The Nation-State in the Global Economy

THE IDEA that the nation-state has been undermined by the transnational forces of economic globalization has appeared in writings on the international system and on the international economy. Many writings have argued that international organizations (IOs) and nongovernmental actors are replacing nation-states as the dominant actors in the international system. Books that have made this claim include those with such dramatic titles as *The Retreat of the State, The End of Geography*, and the *End of Sovereignty?*[1] Daniel Yergin and Joseph Stanislaw maintain that the market has wrested control from the state over the commanding heights of the economy and that the economic role of the nation-state is just about at an end.[2] Other writers believe a global economy has emerged or is emerging in which distinct national economies no longer exist and national economic policies are no longer possible.[3] This chapter disagrees with such views and argues that the nation-state continues to be the major actor in both domestic and international affairs.

At the beginning of the twenty-first century, the nation-state is clearly under serious attack from both above and below, and there is no doubt that there have been very important changes. Within many nations, the politics of identity and ethnic conflict is challenging the integrity of states, as ethnic and regional groups seek independence or at least greater autonomy.[4] Yet it is important to understand that the Kurds, Palestinians, and many other groups all want nation-states

[1] Richard O'Brien, *Global Financial Integration: The End of Geography*; Walter B. Wriston, *The Twilight of Sovereignty: How the Information Revolution Is Transforming Our World* (New York: Scribner's, 1992); Joseph A. Camilleri and Jim Falk, *End of Sovereignty? The Politics of a Shrinking and Fragmenting World* (Brookfield, Vt.: Elgar, 1992); Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (New York: Cambridge University Press, 1996).

[2] Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: The Battle Between Government and the Marketplace That Is Remaking the Modern World* (New York: Simon and Schuster, 1998).

[3] Paul Hirst and Grahame Thompson, *Globalization in Question: The International Economy and the Possibility of Governance* (London: Polity Press, 1996), 1.

[4] Vincent Cable,"The Diminished Nation-State: A Study in the Loss of Economic Power," in *What Future for the State? Daedalus* 124, no. 2 (spring 1995): 44–46.

of their own; they do not wish to eliminate nation-states but to divide present nation-states into units that they themselves can control. It is also accurate to say that economic globalization and transnational economic forces are eroding economic sovereignty in important ways. Nevertheless, both the extent of globalization and the consequences of economic globalization for the nation-state have been considerably exaggerated. For better or for worse, this is still a state-dominated world.

As Vincent Cable of the Royal Institute of International Affairs (London) has noted, it is not easy to assess globalization's implications for the nation-state.[5] Although the economic role of the state has declined in certain significant ways, it has expanded in others and, therefore, it is inaccurate to conclude that the nation-state has become redundant or anachronistic. As Cable says, the situation is "much messier" than that. The impact of the global economy on individual nations is highly uneven, and its impact varies from issue to issue; finance is much more globalized than are services and industrial production. While globalization has reduced some policy options, the degree of reduction is highly dependent on national size and economic power; the United States and Western Europe, for example, are much less vulnerable to destabilizing financial flows than are small economies. Indeed, the importance of the state has even actually increased in some areas, certainly with respect to promoting international competitiveness through support for R & D, for technology policy, and for other assistance to domestic firms.

Economic globalization is much more limited than many realize, and consequently, its overall impact on the economic role of the state is similarly limited. Moreover, although economic globalization has been a factor in whatever diminishment of the state may have occurred, ideological, technological, and international political changes have had an even more powerful influence. Furthermore, many and perhaps most of the social, economic, and other problems ascribed to globalization are actually due to technological and other developments that have little or nothing to do with globalization. Even though its role may have diminished somewhat, the nation-state remains preeminent in both domestic and international economic affairs. To borrow a phrase from the American humorist Mark Twain, I would like to report that the rumors of the death of the state "have been greatly exaggerated."[6]

[5] Ibid., 38.

[6] Mark Twain was a nineteenth-century American author whose obituary was mistakenly published before his death, leading Twain to comment that rumors of his death were greatly exaggerated.

