

CHAPTER I

THE HARMONY OF INTERESTS REVISITED

The economic expert, dominated in the main by *laissez-faire* doctrine, considers the hypothetical economic interest of the world as a whole, and is content to assume that this is identical with the interest of each individual country. The politician pursues the concrete interest of his country, and assumes (if he makes any assumption at all) that the interest of the world as a whole is identical with it. (Carr, 1964:55)

The contours of contemporary international political science took shape in the aftermath of the two World Wars — violent clashes pitting the most powerful countries on the globe against each other in bloody battles that remain unsurpassed in terms of the number of human lives lost. Not surprisingly, the field's agenda has been dominated by the desire to avoid a third such confrontation.

Quite surprisingly, international relations theory has come full circle in the past half-century, from optimism to pessimism and back again. The interwar optimism concerning the prospects for world peace was based on the belief that no country would be tempted to wage war when World War I remained a fresh reminder of how destructive armed conflict might be to the community of nations as a whole: Wilsonian idealism was predicated first upon a failure to recognize that countries such as Germany, Italy and Japan might be able to improve their individual lots if victorious in war regardless of any collective interest in peace; and second, upon

misplaced faith in the influence of international institutions such as the League of Nations.

World War II was only the final stunning piece of counterevidence in a series of international events that underscored the fallacy of such beliefs; the tide of international opinion reversed so dramatically that the new pessimism was termed “realism.” International relations theory became dominated by the cynical certainty that conflict was inevitable among sovereign nations subject to no central authority; indeed, the pessimism was so powerful that the United States was quickly plunged into a lengthy standoff with a wartime ally for reasons that remain mysterious to this day.

Fifty years later, the Cold War has ended with the dissolution of the Soviet Union, the World Wars seem a distant memory to many, economic issues have pushed to the forefront of international relations, and the tide has turned again. President Clinton describes himself as “Neo-Wilsonian”¹ and embraces multinational institutions, urging Congress to “renew America’s commitment to the International Monetary Fund” and “make good on our debt to the United Nations.”² In his emphasis upon countries’ common goals, President Clinton seems to parrot his predecessor, who called for “a new world order, where diverse nations are drawn together in a common cause to achieve the universal aspirations of mankind — peace and security, freedom, and the rule of law.”³ Their shared belief that multilateral institutions promote the interest of the world as a whole rather than merely the United States’ interest is echoed in the academic literature in the form of neoliberal institutionalism, which holds that the United Nations, the International Monetary Fund, the World Bank and the like

¹ See Holmes Steven A. (1993) Choice for national security advisor has a long-awaited chance to lead. *New York Times*, January 3, 1993.

² President William Clinton, “Address Before a Joint Session of Congress on the State of the Union,” January 27, 1998.

³ President George Bush, “Address Before a Joint Session of the Congress on the State of the Union,” January 29, 1991

induce international actors to forego their individual interests in favor of the collective good. While the new optimism is girded by impressive technological developments in both political science and economics, its theoretical foundation is precisely the same as that of Wilsonian idealism: neoliberal institutionalists argue that nations will cooperate to remove individual incentives to compete because trade wars and arms wars are counter to the collective interest in free trade and peace, and that international institutions are an effective means of inducing nations to forego their individual interests in favor of the collective good. Without any reference at all to contemporary politics, one might wonder at the resuscitation of the logic that was so catastrophically belied by World War II.

Contemporary politics, to be sure, is as confusing as it is enlightening. Neoliberal institutionalists correctly note that deepening institutionalization and increasing coordination of economic policies among the major powers are hallmarks of the contemporary political arena and apparent contradictions of the brand of realism that has dominated international relations theory for the past few decades. There is a suspicious pattern to the adoption of the free trade principles advocated by multilateral institutions, however: the push for free markets has been led by the wealthiest, most powerful countries in the international system and joined only reluctantly by most third world countries. Indeed, conflict between northern-led international economic institutions and the developing world in the south has become daily news. If market liberalization is appropriately characterized as mutual cooperation in a symmetric prisoner's dilemma game, as neoliberal institutionalists suggest, why is the behavior of these two groups of international actors so different?

Popular answers tend to be ad hoc and unconvincing. Third world citizens, many argue, are victimized by the graft of their political leaders to an extent unparalleled in developed countries where public scrutiny is better institutionalized. (One might think that the savings and loan scandal happened in Burundi.) More formally, com-

parative political scientists often distinguish between the “patron–client” nature of domestic politics in third world countries and the interest articulation role lobbyists play in more advanced polities. (The distinction seems not to be obvious to those concerned with campaign finance scandals in the United States, France, Japan, Germany and Israel.) Often, leaders of developing countries are dismissed as being merely backward.⁴

I propose instead a twofold answer. In this chapter, I begin to reexamine the contemporary debate between realists and neorealists and find both sides lacking. I argue that one of the earliest modern attempts to introduce a logical framework into the study of international relations remains the most persuasive and the most powerful. For Edward H. Carr, power and interest were the keys to understanding international actors’ behavior. Modern day realists, who equate power and interest in the tradition of Morgenthau, are at a loss to explain anything but conflictual behavior. Neoliberal institutionalists, by ignoring power, have introduced a perspective that is tenable only through selective attention to evidence: they tend to focus on interactions among only the most powerful countries in the world system. To the extent that the third world’s resistance to norms and institutions that are held to be in the best interest of all is given any consideration, it is typically written off as misguided ideology.⁵

The story told here is that contemporary calls for a new world order based on expanding markets and liberalized trade are only the most modern means by which the most powerful countries in the world strive to advance their own interests, and that these interests are not shared by less powerful countries. The foundation for

⁴ Consider this astonishing lead in a *Wall Street Journal* article rejecting currency speculator George Soros’s role in the Asian currency crisis of 1997: “In faraway Hong Kong the prime minister of Malaysia did his rain dance against modern finance, inveighing against George Soros and other ‘morons’ of the currency markets.” (Jenkins, Jr., 1997)

