought, and particularly from liberalism, are the two additional foundational assumptions, which regard war and the state. These also fundamentally shape the distinct way in which realists have interpreted the consequences of the assumption regarding economic growth. Realists expect states to prefer high rates of economic growth, but they also assume that *states must anticipate the possibility of war*. It is important to stress that the concern for war is best conceptualized as a dimension. Realists need not see a constant "state of war," nor do liberals consider war impossible. What distinguishes realists is that they can be placed on that end of a continuum which stresses the likelihood of war, threats of war, and the need for states to shape their policies in the light of this consideration. For E. H. Carr, for example, "Potential war" is "a dominant factor in international politics."[4] This prevents states, realists argue, from pursuing policies that, while optimal from an economic perspective, threaten national security.

Realists are also distinguished by their view that *the state is a distinct actor with its own interests*. As with the significance of war, assumptions regarding states rights are not absolute, but are held to varying degrees. Thus, non-realists do not deny the existence of an autonomous state; they simply differ as to the extent and consequence of that autonomy. Realists stress the state as a distinct entity from the sum of particular interests; as an entity with the capability and inclination to pursue its own agenda; and as the principal actor in international relations.[5] Significantly, the interests of the state will often diverge markedly from the sum of particular interests within society, and the state will act to defend its interests.

These three foundations combine in ways that define some of the broader contours of realist expectations. Divergences between state and societal interests, for example, can come from a number of sources but are most likely to arise in regard to issues related to security. This is because in a world where war is possible, states are likely to be very sensitive to national security issues, while, due to a collective action dynamic, individual actors within society are likely to be suboptimally concerned with the common defense. Thus, while power and plenty are complementary in the long run, the state will often be willing to sacrifice short- and medium-term economic gains when tradeoffs present themselves. Indeed, states may routinely make economic sacrifices in order to further international political goals.

Concerns for war also catalyze the instinct of the state for autonomy from all quarters (domestic interests, other states, and economic forces) resulting in a preference for national self-sufficiency. Limiting international exposure reduces vulnerabilities, which would result from the disruption of peacetime patterns of international economic flows. Given these preferences, realists tend to discount the benefits of interdependence, stressing instead how it may be an irritant for states, and as such a source of friction between them.[6]

Realist political economy thus presents states with a delicate balancing act. Given the possibility of war, states would prefer to limit interdependence, retain a reservoir of resources, and forgo a number of beneficial transactions. But such behavior will direct economic activity along suboptimal paths, and this in turn threatens economic growth, which provides the basis for long-run power. Thus complete autarky will rarely be sought—the state must mediate between its desire for autonomy and its need to assure adequate long run economic growth.[7]

REALIST TRADE CONFLICTS? THE BATTLE OVERSTATED

The realist perspective tends to be pessimistic about the prospects for international cooperation, and in no sphere is this more obvious than with regard to trade. Since economic growth determines long-run military capability, and given concerns for the possibility of war, states will find it difficult to cooperate. Even with the recognition that mutual gains exist, states must still be concerned with the distribution of those gains, lest potential adversaries become relatively more powerful.[8]

Realists do not deny the existence of mutual economic gains from trade, but rather question whether the existence of such shared gains are sufficient to assure that they will be reached. One barrier to cooperation is the question of dynamic comparative advantage: whether the pattern of specialization imposed by international market forces would put a nation on a trajectory of relatively low growth. Economically rational specialization might also make the state less able to defend itself, causing a contraction of the steel industry, for example, in favor of expanded agricultural cultivation.

In the latter case, concerns for security will force states to include noneconomic factors in their calculations of the costs and benefits of efficient specialization, and deviate indefinitely from economically optimal patterns of production.[9] More subtly, in the former instance, if temporary protection or other measures, which, when removed, would allow for specialization in more attractive products, then free trade would not be the optimal policy in the short run. Again, the gains from trade are not denied—rather, this is a classic case of the state imposing short-term costs on society for greater benefits in the long run.[10] It is important to note that the realist concern is for the *composition* of trade, and not its overall balance. This one way in which realists can be distinguished from crude protectionists.

Even in the absence of concerns for dynamic comparative advantage, realists would still expect cooperation to founder over the distribution of gains in a static setting. As Gilpin noted, "the distinction between absolute and relative gains" is "a fundamental difference in emphasis" which distinguishes realism. In contemporary international relations theory, this issue has received a disproportionate share of attention. While the concern for the distribution of mutual gains (the "relative gains" issue) is significant for realist political economy, what ultimately distinguishes realism is not the pursuit of relative gains, but the *motives* behind that pursuit: the existence of anarchy and the concern for security. Actors in the absence of anarchy routinely seek relative, not just absolute, gains in their interactions. Thus while realists offer a fundamental motivational difference for state behavior, the behavior itself (pursuit of relative gains) is not incompatible with other approaches to political economy.[11]

Liberals, for example, do not deny the possibility of conflicts about the distribution of relative gains—these take place in many instances between friendly partners in the absence of threats of force, readily seen, for example in most transactions between actors within a domestic economy. In international trade, and especially in the high-technology sectors, oligopoly competition, strategic behavior, economies of scale, high start-up costs, and other deviations from the "classical" model may stimulate trade conflict and provide the grounds for government intervention in commercial policy. These conflicts need not be rooted in concerns for security, but solely for optimal economic growth.[12]

Realist motives simply raise the stakes in these conflicts, supplying an additional source of friction. Actors are not concerned simply with others reneging on promises, a sense of distributive justice, or the need to establish a tough reputation for future negotiations, but rather, as Grieco argues, "states in anarchy must fear that others may seek to destroy or enslave them."[13] Thus what distinguishes realists' expectations in practice are not conflicts over relative gains, but *sharper* conflicts over relative gains; with partners walking away from *a significant number* of deals with mutual gains left on the table. For both liberals and realists, then, the "core" of agreements is smaller than the set of mutually beneficial deals. The realist subset is simply smaller still. Distinguishing between these subsets in practice is extremely difficult, since the simple illustration of relative gains conflicts will not be sufficient.[14]

As a result there are no distinct realist expectations with regard to trade between the U.S and Japan and between the U.S. and China. While there may be good realist reasons to expect trade conflicts between the U.S. and Japan, there are good liberal reasons to expect the same thing.[15] While many analysts expect increasing trade frictions to emerge between the U.S. and China,[16] there is no theoretical justification in liberal *or* realist theory for placing the *balance* of trade into the first (or even second) rank of policy concerns. Thus we are likely to witness trade conflicts that are overdetermined—consistent with both liberal and realist expectations, and other disputes that neither perspective can productively address.

There is, however, one distinct realist theory of international trade, articulated by Hirschman, in his book *National Power and the Structure of Foreign Trade*.[17] Hirschman focused on German interwar trading relations, demonstrating how Germany cultivated a series of asymmetric trading relationships with the small states of southeastern Europe, as part of its pre–World War II grand strategy to secure needed raw materials and increase German leverage there. Although inefficient from an economic perspective, redirecting trade enhanced Germany's autonomy. Focusing on small states increased Germany's political leverage in these relationships by making exit more costly for others. This asymmetry, plus the relatively sweet deals offered by Germany, exerted, as Hirschman noted, "a powerful influence in favor of a 'friendly' attitude towards the state to the imports of which they owe their interests."[18]

But there is much more to Hirschman's story than coercion: there is also a story about influence, and in practice this is almost certainly the more significant of the two.[19] Simply put, *National Power* shows that the pattern of international economic relations affects domestic politics, which in turn shape the orientation of foreign policy. This effect is always present but most consequential in asymmetric relations, where the effects are typically large, visible, and almost wholly found within the smaller economy. Consider, for example, a free trade agreement between a large and a small state. The likely result is a change in the smaller state's self-perception of its own interest: it will converge toward that of the larger. Why? Because the simple act of participation in the arrangement strengthens those who benefit from it relative to those who, by definition, do not. This strength should translate into political power.[20] Further, because firms and sectors engage in patterns of activity based on economic incentives, and since this constellation of incentives will be transformed by the trade agreement, the subsequent reshuffling of behavior will lead to new interests and the formation of political coalitions to advance those interests.[21] Most important, decisions based on these new incentives give firms a stake in their country's continued participation, and they will direct their political energies to that end. In Hirschman's words, "these regions or industries will exert a powerful influence in favor of a 'friendly' attitude towards the state to the imports of which they owe their interests."[22] Finally, the central government can find its own interests reshaped, above and beyond that which results from domestic political pressures.[23]