In one sense, globalization has been taking place for centuries whenever improvements in transportation and communications have brought formerly separated peoples into contact with one another. The domestication of the horse and camel, the invention of the sailing ship, and the development of the telegraph all proved powerful instruments for uniting people, although not always to their liking. For thousands of years, ideas, artistic styles, and other artifacts have diffused from one society to another and have given rise to fears similar to those associated with economic globalization today. Nevertheless, it is important to discuss the economic globalization that has resulted from the rapid economic and technological integration of national societies that took place in the final decades of the twentieth century, especially after the end of the Cold War. This recent global economic integration has been the result of major changes in trade flows, of the activities of multinational corporations, and of developments in international finance.

Despite the increasing significance of economic globalization, the integration of the world economy has been highly uneven, restricted to particular economic sectors, and not nearly as extensive as many believe. As a number of commentators have pointed out, there are many ways in which the world is less integrated today than it was in the late nineteenth century. This should remind us that although the technology leading to increased globalization may be irreversible, national policies that have been responsible for the process of economic globalization have been reversed in the past and could be reversed again in the future.

As the twenty-first century opens, the world is not as well integrated as it was in a number of respects prior to World War I. Under the gold standard and the influential doctrine of laissez-faire, for example, the decades prior to World War I were an era when markets were truly supreme and governments had little power over economic affairs. Trade, investment, and financial flows were actually greater in the late 1800s, at least relative to the size of national economies and the international economy, than they are today. Twentieth-century changes appear primarily in the form of the greatly increased speed and absolute magnitude of economic flows across national borders and in the inclusion of more and more countries in the global economy. Yet, economic globalization is largely confined to North America, Western Europe, and Pacific Asia. And even though these industrial economies have become much more open, imports and investments from abroad are still small compared to the size of the domestic economies. For example, American imports rose from 5 percent of the total U.S. production in 1970 to just 13 percent in 1995, even though the United States was the most globalized economy.

Although trade has grown enormously during the past half century, trade still accounts for a relatively small portion of most economies; moreover, even though the number of "tradables" has been increasing, trade is still confined to a limited number of economic sectors. The principal competitors for most firms (with important exceptions in such areas as motor vehicles and electronics) are other national firms. The largest portions of foreign direct investment flows are invested in the United States, Western Europe, and China; a very small portion of the investment in sectors other than raw materials and resources has been invested in most less developed countries. International finance alone can be accurately described as a global phenomenon. Yet, even the globalization of finance must be qualified, as much of international finance is confined to short-term and speculative investment.

The most important measure of the economic integration and interdependence of distinct economies is what economists call the "law of one price." If identical goods and services in different economies have the same or nearly equal prices, then economists consider these economies to be closely integrated with one another. However, evidence indicates that the prices of identical goods around the world differ considerably whether measured by *The Economist* magazine's Big Mac index or by more formal economic measures.[7] When the law of one price is applied to the United States, it is clear that American prices differ greatly from those of other countries, especially Japan's. Price differentials in the cost of labor around the world are particularly notable, and there are large disparities in wages. All of this clearly suggests that the world is not as integrated as many proclaim.

The significant and sizable decline in migration is one of the major differences between late-nineteenth-century globalization and globalization of the early twenty-first century. During the past half century, the United States has been the only country to welcome large numbers of new citizens. Although Western Europe has accepted a flood of refugees and "guest workers," the situation in those countries has been and remains tenuous; few have been or will be offered citizen-

[7] Charles Engel and John H. Rogers, "Regional Patterns in the Law of One Price: The Roles of Geography versus Currencies," in Jeffrey A. Frankel, ed., *The Regionalization of the World Economy* (Chicago: University of Chicago Press, 1998), 153.

ship. The globalization of labor was considerably more advanced prior to World War I than afterward. In the late nineteenth century, millions of Europeans crossed the Atlantic to settle as permanent residents in North America; West Europeans also migrated in significant numbers to such "lands of recent settlement" as Australia, Argentina, and other temperate-zone regions. There were large migrations of Indians and Chinese to Southeast Asia, Africa, and other tropical regions. All these streams of migration became powerful determinants of the structure of the world economy.[8] In the early twenty-first century, labor migration is no longer a major feature of the world economy, and even within the European Union, migration from one member nation to another is relatively low.