⁵ A notable exception is Krasner, 1985.

this argument is developed in later chapters, where a reexamination of classical trade theory leads to revised assumptions about whose material interests are served by liberalized markets. More specifically, neoliberal advocacy of liberalized trade is based on the notion that intervention in the form of subsidies, tariffs and non-tariff barriers distorts international production from an efficient optimum that arises naturally in the absence of intervention; thus liberalized trade is alleged to be in the collective interest. This belief is adopted wholesale from economic models based on the works of Adam Smith and David Ricardo, who could not have anticipated the historic changes that have transformed the international system in recent years. The rapid decolonization of the 1950's and 1960's coupled with unprecedented and growing international interdependence has resulted in a system in which very wealthy, highly institutionalized countries trade with much poorer countries at very low levels of political development. The risks associated with holding currencies from the two sets of countries are so markedly different that the distinction between "hard currency" and "soft currency" is second nature to policymakers even as it remains foreign to the literature concerning gains from trade. By incorporating this feature into standard models, I conclude that perfectly free markets lead to a redistribution of global income favoring the most powerful countries in the system. More important, I find that liberalized markets are not consistent with the interests of the international community as a collective; I directly challenge the basis for the presumed moral high ground of economic liberalism.

Since the distinctions between the "collective interest," "common interest" and "individual interest" are central to both parts of my argument, and are frequently muddled in both the political science and economics literatures, an illustrative aside may be in order.

Suppose that Donald Trump, Mother Teresa and I are all rational expected value maximizers and are presented with two possible ways of splitting monetary pools of

different sizes, as in Table 1.

Pursuit of our “individual interest” means that we will each prefer the arrangement that affords each of us the largest winning: Donald Trump will prefer Arrangement A while Mother Teresa and I will prefer Arrangement B. Additionally, Mother Teresa and I are said to have a “common interest” in Arrangement B.

Foregoing individual interests in favor of the “collective interest” (or “collective good”) means maximizing the winnings of the group as a whole — in this case, we would all choose Arrangement A, in which the total winnings are \$5,000,002 rather than the \$3000 afforded by Arrangement B.

Table 1. Illustration of Individual and Collective Interest

	<i>Arrangement</i>	
	A	B
Donald Trump	\$5,000,000	\$1000
Mother Teresa	\$1	\$1000
Me	\$1	\$1000
Total	\$5,000,002	\$3000

As a further aside, those acquainted with social welfare theory will recognize that while both arrangements are Pareto-optimal, only Arrangement A satisfies the Kaldor–Hicks criterion of social welfare: Donald Trump could compensate Mother Teresa and me so that all three of us are better off than we would be under Arrangement B. If unmoved by my carefully contrived example, consider the advice of Nobel laureate Amartya Sen, who has suggested that compensation approaches are “*either* unconvincing *or* redundant... If compensations are not actually paid, then it is not

obvious why this should be seen as an improvement” — i.e., the Kaldor-Hicks criterion is unconvincing as a standard for improved social welfare. If, on the other hand, compensations are paid, then “the change *along with the compensation* is simply a Pareto-improvement” — i.e., Kaldor-Hicks is redundant. (Sen, 1986:5) This sort of objection to standard welfare theory has formed the basis for Sen’s extensive efforts toward developing criteria for social welfare that go beyond summing net benefits.

John Rawls assails traditional social welfare theory for the same reason I will challenge neoliberal institutionalism: it is irrational for individuals to choose the collective interest over their individual interest. Beginning with the assumption that one criterion for a just social contract is that all parties would choose it in the absence of any information about their initial positions, Rawls notes

Offhand it hardly seems likely that persons who view themselves as equals, entitled to press their claims upon one another, would agree to a principle which may require lesser life prospects for some simply for the sake of a greater sum of advantages enjoyed by others. Since each desires to protect his interests, his capacity to advance his conception of the good, no one has a reason to acquiesce in an enduring loss for himself in order to bring about a greater net balance of satisfaction. In the absence of strong and benevolent impulses, a rational man would not accept a basic structure merely because it maximized the algebraic sum of advantages irrespective of its permanent effects on his own basic rights and interests. (Rawls, 1971:14)

Rethinking International Relations Theory

It was precisely this line of thought that formed the basis of Edward Hallett Carr’s critique of American foreign policy under Woodrow Wilson; Wilson, Carr argued, was banking on international leaders’ willingness to sacrifice the national interest of each of their countries for the collective interest of the community of nations as a whole. As Wilson’s faith in the efficacy of international institutions was based on the same sort of logic that underpins contemporary neoliberal thought, a review of its foundations and Carr’s critique is in order.

From Utopianism to Neoliberal Institutionalism

Wilsonian Idealism and Carr's Critique

Political thought in the years between the two World Wars was dominated by Wilsonian idealism. Liberal democratic theory underpinned President Wilson's faith in the power of a multinational deliberative institution to resolve international disputes peaceably. "One country, one vote" was established as the norm for decision-making in his League of Nations, and Wilson preached at every opportunity that enlightened men institutionally empowered to discuss their disputes openly would be convinced by the force of reason to do what they should do rather than what they wanted to do – that is, to forego their individual interests for a moral good arbitrarily identified as the interest of the community as a whole.⁶ The avoidance of war in particular was held to be in the collective interest, and signatories to the Covenant of the League of Nations agreed to police themselves by providing a united front against any country that (presumably due to muddled thinking, incorrigible evilness or hapless retrogression⁷) attempted to violate the community norm against waging war.

To President Wilson's embarrassment, the United States Senate provided an early indication of just how utopian such thinking was by refusing to ratify the Treaty of Versailles. Having established in World War I that it was the most powerful country in the world, the United States refused to relinquish its newly won place at the top of the international pecking order by consenting to submit to the authority of international opinion. By dint of its stature, the United States already had much greater influence

⁶ This standard may be so strongly socialized that alternatives — such as maximizing the welfare of the most disadvantaged member — may be difficult to imagine.

