CHAPTER 9

Conclusions

WE MAY now review the answer given to the puzzle motivating this study and examine several of its broader ramifications, which include (1) the relationship of the argument here about rising international interdependence to other arguments about interdependence; (2) the light the comparison of the French and U.S. cases may shed on various aspects of comparative politics; (3) the relationship of this study's conclusions to key theories in international political economy about the sources of free trade and cooperation; and (4) its policy implications.

The Puzzle and Rising Interdependence

This work has asked why the 1970s were less protectionist than the 1920s, when economic and political pressures for protection were similar in both. Serious economic distress and declining British hegemony led, in the eyes of many scholars, to widespread protectionism in the 1920s. Similar conditions characterized the 1970s, but markets remained relatively open then. What was different about the two periods that might have created such different trade policy outcomes?

I have argued that the increased economic integration of advanced industrial states into the world economy in the 1970s altered the domestic politics of trade. Firms and industries that had become dependent on exports, imports, multinational production, and global intrafirm trade were now opponents of protectionism, for such policies had become extremely costly for them. As the cases revealed, when threatened by import competition, internationally oriented firms in both the 1920s and 1970s opposed protectionism, while domestically oriented ones sought it. More firms with more international ties existed in the 1970s, and thus resistance to protection was stronger than in the 1920s. Because fewer demands for protection were made by firms in trouble in the 1970s, states could more easily resist the temptation to close their markets.

This argument touches on one of the key disputes in international political economy—the problem of rising interdependence and its effects. We have examined how the greater integration of domestic and international economies elevated the costs of limiting trade. As their

integration rose, protectionism became a more costly option for advanced industrial democracies, since it would hurt many of their most competitive industries, usually the most internationally oriented ones. These greater international ties raised the costs of severing trade relations via protection for certain industries in all the countries involved. This increased interdependence, then, meant an increase in the mutual costs of foregoing economic relations.[1]

In this sense, the argument is that in the 1970s the advanced industrial countries were more interdependent than in the 1920s. But in both periods interdependence made protectionism a costly strategy. It was avoided by internationally oriented firms in each decade. Nevertheless, the increased economic integration of the 1970s does not rule out protectionist responses by these states. Indeed, rising international trade and production may generate other pressures for market closure, for they may increase the costs of continuing trade relations as usual. For instance, surging imports may threaten sectors once untouched by foreign competition, thereby turning domestically oriented firms into advocates of protection. The growth of economic integration among states may thus generate new pressures both for and against protection. Heightened interdependence need not lead to greater market openness, although one of its effects—as identified here—surely is to do this.

In this study, interdependence has two distinct features. First, interdependence manifests itself *within* the state. Most examinations of interdependence locate it at the level of the state.[2] Here, however, it involves the international economic ties of firms within states. Domestic social actors, not states, are the agents of interdependence. Looking within the "black box" of the state, the analysis has focused on how international economic integration affects domestic social actors. Second, this study has a different view of the effects of interdependence. Traditionally, rising interdependence has been described as affecting states by rendering their individual policy instruments ineffective and thus reducing their autonomy.[3] Here the effect demonstrated was to reshape firms' trade preferences and thus influence states' policy

[1] This definition is from Albert Hirschman, *National Power and the Structure of Foreign Trade* (Berkeley: University of California, 1945); see also David Baldwin, "Interdependence and Power: A Conceptual Analysis," *International Organization* 34 (Autumn 1980):471-506.

[2] Richard Cooper, *The Economics of Interdependence* (New York: McGraw-Hill, 1968); Keohane and Nye, *Power and Interdependence*; Edward Morse, *Modernization and the Transformation of International Relations* (New York: Free Press, 1976).