In practice, Hirschmanesque effects are more profoundly felt with regard to influence than coercion. They are about the fact, to paraphrase one report, "a salesman of [country A's] exports in his own market" becomes "a spokesman of [country A's] interests with his own government."[24] Resulting changes in international political behavior do not occur because of pressure, but because new incentives alter perceptions of interest. This is akin to what Nye has called "soft power." Rather than forcing others to do what you want them to do, soft power, or influence, is about "getting others to want what you want"[25]

The trade strategies that flow from a Hirschmanesque strategy are uniquely realist. Such strategies employ economic means to advance political goals. Small states in this setting typically gain in an economic sense, often handsomely, as large states attempting to enhance their influence make overly generous concessions. Thus asymmetric economic relations offer an exception to, and in fact a reversal of, the concern for relative gains. This expands the core of mutually acceptable bargains and makes cooperation between them even more likely. Such behavior cannot be explained from a liberal perspective, since the states with greater economic leverage and less to gain from exchange are the ones making the greater concessions to assure the bargain. It is the converse of the radical conception of asymmetric trade, where large states use their political power to enforce economic extraction. From the radical perspective, then, power is a means to achieve an economic end. In the realist strategy described by Hirschman, wealth is used to advance a political goal.

In contemporary Asian international politics, then, realist theory will expect that in the context of asymmetric economic relations, great powers will likely tailor their trade strategies to cultivate political influence with smaller states.[26] Of the three, Japan would appear to be the most ideally situated to practice Hirschmanesque diplomacy. The U.S., distant and with the most broadly global interests, may be less inclined to introduce the regionally discriminatory tactics that such a strategy would require. Compared with China, Japan is better placed to follow such a strategy, given the larger size of its economy, its relative economic development, and potential as a financial center. Further, given that Japanese policy is still viewed with suspicion by many states in the region, Japan should be more likely to employ tools designed to increase its influence in order to advance its political goals, rather than introduce baldly coercive policies, which could easily backfire. China's employment of Hirschmanesque devices is thus likely to be more limited and often responsive to Japanese measures.

INTERNATIONAL MONETARY RELATIONS: THE BATTLE POSTPONED

A REALIST THEORY OF MONETARY RELATIONS

The principal general theory that has been employed to explain the pattern of monetary relations is the hegemonic stability thesis.[27] While its story is superficially appealing, there are several compelling challenges to this interpretation. First, it is now clear that in the nineteenth century, Britain was not a monetary hegemon, nor did it behave in the way that the theory would predict. While cooperation was common in this era, the Bank of England was often the *borrower* of last resort, dependent on the support of other central banks in times of crisis.[28] Second, recent investigations of interwar monetary politics have countered that the great depression was not the result of absent hegemony (not to mention that the U.S. may have been "hegemonic" at this time), but was transmitted and exacerbated by the interwar gold standard. According to this interpretation, hegemony was not necessary to overcome the collective action problem of competitive devaluation. Instead, each state held the key to its own recovery through the abandonment of the gold standard and the adoption of expansionary policies.[29] Finally, a state at the center of an international monetary system can also be a source of *instability* in the system. Such states, especially if they provide the "world's currency," are less constrained than other states and may fall prey to temptation, or even purposefully choose to exploit their position.[30]

The concentration of power, then, does not appear to be a good explanation of monetary cooperation.[31] Liberal theories have adapted and now stress the importance of ideological consensus, rather than the provision of public goods, to explain when such cooperation will occur.[32] Realists have yet to articulate a clear alternative; I suggest one possible approach.

While realists tend to be pessimistic regarding the prospects for international cooperation in general, a close look suggests that from any perspective monetary cooperation should be especially difficult. Explaining such cooperation thus requires elucidating under what conditions the formidable barriers to cooperation can be overcome. Those barriers are the complexity of international monetary arrangements, the public nature of macroeconomic externalities, and the distinct nature of the salience of monetary commitments.

The complexity of international monetary arrangements poses unique challenges to monetary cooperation. Even if states believe that such cooperation would be appealing in theory, they may still disagree over practical issues regarding the "rules of the game."[33] Even if these problems are overcome, difficulties associated with complexity of international money remain. Given the existence of large private currency and financial markets, adherence to agreements can be difficult to monitor. Since state intervention may be ineffective against countervailing market forces, there is no way to assure that states are in fact living up to their obligations.[34] Trade agreements, on the other hand, typically require public legislation and such laws are not subject to competing market pressures.

Monetary cooperation is also difficult, as Oye has argued, because of the public nature of macroeconomic externalities.[35] Externalities in international relations result from the fact that states adopt policies that have "spillover" effects: consequences felt beyond a state's borders. These are externalities because they are not part of the cost calculation of the state that transmits them. As a result, there is a tendency toward the over-provision of negative spillover effects in the international system. If injured states punish the producers of the negative spillovers, then those policies will be perceived as costly and curtailed. For example, if one nation raises its tariffs, even if it does so universally, other states can raise tariffs that directly target the protectionist. Each can then bargain for market share, and are the sole beneficiaries of their efforts. While states can discriminate in their trade policies, macroeconomic policies regarding interest and exchange rates are almost inherently standard. Thus producers of macroeconomic bads (say, for example, very high interest rates) will tend to go unpunished, because injured states face a collective-action dilemma: all will benefit from the elimination of the public bad, no matter who bears the cost. Because of the free rider problem (private costs and public benefits), negative externalities in this case will not be significantly reduced.

Finally, monetary cooperation is difficult because it involves the abdication of national macroeconomic policy autonomy. The essence of this problem can be traced to Keynes, who wrote extensively about the difficulty states faces in balancing their preferences for internal and external price stability. Monetary cooperation links the national with the international economy. This is "the dilemma of an international monetary system": the difficulty in providing both stability in external monetary relations while assuring "at the same time an adequate local autonomy for each member over its domestic rate of interest" and other macroeconomic policies.[36]

As a result, even if states are able to reach monetary agreements, those agreements are likely to be fragile. All states gain from international monetary stability. To contribute to that stability, by adherence to agreements of monetary cooperation, governments are often forced to engage in unpleasant acts: austerity budgets, deflationary monetary policy, costly and compulsory intervention in exchange markets, and a number of other initiatives such governments would otherwise not undertake. These pressures often arise at the worst possible time: a state may be in a recession, but to fulfill its commitments to an international monetary agreement it might be forced to engage in deflationary policies. The costs of these actions are often severe and are associated by the general public with the ruling administration.[37]

The problems of externalities and autonomy suggest that monetary cooperation should be extremely difficult to *sustain*. On the other hand, in the absence of economic distress, state autonomy (vis-à-vis domestic actors) with regard to international macroeconomic policymaking is likely to be quite high.[38] Given the typical degree of insulation of exchange rate policy from the domestic political process, monetary cooperation may be relatively easy to establish. Trade agreements, on the other hand, may be more difficult to reach, but easier to keep. This may help explain the different fates of postwar trade and monetary regimes.

A baseline expectation with regard to monetary relations, then, should be that monetary agreements will be reached, but will tend to break down. The relatively free reign of governments over monetary affairs should provide the political space necessary to overcome the problems of complexity in reaching monetary accords. Difficulties in monitoring compliance, dis-incentives to challenge producers of negative macroeconomic externalities, and intense pressure to renounce painful and counter-intuitive pro-cyclical commitments suggest that such agreements will fail when challenged by the course of economic events.