⁷ See Carr, 1939:38-39 for a catalogue of comments along these lines from leading thinkers of the time.

over international affairs than a single vote in the League of Nations could confer. Wilsonian idealism was critically flawed first by its failure to recognize the primacy of power.

More critically, Wilsonian idealism erroneously presumed a harmony of interests surrounding the desire for peace. In his brilliant treatise published shortly before the outbreak of World War II, Edward Carr decried the tendency of American and British leaders in particular to assume that their aversion to another war was shared by the community of nations as a whole. In part, he argued, intellectual leaders simply failed to recognize that the individual interest of any country might not be identical to the obvious collective interest in avoiding bloodshed and destruction because gains and losses might be distributed unevenly:

It was easy after 1918 to convince that part of mankind which lives in English-speaking countries that war profits nobody. The argument did not seem particularly convincing to Germans, who had profited largely from the wars of 1866 and 1870, and attributed their more recent sufferings, not to the war of 1914, but to the fact that they had lost it; or to Italians, who blamed not the war, but the treachery of allies who defrauded them in the peace settlement; or to Poles or Czecho-Slovaks who, far from deploring the war, owed their national existence to it, or to Frenchmen, who could not unreservedly regret a war which had restored Alsace-Lorraine to France; or to people of other nationalities who remembered profitable wars waged by Great Britain and the United States in the past. (Carr, 1964:51-52)

But also, Carr argued, idealists' faith that all countries shared an aversion to war was predicated on a failure to recognize the "all other things equal" nature of the aversion: "The common interest in peace masks the fact that some nations desire to maintain the *status quo* without having to fight for it, and others to change the *status quo* without having to fight in order to do so." (Carr, 1939:52-53)

Indeed, the Covenant was kept only when it served nations' interests to do so. The United States refused to sign at all. Italy invaded Ethiopia in 1935, eliciting only

toothless economic sanctions⁸ from the signers who had pledged to mobilize against unprovoked aggression; the norm of collective security was defended only when doing so was costless. Japan withdrew in 1933 to indulge its expansion into Manchuria and China. Germany withdrew in 1933, sent troops into the Rhineland in 1936, and formed the Rome–Berlin Axis with Italy in 1938 to provide military support for General Francisco Franco in the Spanish Civil War. Russia was expelled early in 1939 for invading Finland. It was obvious long before World War II began with Germany’s invasion of Poland in September of 1939 that the Covenant was readily ignored when honoring it was at odds with nations’ individual interests; the institutionalization of norms against aggression provided no guarantee of peace. International behavior was inconsistent with utopian advice about how countries *should* behave. Carr exhorted students of international relations to adopt his “realism” based on the notion that countries are rational actors: power and interest are the keys to understanding international relations. His greatest influence, though, may have been his plea for a positive, rather than normative, theory of international relations.

Morgenthau and Modern Realism

Hans Morgenthau answered Carr’s appeal for a behavioral theory of international relations with a self-conscious attempt to purge Carr’s theory of its unobservable elements, and it was Morgenthau’s brand of realism that was to capture the imagination of the bulk of the international relations community and to become the foundation of modern realism. While Carr had argued that power and interest — not Wilsonian moralism — were the keys to understanding international relations, Morgenthau forwarded the *a priori* claim that the national interest of all states *is* power; he rejected out of hand Carr’s preoccupation with idiosyncratic and situational individual

⁸ The sanctions excluded oil, iron and steel because including them would be costly to the countries imposing the sanctions.

interests. In part, this was an explicit attempt to respect the artificial boundaries consistent with those of the academic disciplines: Morgenthau built his framework around power because he believed that attention to power distinguished the study of politics from the study of economics, ethics and religion in a way that attention to interests could not.⁹ But more than that, assuming that the international interest of all states is power and domination was a means of sidestepping complexities entailed with a careful consideration of interests, as military power was believed to be roughly observable — and therefore a suitable construct for behavioral research — in a way that interest was not. Indeed, Morgenthau’s discussion of interest in the opening chapter of his classic work is enlightening mostly because it reveals how murky the very concept of “interest” was for many writers of the time; his analysis veers from interest as preferred outcome, to interest as statesmen’s intentions, to interest as statesmen’s stated intentions, to interest as the moral goodness of statesmen’s aims.¹⁰

However questionable Morgenthau’s equation of interest and power may have been, it led to an appealingly simple world view. Power and domination, after all, are relational concepts: one country is only as strong as another is weak; one country dominates only if another submits. If each country’s national interest is identically power, then, international behavior occurs in a setting where there is a pure conflict of interest between all actors.¹¹

⁹ “The main signpost that helps political realism to find its way through the landscape of international politics is the concept of interest defined in terms of power. This concept provides the link between reason trying to understand international politics and the facts to be understood. It sets politics as an independent sphere of action and understanding apart from other spheres, such as economics, ethics, aesthetics, or religion. Without such a concept a theory of politics, international or domestic, would be altogether impossible, for without it we could not distinguish between political and nonpolitical facts...” (Morgenthau, 1954:5.)

¹⁰ See especially the discussion in Morgenthau, 1948/1954:4-6.

¹¹ By “conflict of interest” I mean “the state of incompatibility of the goals of two or more actors.” (Axelrod, 1970:10) There is a good discussion in Axelrod, 1970 (pp 10-15) of the distinction between conflicting goals and what Axelrod terms “conflictful behavior,” a distinction often lost in the academic literature.