[3] Ibid.

choices. The consequences of interdependence are internal to states; they affect domestic social actors' policy preferences, not states' policy instruments. In addition, the effects of growing interdependence are mixed. Rising trade and production among states not only increase the costs of severing these relations but also elevate the costs of maintaining these flows for import-competing firms. Growing interdependence is unlikely to prevent protectionism in sectors where domestically oriented firms are dominant. Only further internationalization of these firms' operations may prevent recourse to protection.

This brings us to the question of why the international integration of advanced industrial economies grew in the postwar period. Why did firms increasingly choose to export and invest abroad? Why did many of them become ever more dependent on the international economy? Economists and political scientists have proposed various answers to this question.[4] For many economists, trade and direct foreign investment (DFI) are the products of firms' comparative advantages. Trade occurs when firms can produce and sell abroad at a relatively lower cost than can the firms in that market. Likewise, DFI occurs when "[s]uperior knowledge or technology gives American firms a competitive edge in overseas markets that more than compensates for the costly disadvantages of operating in a foreign country."[5] In addition, observers have noted that DFI often acts as a substitute for exports, since this investment provides entry to markets where trade barriers are high.[6] Economists thus focus on the specific assets—tangible and intangible—of firms that give them competitive advantages globally to explain the internationalization of firms. But have these assets gained importance since World War II in a way that induced the secular increase in firms' international ties? The growing significance of high technology industries might account for this. In the postwar period, knowledge and technology—both intangible assets—have become more important for firms, at least in the United States, as skill levels and R&D requirements for industries have risen.[7] These economic changes may account in part for the growing internationalization of firms since 1945.

Others have focused more on the political determinants of trade

[4] See, e.g., Raymond Vernon, *Sovereignty at Bay* (New York: Basic Books, 1971); Gilpin, *U.S. Power*; Caves, *Multinational Enterprise and Economic Analysis*.

[5] Kenneth Flamm, *Targeting the Computer* (Washington, D.C.: Brookings Institution, 1987), p. 1.

[6] Caves, *Multinational Enterprise*, pp. 36-45.

[7] Feldstein, ed., *The American Economy in Transition*, pp. 359, 392, 533-36

and DFI.[8] One prominent theory maintains that the growth of trade and DFI were dependent upon U.S. hegemony, which established a stable regime conducive to such flows. Robert Gilpin claims:

> Just as the *Pax Britannica* provided the security and political order for the expansion of transnational economic activity in the nineteenth century, so the *Pax Americana* has fulfilled a similar function in the mid-twentieth century. Under American leadership, the various rounds of GATT negotiations have enabled trade to expand at an unprecedented rate. . . . Finally, the multinational corporations found the global political environment a highly congenial one. As a consequence, they were able to integrate production across national boundaries.[10]

In this view hegemony was necessary for the internationalization of firms.

This theory fails to consider explicitly why a hegemon wants an open international system. Why do hegemonic states, or at least the United States, prefer openness? Answering this necessitates looking at the hegemon's "national interest" and its definition. By examining the domestic bases of support for an open system, the argument here can help fill this gap in hegemonic stability theory. U.S. interest in the creation of an open system in the 1940s and 1950s was probably encouraged by domestic social actors' interests in such openness. Gilpin himself notes that "corporate interest and the 'national interest' . . . have coincided. . . . Corporate and political elites have shared the American vision of a liberal world economic order."[11] In the immediate postwar period, large multinationals and exporters were likely supporters of such a policy, while the lack of foreign competition quieted traditional opponents of liberalization.[12] Policy makers' understanding of the rising importance of the country's international ties may thus have been one factor propelling them to act "as a hegemon should." Although hegemonic stability theory helps explain the growing internationalization of firms, this study points out the domestic political sources of support underlying the United States' initial decisions to create a system promoting such internationalization.

[8] E.g., Gilpin, *U.S. Power*.

[9] See the literature on hegemonic stability theory in chapter 1, note 2

[10] Gilpin, *U.S. Power*, pp. 111-12.

[11] Ibid., p. 142.