When can these problems be overcome? One realist answer is that monetary cooperation is likely to be sustained to the extent to which potential participants have *shared, salient security concerns*. The greater the consensus that exists on core security issues and their significance, the more likely it is that "high politics" will dominate "low politics." Simply put—states will be more willing to bear the costs of monetary cooperation when they share a common security vision. When states have similar security concerns and shared threat perception, the costs of monetary cooperation remain the same while the benefits are increased to the extent that monetary cooperation facilitates and enhances overall political cooperation. Additionally, states may refrain from abrogating monetary agreements because of the fear that such action might cause a larger set of political understandings to unravel, or signal dissension to common adversaries.[39]

PROSPECTS FOR MONETARY CONFLICT

Realist analysis is quite pessimistic about the prospects for monetary cooperation in general, and with the end of the cold war the most important element in preventing monetary conflicts from looming even larger than they have has disappeared. The underlying tensions in U.S.-Japan monetary relations have existed almost from the beginning of the cold war, although they only became salient in the 1970s. Only a serious and mutually perceived threat, that might result, for example, should China become both assertive and belligerent, can prevent serious monetary conflict from erupting between the U.S. and Japan. Moreover, if Chinese behavior does not serve to facilitate monetary cooperation between the U.S. and Japan, then it will likely contribute to an even more complex triangular currency relationship, which will only further confound efforts at monetary cooperation. In most circumstances, monetary relations are likely to be characterized in a stop-go pattern where agreements are repeatedly reached and then collapse.

In retrospect, sources of underlying frictions in money matters can be observed even in the 1940s. On August 25, 1949, an exchange rate of 360 yen to the dollar was introduced, replacing Japan's multiple exchange rate system which featured rates raging from 100 to 1500 yen per dollar. The 360 figure was a compromise between American authorities who preferred a rate of 300, and Japanese businessmen who had hoped for an even weaker level for the yen.[40] It should be underscored that from an economic perspective any fixed rate chosen would be arbitrary, and reflected a political compromise. Worse, since crucial economic conditions like relative rates of inflation, growth, and productivity would vary over time, whatever economic logic was captured by the 360 rate would likely erode over time.

In practice, of course, open monetary conflict in the first two decades of the cold war was muted by the primacy of the U.S. goal of nurturing the Japanese economy to counter the Soviet Union, and by the relative insignificance of the Japanese economy. Even in the 1950s Japanese officials were acutely aware of the relationship between the international monetary system and the performance of the Japanese economy. Growth in Japan repeatedly hit a "balance of payments ceiling," in that as growth surged, domestic demand for imports would outstrip foreign demand for Japanese products, which drained Japan's foreign exchange reserves. In 1953–54, 1957–58, 1961–62, the government was forced to slow the economy's rate of growth through monetary and fiscal tightening in order to defend the country's reserves.[41]

This phenomenon continued into the 1960s, when monetary policy was tightened to reduce growth not only in 1961, but also in 1964 and 1967, in response to balance of payments pressures. This would have become a more serious problem but for two considerations. First, Japan enjoyed a real annual growth rate of over 10 percent in the 1960s, taking some of the sting out of monetary tightening. Second, near the close of the decade the Japanese economy shifted toward a structural balance of payments surplus, rather then deficit. Cumulative increases in Japanese productivity meant that its unchanged exchange rate left the yen increasingly undervalued, while at the same time, macroeconomic policies in the U.S. meant that the dollar was increasingly overvalued.[42]

This set the stage for the open monetary conflict of the 1970s. President Nixon, who, unwilling to swallow the deflationary medicine necessary to defend the dollar, instead closed the gold window of August 15, 1971.[43] Nowhere were the "Nixon shocks" felt more acutely than in Japan. The government had been following an "eight point program to avoid yen revaluation" and was "absolutely opposed even to consideration of a parity change." Japan was so committed to the 360 figure that while all other states closed their exchanges and prepared to revalue their currencies vis-à-vis the dollar, Japan kept its foreign exchange markets open and continued to buy dollars at that rate for almost two weeks. Finally, as part of the Smithsonian agreement in December, the yen was repegged at 308 to the dollar, a revaluation of almost 17 percent.[44]

Although Prime Minister Kakuei Tanaka insisted that the new peg would be defended, the Smithsonian agreement was ultimately a stepping-stone en route to a system of floating exchange rates, and when it collapsed in March 1973 the yen appreciated to 260. The floating provided a continual source of tension. From January 1976 to October 1978, the yen again appreciated, from 305 to 180. Fred Bergsten, writing in 1982, saw three "episodes of major economic conflict" between the U.S. and Japan in the preceding dozen years, each of which he attributed to disputes over the dollar/yen rate. Typically, the U.S. pressed for yen appreciation to ease the growing trade imbalance between the two countries. Japan often intervened to limit yen appreciation, much to the consternation of the Americans.[45]

At that particular moment, however, U.S. pressure for yen appreciation receded. While the easing of cold war tensions during the Nixon and Carter Administrations allowed simmering monetary conflicts to bubble to the surface, the escalating bipolar conflict in the early 1980s reordered foreign policy priorities. When the macroeconomic policies of the first Reagan administration sent the dollar soaring, the free-market instincts of U.S. officials limited pressure on Japan to negotiations over financial liberalization.[46]

By 1985, however, the dollar had appreciated to a level well above what could be considered its "equilibrium" rate. Surging Japanese imports increased the salience of currency issues between the two states. Fears within the U.S. of a "hard landing" for the overvalued dollar coincided with Japan's fear that the exchange rate issue would lead to increased American protectionism. This led to a window of cooperation on monetary issues, from September 1985 February 1987, where the major industrialized nations agreed to oversee an orderly depreciation of the dollar, in practice from about 260 to 150 yen to the dollar.[47]

However, this coordination was closer to harmony than true cooperation, and soon after the successful depreciation of the dollar, traditional lines of disagreement reemerged, with the U.S, in favor of further yen appreciation in order to address imbalances in trade between the two states. In the 1990s, the Bush and Clinton administrations favored further yen appreciation, and the Japanese currency appreciated from 160 to 80.[48]

Since 1995, although the yen has depreciated considerably, conflict over monetary issues has essentially been on hold. The American economy's continued expansion, coupled with serious fears about the fundamental fragility of the Japanese economy, have forced a suspension of U.S. pressure on Japanese currency policy. When these exceptional circumstances fade from view, and the U.S. economy slows and Japan finally recovers, conditions will be ripe for sharp monetary conflict between the two states. Barring a mutually perceived and salient threat from China, the security ties that have bound the U.S. and Japan are looser than at any time since World War II. Further, as McKinnon and Ohno have forcefully argued, yen appreciation in Japan has a relatively deflationary effect on the Japanese economy. This was less consequential decades ago when U.S. inflation rates were high and Japanese growth spectacular. With lower U.S. inflation and the likelihood that growth, when it returns to Japan, will be more "normal," there will be less space for Japan to tolerate yen appreciation and attendant "high yen induced recessions" (endaka fukyo).[49]

In sum, with regard to monetary cooperation in the Pacific, the future offers fewer incentives and greater barriers. Excepting a dramatic change in Chinese foreign policy, the problems raised by the U.S.-Japan bilateral relationship are only exacerbated when considered in the context of a broader regional perspective. By the criteria established above (public externalities, divergent security perceptions, etc.), exchange rate conflict between Japan, China, and other states of South and Northeast Asia would appear to be almost inevitable.[50] These battles, however, await the recovery of Japan's economy, the convertibility of China's currency, and eventual recession in the United States.

FINANCIAL FLOWS AND STATE AUTONOMY: THE BATTLE ENGAGED

One of the defining characteristics of the international economy over the past quarter-century has been its dramatic expansion. These changes in the nature of international trade, investment, and especially finance, pose threats to state autonomy.[51] Market forces undermine state capacity, while private actors may engage in patterns of activity that can diverge from the goals of government policy, creating domestic political barriers to some preferred policies.[52] The unregulated flow of financial capital is the most significant of these phenomena, routinely, but often spectacularly, forcing states to abandon strongly favored policies, as illustrated by the well known French episode of the early 1980s. Unable to contain capital flight and following three devaluations of the franc within eighteen months, the socialist government of François Mitterrand was forced to reverse course, abandon its expansionary macroeconomic policies, and introduce austerity measures that were more restrictive than those of its conservative predecessor.[53]

Realists must expect states to find these challenges to autonomy intolerable, or at least highly objectionable, and anticipate that states will attempt to constrain these forces. It is not sufficient for realists to note, however accurately, that there have been periods of history where the international economy imposed even greater constraints on states.[54] The absence of clear efforts by states to reassert control over many of these flows will challenge fundamental realist conceptions.[55] This issue area also provides a clear contrast between liberal and realist expectations, since a liberal perspective would be to expect that these changes are irreversible, or at least highly likely to continue.

