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State Authority and Market Power

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Can state authority survive the internationalization of the world economy? At the heart of a growing literature in international and comparative political economy, this question provides the theme for Susan Strange’s The Retreat of the State and Louis Pauly’s Who Elected the Bankers? Both authors stress the challenges that open and increasingly integrated world markets pose to the traditional territorial state. As Pauly writes, “In its simplest terms . . . the logic of markets is borderless, but the logic of politics remains bounded” (p. 4). Yet, these two studies provide different interpretations of the relationship between states and markets and, ultimately, of the implications for politics and, ultimately, state legitimacy.

In The Retreat of the State, Susan Strange develops a familiar theme in the literature on globalization: “Impersonal forces of world markets . . . are now more powerful than the states to whom ultimate political authority over society and economy is supposed to belong” (p. 4). The driving force behind globalization, and hence behind the shift in the state-market balance of power, would seem to be impersonal and virtually uncontrollable: the accelerating pace of technological change. Strange does not question whether technological change is endogenous or exogenous to political structures and processes; her point is that such change is now overwhelmingly driving market structures and limiting the conditions under which states exercise sole, or even significant, influence over outcomes that matter to most people’s well-being. Although nonstate actors have long had a place in the study of international political economy (which Strange tends to downplay in order to highlight the shortcomings of more traditional state-centered, unified, rational-actor approaches), few have argued as vehemently as Strange that the growing authority of such forces has contributed to the retreat, if not the obliteration, of the state as the central site of political influence and authority.

What students of international politics should emphasize, she argues, is not the shrinking politics of states. Rather, they should focus on a broader conception that recognizes that power over outcomes is exercised—often unintentionally—by those who buy and sell and deal in markets. Somewhat more controversial, Strange argues that, increasingly, authority in society and over economic transactions is legitimately exercised by agents other than states. Transnational corporations, for example, increasingly act as political authorities over a growing range of activities (p. 45). As foreign direct investment has shifted from primary production to manufacturing and
finally to services, the dependence of these corporations on the territorial state has become more attenuated. No longer predominantly a U.S. phenomenon, and therefore less susceptible to interpretations that closely link corporate and national interests, trends in foreign direct investment have contributed to a substantial shift of power from the territorial state to world markets (p. 53).

The evidence of this shift in power from states to markets, Strange argues, is manifest in a number of areas. For example, states have collectively retreated from their former participation in the ownership and control over industry, services, and trade, and even from their direction over research and innovation. Governments have also been replaced by transnational corporations as the site of authority over labor-management relations. In fiscal matters, firms have increasingly escaped the taxation of corporate profits by governments. And with respect to their impact on the human condition, in the past decade transnational corporations have far exceeded states and their associated intergovernmental organizations as redistributors of wealth around the globe (p. 54). Strange’s conclusion is that transnational corporations are increasingly exercising a “parallel authority,” alongside governments, in matters of economic management (p. 65).

Meanwhile, according to Strange, even traditional arenas of state authority have eroded. For example, most states will never be required to defend their national territory. A growing number of national governments have admitted, either through monetary floating or conversely through monetary unification, that they cannot control the value of their currency. Governments are also increasingly effete economically. Their inability to manipulate their macroeconomies, to sustain social welfare systems as populations age, and to tax highly mobile capital are offered as cases in point. Most ominous perhaps, governments no longer have monopoly power over the legitimate use of force. Organized crime’s use of violence in pursuit of profits is perhaps the “greatest threat to the state’s monopoly of the use of force to emerge in modern times” (p. 82). In general, “The domain of state authority in society and economy is shrinking . . . [or is] now being shared with other loci or sources of authority” (p. 82).