[12] While U.S. DFI at the time was low, U.S. export dependence in the late 1940s was quite high. See the 1985 *Economic Report of the President* (Washington, D.C.: GPO, 1986), tables B-10, B-96, B-98 on export dependence.

Comparative Politics and Domestic Actors

A second argument in this book has been that French and U.S. firms responded similarly to the growth of their international ties in the 1970s and early 1980s. For both, strong dependence on the international economy mitigated preferences for protection even when the firms were besieged by imports. A common international event evoked a similar domestic response in the two countries. This finding contrasts with many in comparative politics that tend to stress the differences in states' responses. Studies often emphasize how particular national characteristics shape states' policies and neglect similarities across the countries.[13] However, as others have argued, the character of the international system may generate similar pressures and responses among states.[14] As Realists in international relations see the condition of international anarchy leading all states to adopt similar balancing behavior, I have argued that rising interdependence prompts the growth of domestic preferences for free trade among certain actors in all developed industrial countries. The compelling logic of these international pressures promotes similar responses in widely differing states. These similarities, as well as differences, deserve recognition.

Responses to international conditions may differ not only among states but also over time. This study, however, found similarities across time in domestic groups' responses to heightened interdependence. In both the 1920s and the 1970s, internationally oriented firms resisted protectionism despite foreign competition. But between these two periods, one change is evident. In the 1920s industries had little trouble translating their trade preferences into policy, as long as they were not too divided. By the 1970s the process was less simple. Industries had more difficulty in realizing their preferences, as discussed in chapter 7. Often firms within industries were seriously divided in their preferences. Other times policy makers resisted their demands. Domestic political institutions had become more important in the determination of policy. Peter Gourevitch notes this change, stating that over time

> the machinery that links state and societal actors has grown in importance, and the variance of countries on that point has also grown. At the onset of the first crisis, in the last third of the nineteenth century, organizations were relatively weak. Functional interests worked directly on politics and policy debate in a relatively unmediated way, and outcomes could be inferred fairly directly from the struggles of societal actors. . . . [Later s]ocietal actors had to act through parties and associations that had their own agendas, goals, and categories. . . . With the growing importance of associations in shaping the behaviors of societal actors and participating in actual making and implementation of policy, differences among associations have come to play a greater role in accounting for choice of policy.[15]

[13] E.g., Peter Katzenstein, ed., *Power and Plenty*. Zysman, *Governments, Markets, and Growth*.

[14] Gourevitch, *Politics in Hard Times*. Realist balance of power theory also suggests this; for an extreme version, see Kenneth Waltz, *Theory of World Politics* (Reading, Mass.: Addison-Wesley, 1979)

This change has important implications, because it suggests that in the 1970s policy structures in France and the United States should have greater influence over outcomes and their differences should be reflected more in policy choices. How important are differences in the French and U.S. responses to rising interdependence? As argued in chapter 8, these states' behavior is constrained in similar ways. As advanced industrial democracies, these governments need the support of their societies, and this support often depends on the economic situation. Since this situation is affected to a large extent by business decisions—e.g., regarding investment and hiring—the government is dependent on business decisions and is responsible for creating an environment conducive to economic growth.

Since the 1940s, both states have taken on increasing responsibility for their economies, intervening more and more. The forms of these interventions have differed. The French developed a planning system and promoted selected industries, all the while creating a "special relationship" with big business. The American government kept a more distant relationship with business, but still aided and created markets for selected industries through large military and space programs. These differences are apparent in the 1970s cases. The U.S. government still has a more adversarial, arms length relationship with industry, although it has been willing to help, especially when "national security" concerns have been raised. The French state, especially the Ministry of Industry, has a much closer relationship with industry. This relationship involves much negotiation and mutual accommodation; the government exchanges aid in return for the restructuring of industries, so they can perform better.