Morgenthau's conflation of interest and offensive capability may have been troubling, but it was not necessary to his conclusion. Other writers¹² forwarded the more explicitly Hobbesian view that the inevitability of international conflict arises from the defensive interests of states¹³ in an anarchical world system.¹⁴ The problem was stated succinctly by Raymond Aron:

But so long as humanity has not achieved unification into a universal state, an *essential* difference will exist between internal politics and foreign politics. The former tends to reserve the monopoly on violence to those wielding legitimate authority, the latter accepts the plurality of centers of armed force. Politics, insofar as it concerns the internal organization of collectivities, has for its immanent goal the subordination of men to the rule of law. Politics, insofar as it concerns relations among states, seems to signify — in both ideal and objective terms — simply the survival of states confronting a potential threat created by the existence of other states. (Aron, 1966:6)

States concerned with survival and uncertain of the intentions of other states must arm, then, but in so doing they threaten the security of the other states who cannot be certain that their arms will be used only defensively, a dynamic referred to as the security dilemma.

¹² See, for example, Herz (1959) and Jervis (1976).

¹³ This strain of realism has since been labeled “defensive positionalism.” (Grieco, 1988)

¹⁴ Indeed, the presumption that the absence of any sort of central authority predisposes the international system to conflict and war is so pervasive that the central question in international relations is frequently posed as “Is cooperation possible in a world without central authority?” The question is sensible only if one makes very narrow assumptions about the role of the state — in particular, that the state behaves as an independent arbiter. Charles Lindblom phrased an objection this way:

To Thomas Hobbes we owe some confusion on the relation of politics to economics. Since the *Leviathan*, the study of politics has been largely the study of conflict and its resolution. But government is not merely or primarily a conflict resolver. And when it does attend to conflict, it is not conflict, as Hobbes saw it, over land, wives and cattle. It is conflict over the control of government itself, over the terms of man's cooperation in government, and over the purposes of that cooperation. (Lindblom, 1977:8)

It is puzzling that we perpetuate this confusion today while working in close proximity to colleagues who study things like “representation,” “interest group influence” and “mass–elite linkages.”

Interdependence Theory and Other Developments

At the same time that scholars concerned with security issues had become convinced that international conflict was inevitable in a system without central authority, an “interdependence” school was forming around the recognition that all international interactions are not directly security-related, not clearly zero-sum and not always conducted by official representatives of the state. Institutions such as the GATT and the International Monetary Fund (IMF) were credited with promoting an international order conducive to freer international movement of goods and capital, and in fact, the postwar growth in world trade has outstripped growth in world production by a factor of two. Moreover, the growth of foreign direct investment and the internationalization of production that accompanied the proliferation of multinational corporations (MNC’s) meant both that foreign non-state actors were highly sensitive to policies in other countries and that policymakers had incentives to woo foreign as well as domestic constituencies. And the number of international non-governmental organizations grew from about 330 in 1914 to almost 6000 by 1980. (Jacobson, 1984:10) This marked the beginning of a tendency among many international relations theorists to argue that relations in the economic and security realms were best understood by different intellectual frameworks: apparent inconsistencies between the realists and the interdependence school theorists were resolved by the suggestion that the security realm is inherently conflictual in a way that the economic realm is not, a strain of thought which persists in some of the contemporary literature.

Such a resolution is unsatisfactory for two sets of reasons. First, it is not clear that the two issue areas are so neatly separable. Deepening economic ties may have security implications: writers such as Rosecrance have repeated Montequieu’s advice that strong commercial ties between nations increase the costs of war to trading part-

ners¹⁵; an important motivation behind the exchange programs sponsored by the United Nations Educational, Scientific and Cultural Organization (UNESCO) was the hypothesis that increasing contact between citizens of different countries would erode domestic support for war between them; interdependence theorists are wont to suggest that the formation of the European Coal and Steel Community (ECSC) effectively precluded war between longtime enemies France and Germany because neither could independently produce enough steel to mount a military campaign against the other.¹⁶ Choucri and North, Lenin and Hobson¹⁷ underscored the fact that many wars are fought for economic reasons such as access to resources or markets. A.F.K. Organski, Charles Kindleberger and Klaus Knorr¹⁸ have made compelling cases for the importance of economic strength to military power.¹⁹

Second, the suggestion that security issues are inherently conflictual while economic issues are inherently harmonious does not bear scrutiny. The writer most frequently cited in support of this view, Charles Lipson, has noted that potential sources of harmony exist in the security realm:

Yet it is seriously misleading to assume that security issues do not present the opportunity for significant joint gains, or at least the prevention of joint losses. Even adversaries like the United States and the Soviet Union wish to avoid nuclear war. And both could profit from restraints on arms racing: limits on the number of launchers and warheads, reduction of conventional forces in Europe, and so forth. (Lipson, 1984:13)

¹⁵ Rosecrance, 1986; Montesquieu, 1748/1989: 338. The argument that strong commercial ties might soften the political antagonisms between Britain and France is frequently cited as an important motivation behind the Cobden-Chevalier Commercial Treaty of 1860; see Iliasu (1975), Ratcliffe (1975) and Ratcliffe (1973). Cobden's ulterior motive was stated quite explicitly: see Hobson, 1919:244.

¹⁶ The suggestion that a mutual disinterest in fighting each other was requisite to the formation of the ECSC.

¹⁷ See Choucri and North, 1975; Lenin, 1939; Hobson, 1965.

¹⁸ Organski, 1958; Kindleberger, 1970; Knorr, 1973.

¹⁹ More recently, several writers have examined the relevance of military alliances to trade arrangements. See, for example, Gowa and Mansfield, 1993; Gowa, 1994; Pollins, 1989a, 1989b; Morrow, Siverson and Tabares, 1999,1999.

He might also, however, have qualified the common wisdom that “economic games often involve relatively simple coordination or mutually beneficial exchange.” (Lipson, 1984:12) While it is often true that economic agents have a mutual interest in reaching a deal, they frequently have a direct conflict of interest over the terms of the deal: buyers prefer low prices while sellers prefer high prices; borrowers prefer low interest rates, lenders prefer that rates be high; and one need not be a committed Marxist to acknowledge that workers prefer high wages while employers prefer to keep them low. Indeed, Adam Smith argued that these conflicting interests are a critical part of the “invisible hand” that promotes economic efficiency.