Many readers will be skeptical that such sharing of authority, as Strange puts it, is something fundamentally new for the modern state. Completely ignored, for example, is the historical church-state relationship. Religious authority aside, many would be more persuaded by Pauly’s assessment that “in the modern era, states are the principal wielders of power, although they have never exercised a monopoly on it” (p. 11). What, one might ask, is so strikingly new about the existence of nonstate authority? Strange argues that the recent shift is one not only of degree but implies that the resultant policy constraints arise squarely from the international economy: “What is new and unusual is that all—or nearly all—states should undergo substantial change of roughly the same kind within the same short period of twenty or thirty years” (p. 87). Similarity and rough temporal propinquity are offered as evidence that the world economy has contributed to homogenizing trends that cumulatively contribute to the “retreat of the state.”

Strange’s thesis is provocative. But it is one for which the evidence is not completely convincing. Clearly, elements of convergence are not difficult to find in a global smorgasbord of national and transnational developments. What goes unvaluated, however, is a systematic assessment of continued divergence that would undermine Strange’s general thesis. One can appreciate that international markets provide opportunities for international crimes, and thus an opening for transnational criminal organizations. But why is Italy more subject to Mafiosi than Germany? If internationalization forces a homogenization of corporate structures and even of the form of capitalist governance, why has firm structure continued to diverge between the U.S. model and the continental model, and why have Great
Britain and the United States proceeded much further than their continental European counterparts in dismantling various manifestations of the welfare state? If the fiscal capabilities of states with respect to mobile capital have eroded so significantly, why does this not show up in reduced capital taxes across all members of the Organization for Economic Cooperation and Development? Current research increasingly suggests that it has not (Quinn 1997). Even though common approaches to liberalization can be detected (in the financial sector of the major economies, for example), open questions remain as to whether domestic or international forces are the primary cause (Sobel 1994).

Nonetheless, The Retreat of the State provides a valuable wake-up call for those scholars who feel that international relations can be oblivious to market developments. Dated conceptions of power, as reflected in capabilities for example, should give way to more nuanced conceptions that will help researchers think broadly about the ability to influence outcomes that affect living conditions and life chances. Politics should, as Strange suggests, be defined broadly to include those processes and structures through which the mix of values in the system as a whole and their distribution among social groups and individuals is determined (p. 34). But Strange appears to be slightly behind the crest of current research in international and certainly comparative political economy. She is perhaps more obsessed with U.S. “hegemony” (pp. 21–23) than scholars of international relations have been for a number of years. Similarly, her call to end the “trench warfare between economics and politics” based on “narrow-minded specialization” (p. 31) will sound threadbare to the growing number of scholars who have been working at the nexus of the disciplines for a decade or more. In training her sights on the “vested interest” that students of international relations have in viewing the state as the primary, unitary actor concerned only with security issues (pp. 67–69), Strange has missed the extent to which the intellectual world under attack has already changed. Much to her credit, it has moved toward analyzing precisely the kinds of questions that The Retreat of the State so critically raises.

By contrast, Louis Pauly’s Who Elected the Bankers? sees states not so much in retreat as increasingly constrained by the consequences of their own choices and self-created policy dilemmas. Pauly is interested in analyzing the strategies available to such states, which want to gain the advantages of integrated international markets but retain the legitimacy and authority that Strange believes are declining so dramatically.

The creation of international institutions is one strategy through which states can “have their cake and eat it too.” Strange sees intergovernmental organizations as noncentral actors on the stage of the world political economy—largely under the thumb of state actors but hopelessly feeble compared to international markets (pp. 161–179). Pauly, by contrast, sees such institutions as potentially a way to square the circle of territorial political authority and international market power. Indeed, Pauly argues that international economic institutions are increasingly important under the changing conditions of the world market. “The closer we get to a world of truly global finance,” he argues, “the more central they become—not because they must inevitably usurp the political authority of states, but because they help states address their deepening legitimacy problem” (p. xi). Thus international organizations are neither in competition with states for authority, nor can they be narrowly interpreted as strategic efforts of the strong to gain greater leverage over international outcomes, as Strange’s critique suggests.