The balance of influence in this relationship has shifted over time. In the years following World War II, the French state held the upper

[15] Gourevitch, *Politics in Hard Times*, pp. 230-32.

hand, as industry was discredited and devastated. State control began to wane by the late 1960s. The reconstruction and internationalization of French industry gave it more resources of its own. As we have seen in the cases, in the 1970s this allowed many French industries to design their own policies and pursue their own business strategies. At times, when facing serious foreign competition and economic problems, certain industries looked to the state for help, as they did in the United States. In neither country was there a clear preference among industries for seeking state aid or adjusting on their own. The evolution of French industry in the 1970s was not predominantly "state-led"; nor was that of U.S. industry solely "company-led."[16] Rather, a mix of state action and corporate strategy prevailed in both.

In each country, large international firms preferred to pursue their own adjustment strategies, largely independent of the state, while smaller domestically oriented firms were more likely to seek state aid. Larger firms in both seemed to possess greater resources and flexibility for adapting, especially when success depended on further internationalization of their operations. Contrary to arguments touting the adaptive powers of small, specialized firms, the cases here show that when facing strong foreign competition small firms, if they lacked international ties, had trouble adjusting and often turned to the state for help.[17] In numerous cases, the market had become international, and only by expanding to a global scale could these firms survive and prosper.

In many ways the internationalization of markets since 1945 has produced similar pressures in advanced industrial democracies. This expansion of the market has forced industries to compete internationally. Increasingly, domestic markets, even in the United States, are not large enough to support firms; rather, firms must become global players. This makes firms at once more and less dependent on their governments. If they are successful internationally, the home market is less important. But often to be successful on a global scale, they need their government's help. To ensure the safety of their foreign investments, to open markets abroad, or to maintain convertibility of currencies, firms must rely on the actions of their, and other, states. Creating the conditions necessary for a stable, open international market therefore requires the active participation of states and often their international cooperation. Even those firms that operate globally depend upon their governments. Furthermore, if interstate cooperation and the creation of international regimes are necessary for maintaining open markets, then these internationally oriented firms may provide the support and impetus domestically for policies promoting such cooperation.[18]

[16] This contrasts with the argument of Zysman in *Governments, Markets, and Growth*.

[17] This contrasts with the claims of Piore and Sabel in *The Second Industrial Divide*.

Firms and their governments are bound in an interdependent relationship. If, as I am arguing, industries are becoming more international, this may lead to new relations between them and the state in advanced industrial countries. The two may become even more interdependent, as the state must come to the aid of its firms in international markets so they can produce prosperous conditions at home, and firms must rely ever more on their state to ensure a stable, open international system. Governments' foreign economic policies will be of increasing concern to their industries and to their own electoral prospects. Advanced industrial democracies will face similar pressures, and, if this argument is correct, many will be forced by the logic of the market to react in similar ways. Differences in their domestic political structures, ideologies, and governing coalitions will shape the exact way they react, but all will be pressured to act closely with their industries to ensure their international competitiveness.

The International Political Economy and Domestic Preferences

Many observers in the 1970s claimed that the decline of U.S. hegemony would lead to the closure of the international trading system. The

[18] A less optimistic view of business–state relations is evident in the strategic trade policy literature. The argument there is that as industries become more oligopolistic and international in scale, optimal trade policy changes. In such industries, state intervention is critical. A state can capture additional national rents if it protects or subsidizes its firms. More defensively, the claim is that a state must retaliate by protecting or subsidizing its firms if other states are doing this, or else its firms will not survive. In such oligopolistic, international industries, firms must get their governments to aid them in either retaliating or persuading other countries to stop protecting their industries. In this case, firms may be proponents of either cooperative or discordant international trade policies. See James Brander and Barbara Spencer, "Tariffs and the Extraction of Rents under Potential Entry," *Canadian Journal of Economics* 14 (1981):371-89; Avinash Dixit, "International Trade Policies for Oligopolistic Industries," *Economic Journal* 94 (supplement, 1984):1-16; Barbara Spencer and James Brander, "International R&D Rivalry and Industrial Strategy," *Review of Economic Studies* 50 (1983):707-722; Antoine Auquier and Richard Caves, "Monopolistic Export Industries, Trade, Taxes, and Optimal Competition Policy," *Economic Journal* 89 (September 1979):559-81; Jonathan Eaton and Gene Grossman, "Optimal Trade and Industrial Policy under Oligopoly," *Quarterly Journal of Economics* 101 (May 1986):383-406; David De Meza, "Commercial Policy toward Multinational Monopolies," *Oxford Economic Papers* 31 (July 1979):334-37; Paul Krugman, ed., *Strategic Trade Policy and the New International Economics* (Cambridge: MIT Press, 1986); Henry Kierzkowski, ed., *Monopolistic Competition and International Trade* (Oxford. Oxford University Press, 1984).