Game Theory and International Relations Theory

Objections to the argument that security issues are inherently conflictual while economic issues are inherently harmonious highlight a problem central to both Morgenthau-school realism and to interdependence theory: the poles of pure conflict and pure harmony are sloppy characterizations of international relations in either realm; it is not surprising that neither is consistent with the historical record where harmony and discord wax and wane. Fortunately, technological developments facilitated more sophisticated thinking about the nature of harmony and conflict. The introduction of game theoretic models into the international relations literature provided a simple means of representing situations in which actors’ interests are characterized neither by pure conflict or pure harmony. The prisoner’s dilemma (PD) game in particular became a prevalent metaphor for situations in which countries could both gain from cooperating but fail to do so for fear of being exploited, as it provides a simple representation of one type of situation in which actors’ interests are neither purely conflictual nor purely harmonious.²⁰ On the one hand, two nations may have the in-

²⁰ See the appendix to this chapter.

compatible aims of being militarily superior to the other. On the other hand, if both pursue those aims they will find themselves in an arms race that both would prefer to avoid. Moreover, because its focus is on the tension between actors' individual interests — in this case, nations' desires to arm themselves in order to maintain their external security — and the collective interest — here, avoiding costly arms races — it is an apt metaphor for many collective action problems of interest to social scientists. Whether or not international market liberalization should be included among these is a central theme in this volume.

For international relations theorists in general and realists in particular, the PD game introduced another way of thinking about the implications of international anarchy. Without a formal central authority to enforce agreements, nations could not commit to the cooperative choice in PD without fear of being exploited. PD was thus adopted as a powerful metaphor for the predisposition of international actors toward mutually destructive behavior.

Neoliberal Institutionalism

Foundations of Neoliberal Institutionalism

That pessimism evaporated in the early 1980s as Robert Axelrod began publishing papers that were to culminate in his *Evolution of Cooperation*. Axelrod began by asking “when should a person cooperate, and when should a person be selfish, in an ongoing interaction with another person?” or alternatively, “Under what conditions will cooperation emerge in a world of egoists without central authority?” (Axelrod, 1984:*vii*; Axelrod, 1984:3) Rather than relying solely on the mathematical proofs characteristic of most formal game theory, he provided simulation evidence in the form of computer tournament results. Contestants played iterated PD; each participant

submitted a computer program representing a strategy for making a series of choices about whether to cooperate with or defect against another player in a PD setting. The points awarded to each player following each choice reflected the payoff structure of PD. Each program was pitted against each other program for a lengthy series of PD choices. Scores were totalled for each pairwise match and then for each strategy as a whole by adding up all the scores achieved in the tournament. Results were publicized, and a second, much larger tournament was held following essentially the same rules.²¹

The program that won both tournaments utilized a very simple strategy of reciprocity, Tit for Tat (TFT): cooperate if the other player cooperated on the previous move, defect if the other player defected.²² More important, despite the fact that the immediate incentive in PD is to defect, many of the interactions — and, not surprisingly, all of those in which players achieved high scores — included lengthy stretches of mutual cooperation. The key to this result was the “shadow of the future.” Cooperation emerged when players were placed in situations in which they had a long future of PD interactions before them and placed sufficient value on the outcomes of the future interactions. This striking contradiction of earlier expectations of actors’ behavior in PD settings provided the impetus for a new strain of thought in international relations theory, neoliberal institutionalism.

Axelrod went further by outlining advice to participants and reformers. To increase the likelihood of mutual cooperation in an iterated prisoner’s dilemma setting, he advised that reformers attempt to enlarge the shadow of the future by making interactions more durable and/or more frequent — for example, by breaking issues under negotiation into smaller pieces — and by changing the payoffs faced by the

²¹ An important exception: in the first computer tournament, each game was a series of 200 PDs; in the second computer tournament, the length of the game was variable and determined randomly.

²² TFT also includes cooperating on the first move.

players — for example, by government intervention. In a later article, Axelrod and Keohane took still a further step. They argued not only that institutions and regimes might serve to change the international context in a way that could increase the likelihood of international cooperation, but also that actors involved in situations analogous to iterated prisoner’s dilemma might actively seek to do this:

Another way to facilitate cooperation is to establish international regimes. Regimes can be defined as “sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors’ expectations converge in a given area of international relations.” International regimes have been extensive in the post-1945 international political economy, as illustrated by the international trade regime (centered on the GATT) and the international monetary regime (including the I.M.F. as well as other organizations and networks...)

International regimes do not substitute for reciprocity; rather, they reinforce and institutionalize it. (Axelrod and Keohane, 1985: 249-250)

This is the logic that lies at the core of neoliberal institutionalism: cooperation in situations aptly modeled by iterated prisoner’s dilemma can be achieved in highly institutionalized settings, because institutions can serve as means of providing information, reducing transaction costs, and altering the payoffs associated with cooperation. Moreover, many neoliberal institutionalists argue that international actors should promote insitutionalization as a means of promoting the collective interest in international stability.

Neoliberal institutionalism differs from Morgenthau-style realism, then, in three fundamental ways. First, Morgenthau and his strict adherents assumed an identification between power and interest that neoliberal institutionalists correctly rejected; clearly nation-states have interests apart from security concerns. Second, because power is a relational concept, if it is the driving interest behind international behavior, actors must be concerned with the distribution of any gains: an absolute gain smaller than the absolute gain accruing to a rival means that the power differential between the two has changed in the rival’s favor. Realists, then, believe that inter-

national actors are concerned with relative gains, while neoliberal institutionalism is based on the premise that only absolute gains matter.²³

The third important difference concerns the role of international institutions. Neoliberal institutionalists believe that international institutions are an important means of transcending nations' short-term individual interests in order to reach collectively preferred outcomes. Realists disagree. In John Mearsheimer's words, "Realists maintain that institutions are basically a reflection of the distribution of power in the world. They are based on the self-interested calculations of the great powers, and they have no independent effect on state behavior." (Mearsheimer, 1995a:7) Further, "The most powerful states in the system create and shape institutions so that they can maintain their share of world power, or even increase it." (Mearsheimer, 1995a:13)