Ironically, the collapse of the Bretton Woods system, which ushered in the era of unregulated capital, was a reassertion of autonomy by states. Large countries, most notably the U.S., were no longer willing to play by the constraints imposed by the fixed-exchange rate system. Flexible exchange rate systems were thought to afford macroeconomic policy autonomy following the logic that states could select only two items from the following menu: free capital flows, fixed exchange rates, and autonomous monetary policy.[56] States thought that by abandoning fixed rates, they could pursue the monetary policies of their choice. This did not turn out to be the case. In theory, given flexible rates, policy disparities should be mediated at the border. Thus if a state's policies resulted in an inflation rate that was 5 percent above the international average, its currency would depreciate by 5 percent and that would be that. But if capital mobility is accompanied by a consensus with regard to what is a "correct" monetary policy, then the depreciation will not stop at 5 percent. Capital flight in this case will punish the state for pursuing a deviant policy. Failure to reverse that policy in the wake of a sustained depreciation will stimulate even further capital flight and depreciation, and so on. Thus a state that preferred to pursue a more expansionist monetary policy than average, even one that was willing to tolerate the depreciation necessary to restore equilibrium in international prices, may be unable to chart such a course in the face of punishing (as opposed to equilibrating) capital flows. Thus the "holy trinity" is a myth: if there is an ideological consensus regarding macroeconomic policy, it is not possible to have capital mobility and policy autonomy at the same time. Given this realization, the same motives that led states to break with the fixed exchange rate system should, for realists, lead them to abandon capital mobility as well.

One manifestation of realist expectations should be calls from states in the system to somehow limit the mobility of financial capital. How might this occur? A minimalist avenue, perhaps most plausible given the power of the neoliberal consensus, will be that calls for new regulations will be phrased in the language of "market failure," in order to provide a theoretical justification for regulatory intervention.[57]

In fact, unregulated capital flows can easily be considered a case of market failure, for three reasons. First, contemporary technology allows investors to move huge amounts of money almost instantaneously, at very little cost. Thus the value of assets, including national currencies, can change significantly, literally overnight, undermining the basic price stability that economies need to function smoothly. Second, to an important extent, financial assets are worth what people think they are worth. Fears regarding what other people are thinking can cause herding behavior, unleashing financial stampedes with economic consequences that veer far from the path suggested by any reading of the economic “fundamentals.” Third, states face diverse economic conditions, and need to tailor their economic policies accordingly. Investors, scanning the globe for the best rates of return, create pressures for conformity across countries’ macroeconomic policies. Nations that deviate from the international norm, even when pursuing policies appropriate for local needs, are “punished” by capital flight.[58]

States can seize upon this logic to apply the standard policy prescription for dealing with externalities: tax the externality in order to force producers to consider the full range of its costs, so that pursuit of narrow self-interests and the social optimum again converge. Right now, there is clear evidence that there is “too much” short term capital movement. The data suggest that 80 percent of all foreign exchange transactions involve round trips that take place in less than a week—and more than half of those in under two days.[59] A small uniform tax on foreign exchange transactions, known as the “Tobin Tax,” would have a much larger effect on short- as opposed to long-term capital flows.[60] It is a very modest measure, and not the only way that states can reassert control over international finance. It does represent a minimalist threshold—if states are unable to impose a Tobin Tax, which would not “control” capital but simply afford some modest policy autonomy—then there is good reason to question how well states are able to pursue their interests in the contemporary international economy.

Regardless of the specific measure, realists must anticipate that states will try to reassert control over capital flows. If international reform does not occur, then individual states should be expected to take more dramatic measures. A few short years ago there was no evidence to support any conclusion other than the liberal view that financial liberalization was irreversible, and that international institutions were important forces in driving these changes further.[61] However, in the wake of the Asian financial crisis, an emerging battle is increasingly visible.

The first sign that the tide has turned—that there will be, at least, a debate over unmitigated financial globalization—is the emergence of a literature that has challenged the efficiency of completely unregulated financial capital. The credentials of some of these new critics of unlimited capital mobility are formidable, and this will make them difficult to ignore. Jagdish Bhagwati, the distinguished Columbia University economist and noted champion of free trade, argues in “The Capital Myth” that while proponents of free trade have provided evidence to support their claims, the supporters of free capital have not: :“The weight of evidence and the force of logic point in the opposite direction, toward restraints on capital flows. It is time to shift the burden of proof from those who oppose to those who favor liberated capital.”[62]

Harvard’s Dani Rodrik, whose analysis from a 100-country sample finds “no evidence that countries without capital controls have grown faster, invested more, or experienced lower inflation,” underscores Bhagwati’s challenge.[63]

These arguments have taken on added weight with the unexpected spread and depth of the Asian financial crisis. Efforts by states in Asia to defend their currencies in an environment of capital mobility required interest rate increases that exacerbated economic distress. This stimulated new interest in capital controls, which, as Paul Krugman argued, would give states the ability to lower interest rates and stimulate their economies. While still a minority position, there is now, for the first time in many years, a debate over capital mobility.[64]

Possibly influenced by this debate, Malaysia introduced strict controls over capital movements on September 1, 1998.[65] Trade in the ringgit was banned and new restrictions on foreign stock investors introduced.[66] While the proponents of capital controls might have preferred another champion than Malaysia's Prime Minister Mahathir, a reckless figure engaged in a bitter domestic political struggle, Malaysia is the front line in the battle over capital control. It has been noted that those countries which had controls in place before the crisis emerged, such as Taiwan, have to date fared well, while those without controls are closely monitoring the Malaysian experiment. It is still much too early to tell, but initial signs are promising. The exchange rate has stabilized, making business planning more feasible, the stock market rebounded quickly, gaining 50 percent in the first week, and the government has announced interest rate cuts in support of an aggressive pro-growth policy. While the foreign business community has been less enthusiastic, this has not yet translated into action. Intel recently reaffirmed its plans to spend $400 million to expand its Malaysian operation.[67]

The world is clearly watching, and those with ringside seats: Thailand, Indonesia, and the Philippines, are paying particularly close attention. If the Malaysian experiment does not fail quickly, it is quite likely that Indonesia, whose economy has been hard hit by high interest rates, will be the first to follow Malaysia's lead.[68]

The proponents of unregulated capital, however, are not merely spectators in this drama. Stressing the "fundamentals" of an economy, their credo remains "get the pricing right and hot money will take care of itself."[69] The fundamentalists remain in vogue in the business and academic community, and in control of international institutions such as the International Monetary Fund.[70] In September 1996, IMF asserted that "international capital markets appear to have become more resilient and are less likely to be a source of disturbances."[71] Following this assumption, the Fund embarked upon a fundamental revision of its charter, and in May 1997 announced plans to amend its constitution—the Articles of Agreement—"to make the promotion of capital account liberalization a specific purpose of the IMF and give it jurisdiction over capital movements."[72] This would be a profound change in the very nature of the international economy. It is the *opposite* what the founding fathers of the IMF intended. They thought that capital controls were necessary to assure the smooth functioning of an open international economy, and the Bretton Woods era, the "golden age of capitalism," was a period of ubiquitous capital control. Now, however, the IMF has declared explicitly that "Forces of Globalization Must Be Embraced." Its new policy was has been repeatedly characterized as a proposition "to make unrestricted capital flows a condition of membership in the global economy."[73]