argument here challenges this. Closure of the system through widespread protectionism depends less on declining U.S. power than on reductions in an economy's integration into the world economy. As the cases indicate, despite the loss of U.S. influence, extensive interdependence helped prevent spiraling protectionism like that of the 1920s from recurring in the face of serious economic distress. Protectionism, nevertheless, did increase in the late 1970s and early 1980s. Certain troubled sectors—e.g., textiles, apparel, footwear, and steel—were given protection in most advanced industrial countries. But this sectoral pattern of trade policy cannot be explained by focusing on the loss of hegemony.[19] The argument here is more helpful in explaining this pattern. The most internationally oriented sectors should be the most open, and those whose international ties are weak or declining should be the most protected. As noted, U.S. hegemony may have been partly responsible for the creation of a stable international economy, which allowed the expansion of interdependence in the postwar period. But the decline of such hegemony need not cause the collapse of the free trade system. Rather, the persistence of interdependence, itself a legacy of U.S. hegemony, may promote the maintenance of an open trading system, even after hegemony has passed. Pessimism over the imminent decline of the liberal trading system may thus be overstated.

This is not to claim that in the future protectionist outbreaks like that of the late 1920s and early 1930s cannot or will not occur. Conditions in the international and domestic political economies are constantly changing. In fact, changes in the economics of industries, combined with new forms of state intervention in the economy, may be leading to the growth of new, strategic trade preferences and policies. As increasing numbers of industries have become global in scope, their trade preferences have come to depend more on the trade practices of other countries. When industries, as their scale economies, R&D requirements, and learning effects all multiply, require access to foreign markets to remain profitable, they are pushed to adopt strategic trade preferences in the face of foreign governments' activities aimed at protecting their markets. These preferences entail a shift from demands for freer trade at home and abroad by large exporters and multinationals, to increasing demands by these firms for closure of the home market *if* foreign markets are kept closed. These strategic

[19] Aggarwal, *Liberal Protectionism*, has a sectoral argument about the effects of hegemonic decline. But some of the cases here appear to be in "hegemonic decline" in his terms (that is, facing declining oligopsony power), and not all of them turn protectionist.

demands link access to the home market to access to foreign markets; this is not old-fashioned protectionism. If, as is argued elsewhere, these changes in industry economics and foreign-government intervention are increasing, then the future international trading system may be a more strategic and closed one than that predicted by simply extrapolating from the argument here about the 1970s and early 1980s.[20]

Other explanations for the persistence of international cooperation in trade in the 1970s in the absence of U.S. hegemony focus on elements of the international system. In these analyses, the sources of pressures against a revival of widespread protection lie either in the structure of the trading system—i.e., its payoffs, iterativeness, or number of players—or in the functions of the international trade regime.[21] These accounts overlook what states' preferences regarding trade are and how they are formed. Instead, large, often implicit assumptions about these preferences are made. For example, in arguing that states will maintain a liberal trade regime because of the transaction costs they save in doing so, it is being implicitly assumed that those costs are more significant for the state than the costs of not protecting their economies.[22] Game theoretic models of cooperation also provide little discussion of how each country's payoff from cooperation or defection are determined. For example, Duncan Snidal constructs states' payoffs by assuming that "all states benefit from provision of the good . . . [;] the benefits received by the state are proportional to its size: larger states benefit more . . . [; and] there are declining marginal payoffs, . . . while its unit cost is constant."[23] Whether these assumptions hold for cooperation in trade is unclear. It is debatable, for instance, whether large states gain more from liberal trade than small states.[24]