Curiously little evidence has been adduced in support of neoliberal institutionalism. In a volume dedicated solely to that purpose, contributors found themselves unable to distinguish between a PD setting and a setting in which actors' goals were unambiguously compatible (Jervis, 1986), or illustrating the ways in which institutions might have made a difference if they existed (Van Evera, 1986; Conybeare, 1986), or noting how fleeting any real-life approximations to iterated PD might be (Downs, Rocke and Siverson, 1986; Oye, 1986b). Only Charles Lipson described a case in which extended cooperation was observed, and he was careful to note first

²³ The debate in the modern political economy literature over whether actors are concerned with absolute gains or relative gains appears at least as early as 1975, when Robert Gilpin cited it as a fundamental difference between economic thought and political thought. (Gilpin, 1975:33-38. Gilpin credits Rousseau for the observation that the relativity of power necessarily leads to a concern for relative gains.)

The debate has since been revived as a key point of difference between liberals and mercantilists (Stein, 1984:384) and more famously as the divide between neoliberal institutionalists and realists (Grieco, 1988). Curiously, Stein describes both sides of the debate as being compatible with realism. For protracted scrutiny of the relevance of the absolute vs. relative gains argument to neoliberal institutionalism and realism, see Snidal, 1991; Powell, 1991; Grieco, 1993; Powell, 1993; and Snidal, 1993.

that cooperative arrangements were reached by bankers privately by and large, in the absence of any institutional intervention or assistance (Lipson, 1986:205-206); and second, that in the rare cases in which international organizations intervened, they did so by increasing the costs to the least powerful players of resisting the dictates of the most powerful banks — that is, international institutions behaved in precisely the way that a realist would predict. Lisa Martin's careful analysis of EEC cooperation in imposing economic sanctions against Argentina during the Falkland Islands crisis is a rare case that neoliberal institutionalists cite as evidence that an institution did, once, help international actors to overcome collective action problems (Martin, 1992). More generally, institutions such as the GATT and the IMF are cited as evidence that international institutions can help overcome resistance to trade liberalization without any careful analysis of whose interests might be served by such a goal.

Objections to Neoliberal Institutionalism

The harmony of interests revisited

Perhaps the paucity of empirical evidence for neoliberal institutionalism derives from its inherent illogic, for neoliberal institutionalism is based on a stunning contradiction of the rational choice theory in which the PD game is embedded: the rational actor will not promote institutions that foster the CC outcome, but rather, should selfishly promote those institutions that might facilitate her reaching the DC outcome. The optimism of the neoliberal institutionalists, then, is based on the the same logical fallacy as the optimism of Wilsonian idealism: implicit in both Axelrod's advice to participants and reformers and in later works which echo his exhortations is the assumption that actors will forego their individual interests in favor of the collective interest. There is not a rational basis, then, for suggesting that actors actively

promote institutions as a means of changing their own incentives.

Indeed, neoliberal institutionalism is founded upon a failure to appreciate the extent to which Axelrod's landmark book broke with the rational choice tradition. Remember that he based his theory on computer simulations rather than analytical proofs demonstrating that a rational actor could expect higher returns from playing the TFT strategy. Not only did he not argue that there was a rational basis for pursuing a strategy of reciprocity, he proved that there could be no rational basis for preferring one strategy over another in a standard PD setting. Recall his Proposition 1: "If the discount parameter w is sufficiently high, there is no best strategy independent of the strategy of the other player." (Axelrod, 1984:15) Moreover, his empirical anecdotes deliberately established his departure from strategic rationality. Foresight was not necessary to the pattern of cooperation that he observed; indeed, he argued, the same patterns were characteristic of unthinking parasites and pathogens.

To note that it is irrational for actors to promote institutions that lead them to forego their own short-term interests is not the same as suggesting that institutions do not serve this function anyway; it is merely a contradiction of the claim that "institutionalist theory is utilitarian and rational." (Keohane and Martin, 1995:39) To be logically complete, neoliberal institutionalism must include an explanation for why individuals might pursue a strategy of reciprocity and further, why they might foster institutions which commit themselves to doing this. Evidence of behavior consistent with neoliberal predictions would provide interesting evidence of the limits of strategic rationality as an explanation of international behavior.²⁴

²⁴ See Allison, 1971 for a careful presentation of alternative models.

Reciprocity and relative gains seeking

Identifying such evidence is trickier than it might appear, however. Preferences are not directly observable, so stories about the games that best represent a given situation necessarily involve some subjective interpretation and speculation. Because behavior is somewhat more observable, many neoliberal institutionalists reassure themselves with evidence that international actors do sometimes follow strategies of reciprocity, assuming that such descriptions do not involve subjective interpretation and speculation and are therefore incontrovertible evidence of the neoliberal position.

It is difficult, however, to distinguish such behavior from the relative-gains seeking behavior that a realist might believe is more likely. Reciprocity, after all, is one way of negating any relative gain an opponent might have achieved. The critical difference between the two is that the actor pursuing a strategy of reciprocity will exact only enough retribution to restore the previous *status quo*, while a relative gains seeking actor will attempt to shift the balance to his advantage. Consider the statement of a soldier quoted by Axelrod in his description of cooperation between trench warfare combatants in World War I:

The real reason for the quietness of some sections of the line was that neither side had any intention of advancing in that particular district....If the British shelled the Germans, the Germans replied, and the damage was equal: if the Germans bombed an advanced piece of trench and killed five Englishmen, an answering fusillade killed five Germans. (Belton Cobb, 1916:74, cited in Axelrod, 1984:76)

The logic here is clear; had the responding side been seeking a relative gain, it would have responded with a more than commensurate attack.²⁵

²⁵ A similarly clear proposal appeared recently in a discussion of the obstacles impeding philanthropy on the part of American billionaires. In an interview with *New York Times* columnist Maureen Dowd, Ted Turner discussed his anxiety over donating two hundred million dollars to charity: “My hand shook when I signed the papers because I knew I was taking myself out of the running for the richest man in America.” He explained that he and fellow billionaires are generally