The position of the IMF has profound practical consequences. It is also of interest to IR theorists. The amended IMF articles of agreement, once in place, would be a dramatic change in the balance of power between states and international market forces, in an arena where the state has already experienced a withering away of its autonomy. They represent triumphant liberalism spearheaded by an international institution, a one-two punch that realists can not easily shrug off. The alternative path is marked by some form of controls, coordinated or not, on the mobility of short-term capital. What happens in response to the Asian financial crisis may be decisive in determining which path is chosen. This is clear to the guardians of the neoliberal consensus, some of whom, according to the *New York Times*, have "quietly expressed the hope that his experiment would fail so spectacularly that the smoldering ruins of the Malaysian economy would act as a caution to other countries." In particular, the nature of China's financial liberalization is at stake, and that in turn will have a formative effect on the evolution of finance in the Asian region.[74]

REALIST POLITICAL ECONOMY IN THE PACIFIC RIM

This essay has addressed some realist expectations with regard to the trajectory of great-power relations in the Pacific. It is not intended as a comprehensive survey of the relevant issue areas, or a "test" of the realist approach to political economy. Rather, it is an effort to elucidate and provide the criteria to evaluate three specific theories that derive from a realist tradition, ones that yield distinct expectations in the spheres of international trade, monetary, and financial relations. With regard to trade, it has been argued that while realist approaches stress different motivations for state behavior, there are no distinct realist expectations with regard to trade between the U.S and Japan and the between the U.S. and China. Distinctly realist trade strategies do exist with regard to asymmetric relations, and these should be relevant, especially in explaining Japanese trade policy. One argument of this essay is that trade relations will not the best place to look to gauge realist behavioral expectations, for three reasons. First, while the international economy continues its broad expansion, trade is of relatively decreasing significance. Second, arguments based on realist assumptions require highly complex assessments of the relations between trade and the differential rates of and composition of economic growth across states, and then of the translation of those changes into military prowess and intentions. Third, realist expectations with regard to trade are likely to be overdetermined—that is, consistent with theories derived from other traditions as well.

On the other hand, the monetary and financial spheres pose increasing challenges to state autonomy, and yield distinct realist behavioral expectations. Realists must expect states to reassert greater control over these matters. Thus while current conditions (Japan's fragility, China's inconvertibility, America's robust economy) have postponed monetary conflict, such conflict is likely to characterize trans-Pacific monetary relations in the future. More imminent is the realist prediction that states will re-regulate international capital flows.

Finally, speaking more broadly and speculatively about the prospects for relations in region as a whole, two other realist theories yield some intriguing expectations. First, realist theories expect that China's growing economic strength will translate into greater external ambition.[75] But that "ambition" is underdefined. If China becomes highly assertive and belligerent, we have, of course, a very pessimistic assessment of the region's prospects. But if China's increasing might is coupled with more subtle tactics, then the net result might be to facilitate greater cooperation among the other states in trade and money, following the theories discussed above.

Second, realist expectations with regard to money and finance might also leave room for optimism. The claims of some realists that trade interdependence leads to war has always sounded like a rhetorical overreaction to the liberal argument that such ties promote peace.[76] But shift the discussion—from war to economic relations, from trade to money and finance and from interdependence to globalization—and the realist view that states crave autonomy yields another glimmer of optimism. Here the argument that increased economic exposure leads to greater friction between states makes more sense. If the realists are right, and states reassert some control over monetary and financial flows, greater economic stability in the region might allow for enhanced economic cooperation.

ENDNOTES

1. This section draws on Jonathan Kirshner, "The Political Economy of Realism," in Ethan Kapstein and Michael Mastanduno, eds., *Unipolar Politics: Realism and State Strategies After the Cold War* (New York: Columbia University Press, 1999).

2. See Adam Smith, *An Inquiry into the Nature and Causes of The Wealth of Nations* (Chicago: University of Chicago Press, 1976 [1776]); Alexander Hamilton, "Report on the Subject of Manufactures" (1791), in Harold C. Syrett, ed., *The Papers of Alexander Hamilton—Volume X* (New York: Columbia University Press, 1966); Edward G. Bourne, "Alexander Hamilton and Adam Smith" *Quarterly Journal of Economics* 8:, no. 3 (April 1894): 329–48; Friedrich List, *The National System of Political Economy* (London, Longmans, Green and Co., 1885).

3. Jacob Viner, "Power Versus Plenty as Objectives of Statecraft in the Seventeenth and Eighteenth Centuries," *World Politics* 1, no.1 (October 1948): 1–29. esp. p. 10.

4. E. H. Carr, The Twenty Year's Crisis, 1919–1939 (2nd edition) (New York: Harper Row, 1964), p. 109. List emphasized these differences repeatedly, arguing that "The idea of a perpetual state of peace forms the foundation of all [Smith's] arguments." National System, p. 120 see also pp. 316, 347.

5. As one realist study concluded, "This investigation has shown that the state has purposes of its own." Stephen Krasner, *Defending the National Interest* (Princeton: Princeton University Press, 1978), p. 300. See also Robert Gilpin, *U.S. Power and the Multinational Corporation* (New York: Basic Books, 1975), esp. pp. 26–32.

6. See Kenneth Waltz, "The Myth of National Interdependence," in Charles Kindleberger, ed., *The International Corporation* (Cambridge: MIT Press, 1970); also Waltz, *Theory of International Politics* (New York: Random House, 1979), ch. 7; Katherine Barbieri, "Economic Interdependence: A Path to Peace or a Source of Interstate Conflict?" *Journal of Peace Research* 33, no. 1 (February 1996): 29–49; and Norrin Ripsman and Jean-Marc Blanchard, "Commercial Liberalism Under Fire: Evidence From 1914 and 1936" *Security Studies* 6, no. 2 (Winter 1996/97): 4–50.

7. Carr, *Twenty Year's Crisis*, pp. 120–24. For a contemporary example of the trade-offs sometimes faced by states, see Irving Lachow, "The GPS Dilemma: Balancing Military Risks and Economic Benefits," *International Security* 20, no. 1 (Summer 1995): 126–48.

8. Given the concern for empowering adversaries, some barriers to trade can be overcome between partners in a military alliance that is expected to endure indefinitely. It has been suggested that a bipolar structure will be likely to feature stable military alliances, muting state concerns for the consequences of relative gains that result from trade within each pole. See Joanne Gowa, "Bipolarity, Multipolarity, and Free Trade," *American Political Science Review* 83, no. 4 (December 1989). This is not likely to be a factor in Pacific Rim trade for the foreseeable future.

9. Again, the divergence from the economic optimum will have to be balanced against the costs to long-run growth, which states seeking security must also be concerned about.

10. See, for example, Halford J. Mackinder, *Money Power and Man Power: The Underlying Principles Rather than the Statistics of Tariff Reform* (London: Sompkin, Marshall, Hamilton, Kent, 1906), esp. pp. 18–20; also pp. 2, 15, 17, 22.

11. On the absolute/relative gains debate, see for example Robert Powell, "Anarchy in International Relations Theory: The Neorealist-Neoliberal Debate," *International Organization* 48, no. 2 (Spring 1994): 313–44; Powell, "Absolute and Relative Gains in International Relations Theory," *American Political Science Review* 85, no. 4 (December 1991): 1303–20; Duncan Snidal, "Relative Gains and the Pattern of International Cooperation," *American Political Science Review* 85, no. 3 (September 1991): 701–26; Robert Keohane, "Institutional Theory and the Realist Challenge After the Cold War," in David Baldwin, ed., *Neorealism and Neoliberalism: The Contemporary Debate* (New York: Columbia University Press, 1993) and Joseph Grieco, "Understanding the Problem of International Cooperation: The Limits of Neoliberal Institutionalism and the Future of Realist Theory," also in Baldwin, *Neorealism and Neoliberalism*. For an example of how difficult it is to distinguish these behaviors in practice, see Peter

Liberman, "Trading With the Enemy: Security and Relative Economic Gains," *International Security* 21, no. 1 (Summer 1996): 147–75.

12. Laura D'Andrea Tyson, *Who's Bashing Whom? Trade Conflict in High Technology Industries* (Washington: Institute for International Economics, 1992). See esp. pp. 3–4, 12, 17, 31, on deviations from the classical model. See also Paul Krugman, ed., *Strategic Trade Policy and the New International Economics* (Cambridge: MIT Press, 1986); Gene Grossman, ed., *Imperfect Competition and International Trade* (Cambridge: MIT Press 1992).