The deepening legitimacy problem diagnosed by Pauly is a narrower and more conditioned version of the same question addressed by Strange: Does the internationalization of markets impinge on the authority of states? Pauly, however,
believes that state authority has never been absolute and, in many respects, remains remarkably intact. His analysis focuses on capital markets (hence his concentration on bankers and the International Monetary Fund [IMF]). As states have increasingly opted for openness and integration, they have had to give up either fixed exchange rates or monetary policy autonomy—“a choice that brought to the fore basic concerns about political legitimacy” (p. 30). States that gave up fixed exchange rates were potentially subject to protectionist pressures because of the increase in exchange rate volatility (p. 26). States that gave up monetary policy autonomy could no longer pretend to influence the direction of the macroeconomy. As a result, Pauly says, the decision to recast the post-World War II bargain in favor of greater capital mobility diminished the influence that the state has over such basic values as stable growth and a modicum of economic equality among citizens (p. 15). This outcome arguably contributes to a growing crisis of political authority. Although the benefits of open and integrated markets can hardly be denied, citizens still hold democratically elected governments responsible for economic conditions. In short, the unprecedented aspect of internationalization, for Pauly, arises from the confrontation between globalization and the “entitlement state” (p. 33).

The central insight of *Who Elected the Bankers?* is that states have turned strategically to international institutions to help buffer them from sharp market movements and thus to protect a degree of state legitimacy in the face of internationalization. Pauly finds the roots of this role in the League of Nations, whose loans in the 1920s and nascent surveillance activities in the 1930s pioneered the principle that multilateral economic oversight was one way to manage the disjuncture between the international economy and national politics (p. 71). After 1933, the League’s exhortation of orthodox approaches to economic imbalances gave way to a more pragmatic oversight function involving information gathering and systemic analysis, which Pauly views as the precursors to the IMF’s *World Economic Outlook* and the contemporary practice of multilateral economic surveillance (pp. 68–69). Like the IMF, the League’s “overarching goal was to facilitate deliberate policy coordination, a feasible mechanism for managing a legitimacy problem that would never go away in a world of independent states with interdependent economies” (p. 77).

Pauly details the way in which the IMF’s oversight functions evolved—from an asymmetrical system of obligations that applied only to those countries with current account restrictions, to one that applied to all IMF members, and, after 1977, to an ever broader range of policies that have an impact on exchange rates (pp. 108–109). Thus over time, and especially in the past fifteen years or so, the IMF’s role as a crisis manager has become highly developed (p. 116). Moreover, states have discovered the “utility of having a credible multilateral organization in place to confront future emergencies in increasingly integrated financial markets” (p. 117). In crisis after crisis, the major states have turned to the surveillance authority of the IMF and expanded it. Pauly concludes that “when politics is bounded but economic aspirations are global, an institutional bridge is needed . . . something has to buffer the interface between the politics and the economics. They do not mesh together naturally” (p. 139).

The starkest distinction between *The Retreat of the State* and *Who Elected the Bankers?* lies in their divergent perceptions of the ultimate locus of political authority in the international political economy. For Strange, that authority is increasingly to be found in private nonstate actors. For Pauly, the locus of ultimate political authority remains the state, which he argues is demonstrated every time conditions of crisis, especially catastrophic crisis, emerge (p. 34). One can wonder, however, how strong a foundation multilateral surveillance provides for the
preservation of state legitimacy as markets become more integrated and, ipso facto, more volatile. Multilateral institutions may be convenient for assigning blame (the scapegoating function that Pauly notes), but how long will publics believe that the IMF or the bankers, to draw from Pauly’s title, are at the root of a country’s economic woes—rather than a more fundamental vulnerability that the state cannot control? How many more Mexicos and Russias can international economic institutions buffer against the exigencies of the world economy before publics in the larger donor countries cry “enough”? Finally, Pauly himself raises a question in his title that he does not resolve: How long can interdependent, democratic countries depend on essentially nondemocratic mechanisms to support and sustain their legitimacy?

References