Distinguishing between a proportional response and a gains-seeking response, however, is not always as straightforward as counting casualties or dollars. In his second volume detailing the progress of US–Soviet negotiations toward nuclear disarmament, Strobe Talbott explained the logic behind the SALT treaties this way:

Only up to a point, however, does SALT lend itself to comparisons to chess or poker or any other game. The defect of any such analogy is that in these games, the object is victory. A chess player is trying to checkmate his opponent, a poker player to win the whole pot — a warrior to defeat his enemy. In SALT, however, the object has not been for one player to beat the other. While taking some pawns along the way perhaps limiting the freedom of movement of the other’s queen, neither side has sought to check the other’s king — that is, to imperil its self-perceived vital national interest. To play to win would be to seek “unilateral advantage” or “strategic superiority.” It would be to violate the rules of parity and stability. In SALT, the superpowers had been playing to a draw for nearly a year. But the game had been going on much longer. (Talbot, 1980:17-18)

Talbott’s certainty that neither side was seeking a strategic advantage was clear to neither side, however; the history of the SALT negotiations is the history of disputes over the equivalence of various sets of proposed concessions. The same is true of every round of GATT negotiations. This is important for two reasons. First, to the extent that actors are unable to distinguish between reciprocal behavior and relative gains seeking behavior, they are confronted with the security dilemma central to realist thought. Second, neoliberal institutionalists who defend their perspective by citing

reluctant to donate sizeable sums of money because in doing so, they might decrease their net worth to the extent that they would drop in their ranking on the Forbes Four Hundred list of wealthiest Americans. He advised further,

I talked to both Bill Gates and Warren Buffett, the two richest men in the country, and they would be inclined to give more if there was a list of who did the giving rather than the having. What difference does it make if you’re worth twelve billion dollars or eleven billion dollars? With a billion dollars you can build a whole university.

They are fighting every year to be the richest man in the world. Why don’t they sign a joint pact to each give away a billion and then move down the Forbes list equally? (Ted Turner, as quoted in Dowd, 1996.)

examples in which actors appear to be pursuing TFT strategies need to establish the proportionality of the apparently reciprocal behavior.

Cooperation and collusion

A third problem with neoliberal institutionalism centers around conceptual problems with the definition of “cooperation.” Neoliberal institutionalists are very clear about the narrow definition they prefer:

“Cooperation” is a contested term. As I use it, it is sharply distinguished from both harmony and discord. When harmony prevails, actors’ policies *automatically* facilitate the attainment of others’ goals, and are not adjusted to make them more compatible. In both harmony and discord, neither actor as an incentive to change his or her behavior. Cooperation, however, “requires that the actions of separate individuals or organizations — which are not in pre-existent harmony — be brought into conformity with one another through a process of policy coordination.” (Keohane, 1984:51) This means that when cooperation takes place, each party changes his or her behavior *contingent* on changes in the other’s behavior.²⁶ (Keohane, 1988: 380)

At the same time, however, many do not seem to have understood a recurring warning in Axelrod’s work:

Usually one thinks of cooperation as a good thing. This is the natural approach when one takes the perspective of the players themselves. After all, mutual cooperation is good for both players in a Prisoner’s Dilemma... Yet, as previously suggested, there are situations in which one wants to do just the opposite. To prevent businesses from fixing prices, or to prevent potential enemies from coordinating their actions, one would want to turn the approach around and do the opposite of what would promote cooperation. (Axelrod, 1984:125)

Cooperation, after all, may take such diverse forms as honor among thieves, or successful cartelization, or redlining in housing markets. The critical issue in these cases is that cooperation between one pair of actors may be at the expense of one

²⁶ See also Oye, 1986a:5

or more third parties. Consider Martin's paper, in which she carefully details the interests and negotiations leading to the cooperation of EEC countries in imposing economic sanctions against Argentina prior to the Falkland Islands War (Martin, 1992). What she describes as cooperation between EEC countries was clearly hostile behavior *vis à vis* Argentina. Or consider former U.S. President Bush's roseate vision of a brand new era in international cooperation:

We stand today at a unique and extraordinary moment. The crisis in the Persian Gulf, as grave as it is, also offers a rare opportunity to move toward an historic period of cooperation. Out of these troubled times, our fifth objective — a new world order — can emerge: a new era — freer from the threat of terror, stronger in the pursuit of justice, and more secure in the quest for peace. An era in which the nations of the world, East and West, North and South, can prosper and live in harmony. A hundred generations have searched for this elusive path to peace, while a thousand wars raged across the span of human endeavor. Today that new world is struggling to be born, a world quite different from the one we've known. A world where the rule of law supplants the rule of the jungle. A world in which nations recognize the shared responsibility for freedom and justice. A world where the strong respect the rights of the weak. (Bush, 1990)

This promise of a new world order was, in fact, the justification for the strongest country in the world to solicit the cooperation of its allies in waging, by President Bush's count, the 1001st war in the history of mankind, a war against a much weaker adversary.

Only by selective attention to circumstances can such cases be classified as "co-operative." This dark side of neoliberal institutionalism — its failure to draw a distinction between harmless cooperation and exploitative collusion — is not merely an exception to the optimism typically associated with the perspective. To credibly contradict realist thought, one needs to be able to distinguish between, for example, EEC cooperation in opposition to Argentina, and Axis power cooperation in World War II.

Beyond Neoliberal Institutionalism

Back to Basics: Power and Interest

It is to Carr's credit that in his work that preceded both modern realism and neoliberal institutionalism, he introduced a framework that addresses the weaknesses of both. Modern realism errs in its identification of state interests with power. By refusing to presume that interests might be so narrow, Carr's strategic rationality can account for cases of convergent interests noted by interdependence theorists but antithetic to modern realism.