13. Grieco, *Cooperation Among Nations*, p. 217.

14. For investigations into this question, see Michael Mastanduno, "Do Relative Gains Matter?" *International Security* 16, no. 1 (Summer 1991): 73–113; Joseph Grieco, *Cooperation Among Nations: Europe, America, and Non-Tariff Barriers to Trade* (Ithaca: Cornell University Press, 1990).

15. See for example Tyson, *Who's Bashing Whom*; Kenneth Flam, *Mismanaged Trade? Strategic Policy and the Semiconductor Industry* (Washington: Brookings, 1996); Sylvia Ostry and Richard Nelson, *Techno-Nationalism and Techno-Globalism* (Washington: Brookings, 1995); C. Fred Bergsten and Marcus Noland, *Reconcilable Differences? United States-Japan Economic Conflict* (Washington: Institute for International Economics, 1993).

16. Julia Chang Bloch, "Commercial Diplomacy," in Ezra F. Vogel , ed., *Living With China: U.S.-China Relations in the Twenty-First Century* (New York: Norton, 1997); Lardy, *China in the World Economy*.

17. (Berkeley: University of California Press, 1980 [1945]).

18. Hirschman, *National Power*, p. 29. See also Allan G. B. Fisher, "The German Trade Drive in South-Eastern Europe," *International Affairs* 18, no. 2 (March 1939): 143–70; Antonín Basch, *The Danube Basin and the German Economic Sphere* (New York: Columbia University Press, 1943), esp. p. 178.

19. See Rawi Abdelal and Jonathan Kirshner, "Strategy, Economic Relations, and the Definition on National Interests," *Security Studies*, 9, nos. 1–2 (Autumn 1999–Winter 2000): 119–156.

20. Gary S. Becker, "A Theory of Competition Among Pressure Groups for Political Influence" *Quarterly Journal of Economics* 98, no. 3 (August 1983).

21. Charles P. Kindleberger, "Group Behavior and International Trade" *Journal of Political Economy* 59, no. 1 (Feb 1959): 30–47; Peter Gourevitch, *Politics in Hard Times* (Ithaca: Cornell University Press, 1986); Jeffry Frieden and Ronald Rogowski, "The Impact of the National Economy on Domestic Politics," in Robert Keohane and Helen Milner, *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996). Kindleberger emphasizes sectors, Gourevitch coalitions, Frieden and Rogowski factors and price incentives. Hirschman demonstrates the consequences for power politics of economic incentives and group conflict.

22. Hirschman, *National Power*, p. 29.

23. This can result from concerns regarding the overall balance of trade, revenue from tariffs, or trade undertaken or controlled by the government.

24. "The Aski Mark," *The Economist*, 8/12/39, p. 322 (Referring to Latin American importers of German products).

25. Joseph S. Nye Jr., *Bound to Lead: The Changing Nature of American Power* (New York: Basic Books, 1990), p. 188. Nye argues that "trends today are making . . . soft power resources more important." See also pp. 189–201.

26. On these issues, see Mark Selden, "China, Japan, and the Political Economy of East Asia," in Peter Katzenstein and Takashi Shiraishi , eds., *Network Power: Japan and Asia* (Ithaca: Cornell University Press, 1997); Walter Hatch and Kozo Yamamura, *Asia in Japan's Embrace: Building a Regional Production Alliance* (New York: Cambridge University Press, 1996); Richard Doner, "Japanese Foreign Investment and the Creation of a Pacific Asian Region," in Jeffrey Frankel and Miles Kahler, eds., *Regionalism and Rivalry: Japan and the United States in Pacific Asia* (Chicago: University of Chicago Press, 1993); Peter Katzenstein and Martin Rouse, "Japan as a Regional Power in Asia," in Frankel and Kahler; Robert Ash and Y. Y. Kueh, "Economic Integration Within Greater China: Trade and Investment Flows Between China, Hong Kong, and Taiwan," *The China Quarterly* 136 (December 1993); Wayne Bert, "Chinese Policies and U.S. Interests in Southeast Asia," *Asian Survey* 33, no. 3 (March 1993).

27. Considerations of the hegemonic stability theory as it applies to money include: Benjamin M. Rowland , ed., *Balance of Power or Hegemony: The Inter-war Monetary System* (New York: Lehrman Institute, 1976); John Odell, "Bretton Woods and International Political Disintegration: Implications for Monetary Diplomacy," in R. E. Lombra and W. E. White, eds., *Political Economy of International and Domestic Monetary Relations* (Ames: Iowa State University Press, 1982); Joanne Gowa, "Hegemons, IOs, Markets: the Case of the Substitution Account," *International Organization* 38, no. 4 (Autumn 1984) Kenneth Oye, "The Sterling-Dollar-Franc Triangle: Monetary Diplomacy 1929–1937," in Oye, ed., *Cooperation Under Anarchy* (Princeton: Princeton University Press, 1986); Barry Eichengreen, "Hegemonic Stability Theories of the International Monetary System," in Richard N. Cooper, et al., *Can Nations Agree?* (Brookings: Washington DC, 1989).

28. For example, the evidence does not support the contention that Britain, or even the Bank of England, purposefully managed the international monetary system. Britain did not foster the formation of the international monetary regime, encourage policy coordination, or enforce rules. Nor is it clear that Britain's lending in this period was countercyclical. On these points, see Giulio M. Gallarotti, *The Anatomy of an International Monetary Regime: The Classical Gold Standard, 1880–1914* (New York: Oxford University Press, 1995); Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression 1919–1939* (New York: Oxford University Press, 1992); Andrew Walter, *World Power and World Money: The Role of Hegemony and International Monetary Order* (New York: St. Martin's Press, 1991).

29. See Eichengreen, *Golden Fetters*.

30. That a predatory hegemon can be an important source of instability in the international monetary system is emphasized by Walter, *World Power and World Money*, see esp. pp. 180. This argument is also advanced by Susan Strange, in "Still an Extraordinary Power: America's Role in a Global Monetary System," in Lombra and White, eds., esp. p. 74; see also David P. Calleo, *The Imperious Economy* (Cambridge: Harvard University Press, 1982).

31. Even if the hegemonic stability theory does not hold in its basic form, it should be noted that the existence of a distinct monetary leader may make cooperation more likely, ceteris paribus. A monetary leader can provide the international public good of a stable numeraire—a currency around which other actors can base their expectations. It also provides a "focal point" around which states can coordinate their monetary policies. See Jonathan Kirshner, "Cooperation and Consequence: The Politics of International Monetary Relations," *Journal of European Economic History*, forthcoming; also Gustav Cassel, *The World's Monetary Problems* (London: Constable and Co., 1921), p. 80; Eichengreen, "Hegemonic Stability Theories," p. 272.

32. See G. John Ikenberry, "A World Economy : Expert Consensus and the Anglo-American Postwar Settlement" *International Organization* 46, no. 1 (Winter 1992); Kathleen McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Ithaca: Cornell University Press, 1998).

33. On possible disagreements over distribution, preferences, circumstances, see Richard Cooper, "Prolegomena to the Choice of an International Monetary System," *International Organization* 29, no. 1 (Winter 1975): 63–98. For a discussion of various possible objectives and alternative organizing principles, see Benjamin J. Cohen, *Organizing the World's Money* (New York: Basic Books, 1977).

34. On the effectiveness of intervention, see Kathryn M. Dominguez and Jeffrey A. Frankel, *Does Foreign Exchange Intervention Work?* (Washington DC: Institute for International Economics, 1993); Hali J. Edison, "The Effectiveness of Central Bank Intervention: A Survey of the Literature After 1982," *Special Papers in International Economics*, (International Finance Section, Princeton University) No. 18, July 1993.

35. Kenneth A. Oye, *Economic Discrimination and Political Exchange: World Political Economy in the 1930s and 1980s* (Princeton: Princeton University Press, 1992).

36. John Maynard Keynes, *A Treatise on Money: The Applied Theory of Money* (Cambridge: Cambridge University Press, 1971 [1930]), p. 272.