Barriers to labor migration are built by policies intended to protect the real wages and social welfare of the nation's citizens, and the modern welfare state is based on the assumption that its benefits will be available only to its own citizens.[9] Some reformers in industrialized countries have constructed an ethical case that national wealth should be shared with the destitute around the world, but to my knowledge, even they have not advocated elimination of the barriers to international migration in order to enable the poor to move to more wealthy countries and thus decrease international income disparities. I find it remarkable that in the debate over globalization, little attention has been given to the most important factor of production; namely, labor and labor migration. For the billions of people in poor countries, national borders certainly remain an important feature of the global economy.

Alleged Consequences of Economic Globalization

The conjuncture of globalization with a number of other political, economic, and technological developments transforming the world makes it very difficult to understand economic globalization and its consequences. Among far-reaching economic changes at the end of the twentieth century have been a shift in industrialized countries from manufacturing to services and several revolutionary technological developments associated with the computer, including emergence of the Internet and information economy. The skills and education

[8] W. Arthur Lewis, *The Evolution of the International Economic Order* (Princeton: Princeton University Press, 1978).

[9] James Mayall, *Nationalism and International Society* (Cambridge: Cambridge University Press, 1990), Chapter 5.

required by jobs in the computer age place unskilled labor in the industrialized countries at a severe disadvantage in their wages and job security.

Although some economic and technological developments associated with the computer, including the rapid advances in telecommunications, have certainly contributed to the process of globalization, and globalization in some cases has accentuated these economic and technological changes, the two developments are not synonymous. In fact, the contemporary technological "revolution" has been a far more pervasive and, in many ways, a much more profound development than is globalization, at least thus far. For example, the most important development currently altering individual lives is the incredible revolution in the biological sciences, such as biological engineering. Yet this important development in human affairs has nothing whatsoever to do with globalization as it is commonly conceived.

Many of the problems alleged to be the result of economic globalization are really the consequence of unfortunate national policies and government decisions. Environmentalists rage against globalization and its evils; yet, most environmental damage is the result of the policies and behaviors of national governments. Air, water, and soil pollution result primarily from the lax policies of individual nations and/or from their poor enforcement procedures. The destruction of the Amazon forest has been caused principally by the Brazilian government's national development policies; in the United States, forest clear-cutting is actually promoted by generous government subsidies to logging companies. Land-hungry peasants in Southeast Asia are permitted to destroy forests to acquire cultivable land. Small farmers in France, the United States, and elsewhere blame globalization for their economic plight, but small farms are victims of economic/technological changes that have increased the importance of economies of scale in agriculture. Unfortunately, large farms and agribusinesses are now best suited to take full advantage of such economic/technological changes. The American agricultural sector, especially the large farms, even benefit from generous government subsidies. It would be easy to expand the list of problems generally attributed to globalization that have really been caused by technological changes, by national government policies, or by other wholly domestic factors.

In Western Europe, globalization is frequently blamed for many of the problems that have emerged from the economic and political integration of the region. Both globalization and regionalism are characterized by lowered economic barriers, restructuring of business, and other economic/social changes; it is easy, therefore, to see why

tion and regionalism are different, especially in the goals that each is seeking to achieve.

The tendency to blame globalization for many vexing problems of modern life is due in part to nationalistic and xenophobic attitudes on the political right and an anticapitalist mentality on the political left. Nationalistic attitudes have been expressed by Ross Perot, Patrick Buchanan, and American organized labor; the latter long ago gave up the slogan "workers of the world unite" in favor of their own parochial interests. The leftist criticism of capitalism runs deep in some peoples and countries and within advanced capitalist economies, most notably France. The antagonism toward capitalism is directed at the principal representatives of the capitalist system in the modern world: the United States, large multinational firms, and such international economic institutions as the International Monetary Fund and World Trade Organization. When I note these criticisms, I myself do not intend to endorse such excesses of capitalism as rampant commercialism, enormous disparities in wealth and privilege, advertising's creation of "wants," or the worship of wealth as the measure of all things. Capitalism is a system based on self-interest that is too frequently made manifest in outright greed. Despite capitalism's serious flaws, the evils of today's world will not be solved by attacks on globalization. One may say about capitalism what Winston Churchill is reputed to have said about democracy, that it is the worst of all social systems except for all the others.