While more careful consideration of interests is the antidote to modern realism, more careful consideration of power provides an antidote to neoliberal institutionalism. The central tenet of neoliberal institutionalism is based on assumptions about how actors might attempt to change the game they find themselves in. More specifically, neoliberal institutionalists argue that actors promote institutions as a means of helping them achieve the outcomes of mutual cooperation. Consideration of power permits us to restate the problem in a way that sidesteps the illogic of the neoliberal perspective: when will nations promote institutions that help them reach the mutually cooperative outcome? A simple answer is that nations will promote institutions that allow them to achieve the exploitative payoff when they have the power to do so, and bind all actors to the cooperative strategy in cases where they are not sufficiently powerful to tilt the board in their favor. Put another way, one might expect countries to promote institutions that allow them to exploit much weaker countries but avoid exploitation by countries more closely equal in power.

This challenge to the neoliberal interpretation of contemporary international economic institutions is defensible only if it can be shown that the rules and norms furthered by the GATT (now the World Trade Organization), IMF and World Bank

not only favor powerful countries at the expense of weaker countries, but are also inconsistent with the collective interest. The argument I present hinges on the claim that political factors affect exchange rates in ways that systematically affect the global distribution of wealth: risk-averse traders demand a premium for holding the “soft” currencies of developing countries instead of “hard” currencies of established powers, introducing an endogenous distortion that shifts market equilibrium from the desired efficient outcome presented in standard economic exchange models. I refer to the dynamic I describe as “market realism” — the tendency for international markets, under *laissez-faire*, to favor powerful countries at the expense of weaker countries and the community of nations as a whole.

The chapters proceed as follows. Chapter 2 explores the conceptual foundations for the claim that global wealth is maximized in the absence of intervention in international markets. Particular emphasis is placed on the implications these models have for political behavior, assuming actors follow their material interests.

A common feature of these models is that they are based on barter economies. Further, recent pathbreaking work integrating international trade and finance tends to begin with the assumption that all currencies are alike. In Chapter 3, I introduce the mathematical nuts and bolts of these models, and then provide an argument for the relationship between national political capacity and currency prices. When this assumption is incorporated into the model, results critical to my defense of realism emerge. First, to the extent that developing countries must rely on risky local currencies for their international purchases, they pay more in international markets for their goods than do powerful developed countries. Second, currency traders’ aversion to risky currencies shifts the free market equilibrium from the desired point in a way that can be corrected by intervention favoring the developing countries.

Empirical support is presented in Chapter 4. Currency risk premia, long argued by economists to be evidence of market “irrationality,” are shown to be strongly

related to national political capacity. Further, the analysis presented in chapter 4 suggests that capital controls, currency controls and other forms of trade barriers may be optimal strategies for weaker countries. In Chapter 5, I introduce empirical evidence that weaker countries are indeed more likely to follow such policies.

In the final chapter, I discuss broad implications. Neoliberal and neoclassical thinkers begin with the proposition that free trade regimes are in the collective interest and represent cooperative behavior; the imposition of tariffs results from issues of domestic distribution or the fear of cheating. My analysis suggests that their starting point is incorrect. Free trade regimes are not in the collective interest because politically driven currency risk premia result in a market failure; interventions assumed to favor developing countries would also improve global welfare. Advocacy of such institutions as the GATT, then, is more appropriately analyzed from a realist perspective than from a neoliberal institutional framework: the most powerful countries in the international system advocate rules and norms which favor their interests at the expense of those of weaker countries.

APPENDIX TO CHAPTER 1: THE PRISONER'S DILEMMA

Figure I.1: A Prisoner's Dilemma Model of an Arms Race. Cell entries represent ordinal payoffs to A,B with "1" being each actor's most-preferred outcome.

		Country B's Choice	
		Not Arm	Arm
Country A's Choice	Not Arm	2,2	4,1
	Arm	1,4	3,3

In the case of arms races, the logic is as follows. (See Figure I.1)

Suppose countries A and B can choose between arming or not arming. There are four possible outcomes, then. Both countries may choose not to arm. A may arm while B does not. B may arm while A does not. Or both countries may arm. A's most preferred outcome is that it arms while B does not; in this way, it enjoys military superiority and therefore maximizes its level of security. Second in order of preference would be the case where neither country arms; in this way, neither has an advantage and neither has expended resources which could have been put to other purposes. Third, A would choose the outcome where both countries arm. B still has not achieved military superiority, although both have diverted resources to armament that might have been more usefully expended elsewhere. Least preferred is the case where B arms and A does not; A is then vulnerable. The schematic is shown in Figure 1, with A's first choice indicated with a "1", second choice indicated by "2" and so on.

Suppose B chooses to arm. Then A can achieve only its third- and fourth-preferred outcomes. To maximize its security, it should choose to arm also to avoid its least-

preferred outcome. But what if B chooses not to arm? Then A can achieve its most preferred outcome by arming. That is, regardless of what B does, A's rational choice is to arm. Since the same logic applies to country B, the equilibrium solution for this game is for both countries to arm, even though both would be better off if neither armed.

CHAPTER II

ECONOMICS AND INTEREST

As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestick industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the publick interest, nor knows how much he is promoting it. By preferring the support of domestick to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. (Smith, 1776:IV.ii, p 456)

Almost two centuries before the Prisoners' Dilemma game became the ubiquitous metaphor for political scientists' concern that the pursuit of individual interest may lead to an unintended collective bad, the "dismal science" was buoyed by Adam Smith's explication of the invisible hand. In the case of markets, he argued, the pursuit of individual interest leads to an unintended collective good: the optimal allocation of resources. The obvious desirability of such an outcome has led many observers to think of *laissez-faire* capitalism as a politically neutral objective.

David Easton's widely embraced definition of political science is telling. "...Political science," he wrote, "[can] be described as the authoritative allocation of values for a society." (Easton, 1953:129) This characterization has been invoked subsequently to suggest that there is a clear distinction between authoritative allocation and market