37. The saliency of monetary commitments further undermine their sustainability. Cooperation in this sphere requires actions, such as interest rate hikes during a recession, that appear to be clearly at odds with domestic interests. Sticking to a trade agreement, however, even in the face of domestic pressure during a recession, only requires maintenance of the policy status-quo—not passing new protectionist legislation.

38. See Joanne Gowa, "Public Goods and Political Institutions: Trade and Monetary Policy Processes in the United States," *International Organization* 42, no. 1 (Winter 1988); Stephen Krasner, "United States Commercial and Monetary Policy: Unraveling the Paradox of External Strength and Internal Weakness," *International Organization* 31, no. 4 (Autumn 1977); I. M. Destler and C. Randall Henning, *Dollar Politics: Exchange Rate Policymaking in the United States* (Washington: Institute for International Economics, 1989). C. F. Jeffry Frieden, who expects increased interest group conflict over the exchange rate, "Invested Interests: the Politics of National Economic Policies in a World of Global Finance," *International Organization* 45, no. 4 (1991): 425–51.

39. Note that this is distinct from arguments that use security to explain economic cooperation but stress concern for "relative gains." See Joanne Gowa, "Bipolarity, Multipolarity, and Free Trade," and the discussion on trade below.

40. Robert V. Roosa, *The United States and Japan in the International Monetary System, 1946–1985* (New York: Group of Thirty, 1986), p. 1; Robert C. Angel, *Explaining Economic Policy Failure: Japan in the 1969–71 International Monetary Crisis* (New York: Columbia University Press, 1991), p. 38.

41. Thomas F. Cargill, Michael M. Hutchison and Takatoshi Ito, *The Political Economy of Japanese Monetary Policy*, (Cambridge: MIT Press, 1997), pp. 61–62; Angel, *Explaining Economic Policy Failure*, p. 45; Roosa, *The United States and Japan*, pp. 2–3.

42. Kozo Yamamura, "The Legacies of a Bargain: The Reagan Deficits and Japan's "Bubble," in Yukio Noguchi and Kozo Yamamura, eds., *U.S.-Japan Macroeconomic Relations* (Seattle: University of Washington Press, 1996), p. 32; C. Randall Henning, *Currencies and Politics in the United States, Germany, and Japan* (Washington: Institute for International Economics, 1994), p. 123. On Japan's post-war business cycles with an emphasis on interest rate policy, see. Hiroshi Yoshikawa, "Monetary Policy and the Real Economy in Japan," in Kenneth Singleton, ed., *Japanese Monetary Policy* (Chicago: University of Chicago Press, 1993).

43. See Calleo, *Imperious Economy*, esp. p. 30; also Joanne Gowa, *Closing the Gold Window: Domestic Politics and the End of Bretton Woods* (Ithaca: Cornell University Press, 1983); also John S. Odell, *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change* (Princeton: Princeton University Press, 1982).

44. See Angel,*Explaining Economic Policy Failure*, esp. pp. 104 (quote), 115; also Paul Volcker and Toyoo Gyohten, *Changing Fortunes* (New York: Times Books, 1992), pp. 92–100.

45. C. Fred Bergsten, "What to Do about the U.S.-Japan Economic Conflict," *Foreign Affairs* 60:5 (Summer 1982), pp. 1059, 1065–6; On techniques Japan used to mask its interventions, see Dean Taylor, "The Mismanaged Float: Official Intervention by Industrialized Countries," in Michael B. Connolly, ed., *The International Monetary System: Choices for the Future* (New York: Praeger, 1982), pp. 70–72; see also Koichi Hamada and Hugh Patrick, "Japan and the International Monetary Regime," in Takashi Inoguchi and Daniel Okimoto, eds., *The Political Economy of Japan* (Vol. II) (Stanford: Stanford University Press, 1988), pp. 118–19; Cargill, Hutchison, and Ito, *The Political Economy of Japanese Monetary Policy*, 65–6.

46. On the appreciation of the dollar and U.S. opposition to policy coordination, see Martin Feldstein, "Thinking about International Economic Cooperation, *Journal of Economic Perspectives* 2, no. 2 (Spring 1988), esp. p. 12, and Jeffrey A. Frankel, "Exchange Rate Policy," in Martin Feldstein , ed., *American Economic Policy in the 1980s* (Chicago: University of Chicago Press, 1994). See also Jeffrey A. Frankel, *The Yen/Dollar Agreement: Liberalizing Japanese Capital Markets* (Washington: Institute for International Economics, 1984).

47. Volcker and Gyohten, *Changing Fortunes*, pp. 244, 268, 285; Yoichi Funabashi, *Managing the Dollar: From the Plaza to the Louvre* (Washington DC: Institute for International Economics, 1988).

48. Ronald McKinnon and Kenichi Ohno, *Dollar and Yen: Resolving Economic Conflict Between the U.S. and Japan* (Cambridge: MIT Press, 1997), pp. 10, 205 on successive U.S. pressure for yen appreciation.

49. McKinnon and Ohno, *Dollar and Yen*, esp. chapters. 3, 5. For more on the relationship between yen appreciation and recession in the Japanese economy, see Volcker and Gyohten, *Changing Fortunes*, p. 92; Yoshikawa, "Monetary Policy and the Real Economy in Japan," p. 140; Yamamura, "Legacies of a Bargain," p. 36.

50. For an illustration of the differential regional effects of changes in the yen-dollar rate on other Asian economies, see K. C. Kwan, *Economic Interdependence in the Asia-Pacific Region: Towards a Yen Bloc* (London: Routledge, 1994); esp. chapter 3.

51. J. Goodman and L. Pauly, "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets," *World Politics* 46, no. 1 (October 1993): 50–82; Andrew D. Cosh, Alan Hughes, and Ajit Singh, "Openness, Financial Innovation, Changing Patters of Ownership, and the Structure of Financial Markets," in Tariq Banuri and Juliet B. Schor , eds., *Financial Openness and National Autonomy: Opportunities and Constraints* (Oxford: Clarendon Press, 1992); Raymond Vernon, *Sovereignty at Bay* (New York: Basic Books, 1971); P. Cohey and J. Aronson, "A New Trade Order" *Foreign Affairs* 72, no. 1 (Supplement 1992–93); Ethan Kapstein, *Governing the Global Economy: International Finance and the State* (Cambridge: Harvard University Press, 1994).

52. On these issues, see Benjamin J. Cohen, *In Who's Interest? International Banking and American Foreign Policy* (New Haven: Yale University Press, 1986), esp. Part I.

53. Jeffrey Sachs and Charles Wyplosz, "The Economic Consequences of President Mitterrand," *Economic Policy* (April 1986) 262–306; Michael Loriaux, *France After Hegemony: International Change and Financial Reform* (Ithaca: Cornell University Press, 1991); See also Paulette Kurzer, *Business and Banking: Political Change and Economic Integration in Western Europe* (Ithaca: Cornell University Press, 1993).

54. See for example, Robert Zevin, "Are World Financial Markets More Open? If So, Why and With What Effects," in Banuri and Schor.

55. For an illustration of how capital mobility imposes a structural constraint on state capacity, see David Andrews, "Capital Mobility and State Autonomy: Toward a Structural Theory of International Monetary Relations," *International Studies Quarterly* 38, no. 2 (June 1994): 193–218. Eric Helleiner argues that de-regulation was state led, not market driven, but even if one accepts his interpretation the constraints imposed by high capital mobility remain. See his *States and the Reemergence of Global Finance* (Ithaca: Cornell University Press, 1994).

56. Robert Mundell, "The Monetary Dynamics of International Adjustment under Fixed Capital," *Quarterly Journal of Economics* 74 (1960): 227–57.

57. Liberals hold that the market system works because the effort of each actor in pursuit of his or her particular (selfish) interest generally results in the outcome that is optimal for society as a whole. Adam Smith's "invisible hand" assures this outcome, not government policy. However, Smith and the classical economists recognized that there are some instances when the sum of individual actions does not produce socially optimal results. These are cases of market failure, and as such provide justification for government intervention to correct the imbalance. It is interesting to note that Smith himself saw the financial system as an illustration of such a market failure, and called for the regulation of interest rates. *Wealth of Nations*, pp. 379–80.