Elsewhere in this book and in another of my books, *The Challenge of Global Capitalism*, I have addressed many of the negative consequences alleged to have been caused by globalization and have argued that most of the charges against globalization are wrong, misleading, or exaggerated.[10] Domestic and international income disparities, the problems of unskilled workers, and the alleged "race to the bottom" in modern welfare states in general should not be attributed to economic globalization. In almost all cases, such other factors as technological changes, national policies, or the triumph of conservative economic ideologies carry primary responsibility for these developments. Those particularly concerned about income inequalities among national societies should recognize that globalization in the form of exports from industrializing to industrialized countries has actually greatly benefited the industrializing countries; furthermore, very few countries have developed in this century without active participation in the global economy.

[10] A very effective critique of the antiglobalist position is found in Geoffrey Garrett, "Global Markets and National Politics," *International Organization* 52, no. 4 (autumn 1998): 787–824.

Effectiveness of Macroeconomic Policy

Since the end of World War II, and especially since governments accepted Keynesian economics in the early postwar era, national governments in the advanced industrialized economies have been held responsible for national economic performance. States were assigned the tasks of promoting national economic stability and steering their economies between the undesirable conditions of recession and inflation. Through macroeconomic policies, the state has been able to control, at least to some extent, the troubling vicissitudes of the market. However, the argument that the power of the state over economic affairs has significantly declined implies that national governments can no longer manage their economies. While it is true that macroeconomic policy has become more complicated in the highly integrated world economy of the twenty-first century, these policies do still work and can achieve their goals at least as well as in the past. What better example than the Federal Reserve's very successful management of the American economy in the mid-to-late 1990s! Moreover, today as in the past, the principal constraints on macroeconomic policy are to be found at the domestic rather than at the international level.

Macroeconomic policy consists of two basic tools for managing a national economy: fiscal policies and monetary policies. The principal instruments of fiscal policy are taxation and government expenditures. Through lowering or raising taxes and/or increasing or decreasing national expenditures, the federal government (Congress and the Executive) can affect the national level of economic activities. Whereas a federal budget deficit (spending more than tax receipts) will stimulate the economy, a budget surplus (spending less than tax receipts) will decrease economic activities. Monetary policy works through its determination of the size and velocity of a nation's money supply. The Federal Reserve can stimulate or depress the level of economic activities by increasing or restricting the supply of dollars available to consumers and producers. The principal method employed by the Federal Reserve to achieve this goal is to determine the national level of interest rates; whereas a low interest rate stimulates economic growth, a high rate depresses it.

Many commentators argue that the effectiveness of monetary policy has been significantly reduced by increased international financial

... if, for example, a central bank lowers interest rates to stimulate the economy, investors will transfer their capital to other economies with higher interest rates and thus counter the intended stimulus of lower rates. Similarly, if a central bank increases interest rates in order to slow the economy, investment capital will flow into the economy, counter the intended deflationary effects of higher rates, and stimulate economic activities. In all these ways, economic globalization is believed to have undermined the efficacy of fiscal and monetary policy. Therefore, some consider national governments no longer able to manage their economies.

To examine this contention, it is helpful to apply the logic of the "trilemma" or "irreconcilable trinity" discussed in Chapter 9. Every nation is confronted by an inevitable trade-off among the following three desirable goals of economic policy: fixed exchange rates, national autonomy in macroeconomic policy, and international capital mobility. A nation might want a stable exchange rate in order to reduce economic uncertainty and stabilize the economy. Or it might desire discretionary monetary policy to avoid high unemployment and steer the economy between recession and inflation. Or a government might want freedom of capital movements to facilitate the conduct of trade, foreign investment, and other international business activities. Unfortunately, a government cannot achieve all three of these goals simultaneously. It can obtain at most two. For example, choosing a fixed and stable exchange rate along with some latitude for independent monetary policies would mean forgoing freedom of capital movements, because international capital flows could undermine both exchange rate stability and independent monetary policies. On the other hand, a country might choose to pursue macroeconomic policies to promote full employment, but it then would have to sacrifice either a fixed exchange rate or freedom of capital movement.

Such an analysis tells us that although economic globalization does constrain government policy options, it does not impose a financial straitjacket on national macroeconomic policies. Whether an individual nation does or does not have the capacity for an independent macroeconomic policy is itself a policy choice. If a nation wants the capability to pursue an independent macroeconomic policy, it can achieve that goal by abandoning either fixed exchange rates or capital mobility. Different countries do, in fact, make different choices. The United States, for example, prefers independent monetary policy and freedom of capital movements and therefore sacrifices exchange rate stability; members of the European Economic Monetary Union (EMU), on the other hand, prefer fixed exchange rates and have cre-

ated a common currency to achieve this goal. Some other countries that place a high value on macroeconomic independence—China, for example—have imposed controls on capital movements.