The costs and benefits of different actions by states in the trade area

[20] Helen Milner and David Yoffie, "Between Free Trade and Protectionism: Strategic Trade Policy and a Theory of Corporate Trade Preferences," APSA paper, August 1987.

[21] Stephen Krasner, ed., "International Regimes," *International Organization* 36 (Spring 1982); Keohane, *After Hegemony*; Robert Axelrod, *The Evolution of Cooperation* (New York: Basic Books, 1984); Kenneth Oye, "Cooperation under Anarchy," *World Politics* 38 (October 1985); Duncan Snidal, "The Limits of Hegemonic Stability Theory," *International Organization* 39 (Autumn 1985):579-614; Duncan Snidal, "Coordination versus Prisoners' Dilemma," *American Political Science Review* 79 (December 1985):923-42.

[22] Keohane, *After Hegemony*, ch. 6.

[23] Snidal, "Limits of Hegemonic Stability Theory," p. 604.

[24] William Cline, Noboru Kawanabe, T.O.M. Kronsjo, and Thomas Williams, *Trade Negotiations in the Tokyo Round: A Quantitative Assessment* (Washington, D.C.: Brookings Institution, 1978), show empirically that smaller states often gain more from liberalization of trade; see esp. pp. 187-88, 220-27.

need more exploration. The argument in this book contributes to this inquiry. To understand the structure of the international trading game, the extent of each economy's international integration might be examined, since this affects the payoffs states anticipate from liberalizing or protecting. In times of stiff foreign competition, a state whose economy is dominated by domestically oriented firms may find continued cooperation in a liberal system very costly. The payoff a firm receives from defecting may be high. On the other hand, a state with an internationally oriented economy may find protection at home or abroad—i.e., defection by itself or others—costly. Its payoff is maximized, *ceteris paribus*, if cooperation with a liberal trade regime is maintained globally. Overall, this suggests that an international economy with high levels of interdependence may promote continued international cooperation in trade.

Some Policy Implications

This study suggests that protectionism will be most likely in sectors menaced by foreign competition and lacking strong international economic ties. Actions that reduce these ties but leave import competition intact will engender new protectionist pressures. For example, macroeconomic policies that reduce international ties will promote widespread protectionist sentiment throughout the economy. Indeed, this may be one of the lessons of the early 1980s. The growth of protectionist pressure in the United States between 1981 and 1985 was partly attributable to sharp reductions in U.S. export dependence (by almost one-third) and in the profitability of foreign operations, both due to a large extent to the serious and persistent overvaluation of the dollar.[25]

Mismanagement of the macroeconomy can have damaging effects on a country's trade and its trade preferences. Policies eroding an economy's international linkages—i.e., its exports, multinational production, and global intrafirm trade—may undercut its domestic bases of support for free trade. In this way domestic policies, even those unrelated to trade, may affect the state of the international trading system. Policy makers thus should be conscious of the indirect effects of macroeconomic policies on domestic political preferences. They should appreciate these indirect costs when choosing macroeconomic policies, so that domestic support for a liberal trade system is not inadvertently undermined.

[25] Destler, *American Trade Politics*, ch. 3, makes a similar argument. Destler also in a talk at Harvard University on February 18, 1986, cited figures showing that U.S. industrial export dependence (exports as a percent of national production) grew from 9 percent in 1970 to 14.2 percent in 1980 and then fell sharply to 10 percent in 1984. This was, he noted, the same percentage decline experienced in the Great Depression, between 1929 and 1933.