58. On these issues, see Jonathan Kirshner, "Disinflation, Structural Change, and Distribution," *Review of Radical Political Economics* 30, no. 1 (March 1998): 52–89.

59. Mahbub ul Haq, Inge Kaul, and Isabelle Grunberg , eds., *The Tobin Tax: Coping With Financial Volatility* (New York: Oxford University Press, 1996), p. 3.

60. For a recent statement in favor of the Tobin Tax, see Barry Eichengreen, James Tobin, and Charles Wyplosz, "Two Cases for Sand in the Wheels of International Finance," *The Economic Journal* 105 (January 1995): 162–72.

61. See the assessment in Kirshner, "Political Economy of Realism.

62. Jagdish Bhagwati, "The Capital Myth," *Foreign Affairs* 77, no. 3 (May/June 1998), pp. 9, 12 (quote).

63. Dani Rodrik, "Who Needs Capital Account Convertibility?" in *Should the IMF Pursue Capital Account Convertibility*? Essays in International Finance, International Finance Section, Princeton University, no 207, May 1998, p. 61.

64. Paul Krugman, "Saving Asia: It's Time to Get Radical," *Fortune*, Sept 7, 1998; esp. "Part 5: What is Plan B?" See also Jonathan Kirshner, "Culprit is Unregulated Capital," *Los Angeles Times*, Sunday, September 13, 1998; David Wessel and Bob Davis, "Cash Cowed: Currency Controls Debated As Asian Crisis Takes Toll." *Asian Wall Street Journal* Sept. 7, 1998; Karen Pennar, "Is the Global Currency Crisis Greek to You?" *Business Week* Sept. 21 1998, p. 33; Peter Coy, Manjeet Kripalani, and Mark Clifford, "Capital Controls: Lifeline or Noose?" *Business Week*, Sept. 28, 1998, pp. 36–37; Robert Reich, "The Real Policy Makers," *New York Times*, Sept. 29, 1998.

65. It has been suggested that Mahathir was particularly influenced by Krugman's *Fortune* essay. In response, Krugman wrote "An Open Letter to Prime Minister Mahathir from Paul Krugman" on *Fortune*'s Web site (Sept. 1, 1998), in which he qualified his support for controls. Controls will create space for needed economic stimulus and reform, he explained, but are "risky," and "the distortions they impose on the economy are serious, and tend to get worse over time.'

66. "Malaysia Imposes Controls on the Ringgit—Mahathir's Hope is to Insulate Currency From Any Easing of Credit," *Asian Wall Street Journal*, Sept. 2, 1998; "Malaysia's Self-Isolation," *Asian Wall Street Journal*, Sept. 3, 1998; Mark Clifford and Pete Engardio, "Renegade Economy," *Business Week*, Sept. 21, 1998, 46–47.

67. Murray Hiebert and Andrew Sherry, "After the Fall," *Far Eastern Economic Review*, Sept. 17, 1998, p. 11; S. Jayasankaran, "Business as Usual?" *Far Eastern Economic Review*, Sept. 24, 1998; Clifford and Engardio, "Renegade Economy," p. 47. Of course, some sectors of Malaysia have been hit very hard: there have been severe cutbacks at local offices of foreign security firms. Douglas Appell: "Foreign Brokers face Malaysian Struggle—They Stop Equity Purchases under Currency Controls, and Job Cuts Start." *Asian Wall Street Journal*, Sept. 17, 1998.

68. Tom Holland, "Rupiah Advances in Asia as Talk of Capital Controls Spurs Buying," *Asian Wall Street Journal*, Sept. 16, 1998; Grainne McCarthy, "Indonesia hit by talk of Curbs on Capital Flow—Stock Market Slides Despite Denials by President Habibie," *Asian Wall Street Journal*, Sept. 16, 1998; "Indonesia Limits Offshore Banks to Minimize Rupia Outflows," *Asian Wall Street Journal*, Sept. 18, 1998. For relevant background detail and analysis, see Natasha Hamilton-Hart, *States and Capital Mo-*

bility: Indonesia, Malaysia, and Singapore in the Asian Region, Ph.D. Dissertation, Department of Government, Cornell University, 1998.

69. This was how the *Far Eastern Economic Review* expressed its skepticism of any scheme to control capital. "Some Like it Hot: The Mahathir-Soros Complex," July 16, 1998, p. 29.

70. In its retrospective analyses of the crisis, the IMF remains unrepentant, focused on the domestic sources of the crisis and highly suspicious of any forms of capital control. See International Monetary Fund, *International Capital Markets: Developments, Prospects, and Key Policy Issues* (Washington: IMF, September 1998), esp. pp. 6, 11, 57, 63, 73, 148–50; See also International Monetary Fund, *World Economic Outlook: Financial Turbulence and the World Economy* (Washington: IMF, October 1998), esp. pp. 16–18; 101–2. It should be noted, however, that in the wake of the crisis the World Bank has been willing to at least address the issue of the possible benefits of some control over short-term capital flows. See The World Bank, *Global Economic Prospects and the Developing Countries, 1998/99: Beyond Financial Crisis* (Washington: The World Bank, 1999), esp. pp. xi–xii, xxi, 4, 123–24, 128, 142–52; see also the World Bank, *East Asia: The Road to Recovery* (Washington: The World Bank, 1998), esp. pp. 9–10, 16, 34.

71. *IMF Survey*, September 23, 1996, p. 294. Under the headline "International Capital Markets charting a Steadier Course," the Fund also noted that "Although the scale of financial activity continues to grow, market participants—including high-risk high-return investment funds—are more disciplined, cautious, and sensitive to market fundamentals" (p. 293).

72. *IMF Survey*, May 12, 1997, pp. 131–32. Under the headline "IMF Wins Mandate to Cover Capital Accounts," the Survey reported "Managing Director, Michael Camdessus, remarked that global economic prospects warranted 'rational exuberance'." Economic prospects were "bright," and "overheating pressures have abated in many emerging market economies, especially in Asia—where growth has stayed string for several years." (pp. 129–30)

73. *IMF Survey*, May 26, 1997 (1st quote); Darren Mcdermott and Leslie Lopez, "Malaysia Imposes Sweeping Currency Controls—Such Capital Restrictions Win Credence in Wake of Financial Turmoil," *Wall Street Journal* September 2, 1998, G. Pierre Goad, "Acceptance of Capital Controls Is Spreading," *Asian Wall Street Journal*, September 2, 1998 ("condition of membership" quotes).

74. David E. Sanger, "Gaining Currency: The Invisible Hand's New Strong Arm," *New York Times*, Sept. 9, 1998 (quote); Sanger also notes a suspension of U.S. pressure on China to make their currency completely convertible. See also Richard Saludo: "Cold War Over Hot Money," *Asiaweek*, Sept. 18, 1998, who characterizes the struggle between liberalism a la the IMF and state control of the economy as "Cold War 2."

75. See Robert Gilpin, *War and Change in World Politics* (Cambridge: Cambridge University Press, 1981). This also contrasts with many baseline liberal expectations, which expect contemporary economic change to reduce China's aggressiveness, as economic growth and international trade decentralizes power within China and creates vested interests in continued peace. See also Miles Kahler, "External Ambition and Economic Performance," *World Politics* 40, no. 4 (July 1988), p. 451; Denny Roy, "Hegemon on the Horizon? China's Threat to East Asian Security," *International Se-*

curity 19, no. 1 (1994), 149–68; Aaron Friedberg, "Ripe for Rivalry: Prospects for Peace in a Multipolar Asia," *International Security* 18, no. 3 (Winter 1993/4), 5–33; and Alastair Iain Johnston, "Realism's and Chinese Security Policy in the Post-Cold War Period," in Kapstein and Mastanduno.

76. In my experience, realist scholars, when pressed, are not able to come up with a case where *interdependence* caused war. That is, instances when a high level of trade between two states was, *ceteris paribus*, an important cause of war between then.