Different domestic economic interests also have differing preferences. Whereas export businesses have a strong interest in the exchange rate, domestic-oriented businesses place a higher priority on national policy autonomy. Investors prefer freedom of capital movement, whereas labor tends to be opposed to such movement, unless the movement should mean increased investment in their own nation. Economic globalization in itself does not prevent a nation from using macroeconomic policies for managing its economy.

The mechanisms employed to conduct monetary policy have not been seriously affected by globalization. Although various central banks operate differently from one another, an examination of the ways in which the American Federal Reserve (the Fed) steers the American economy is instructive and reveals that, at least in the American case, globalization has had only minimal effects.

Through its power to increase or decrease the number of dollars available to consumers and producers (liquidity), the Fed is able to steer the overall economy. The level of national economic activity is strongly influenced by the size of the nation's money supply; an increase in the money supply stimulates economic activities and a decrease slows down economic activity. The Fed has three basic instruments to influence the nation's supply of money. The first directly affects the money supply; the other tools work indirectly through the banking system.

The Fed's primary means for management of the economy is "open market operations," conducted through the Open Market Desk of the Federal Reserve Bank of New York. Through sale or purchase of U.S. government bonds directly to the public, the Fed can influence the overall level of national economic activity. If, for example, the Fed wants to slow the economy, it sells U.S. Government bonds. This takes money or liquidity out of the economy. If, on the other hand, the Fed wants to stimulate the economy, it uses dollars to purchase U.S. Government bonds and thus increases the money or liquidity in the economy.

The Fed can also change the discount rate, which is the interest rate on loans that the Fed makes directly to the nation's commercial banks. The Fed, for example, loans money to banks whose reserves fall below the Fed's reserve requirements (see below); this may happen if a bank has made too many loans or is experiencing too many withdrawals. By lending to private banks and increasing the reserves

of those banks, the Fed enables banks to make more loans and thus to increase the nation's money supply. Whereas raising the discount rate decreases loans and money creation, lowering of the discount rate increases loans and money creation. These changes in turn have a powerful influence on the overall level of economic activity.

Another tool that the Fed has available is its authority to determine the reserve requirements of the nation's banks. Reserve requirements specify the minimal size of the monetary reserves that a bank must hold against deposits subject to withdrawal. Reserve requirements thus determine the amount of money that a bank is permitted to lend and, thereby, how much money the bank can place in circulation. Through raising or lowering reserve requirements, the Fed sets a limit on how much money the nation's banks can inject into the economy. However, this method of changing the money supply is used infrequently because changed reserve requirements can be very disruptive to the banking system.

Globalization and a more open world economy have had only minimal impact on the Fed's ability to manage the economy. Yet the effectiveness of open market operations has probably been somewhat reduced by growth of the international financial market, and the purchase or sale of U.S. securities by foreigners certainly affects the national money supply. In the late 1990s, it was estimated that approximately $150 billion was held overseas. However, the effect of that large amount is minimized by the size of the more than $8 trillion domestic economy. Also, the American financial system (like that of other industrialized countries) exhibits a "home bias"; that is to say, most individuals keep their financial assets in their own currency. It is possible, however, that central banks in smaller and weaker economies find that their ability to manage their own money supply has been decreased, as was exemplified by the 1997 Asian financial crisis.

One should note that the continuing power of the Fed over the banks and the money supply through control of the interest rate has been challenged by the development of the credit card and other new forms of money. These credit instruments have decreased, at least somewhat, the effectiveness of the Fed's use of this instrument to control the economy. Still more problematic for the Fed is the increasing use of e-money in Internet commerce. In effect, these developments mean that the monopoly of money creation once held by the Fed and the banking system is being diluted. Through use of a credit card and/or participation in e-commerce, an individual or business can create money. Yet, at some point e-money and other novel forms of money must be converted into "real" or legal tender, and, at that point the

Fed retains control of the creation of real money. Thus, although the monetary system has become much more complex, the Fed still has ultimate control over that system and through it, the overall economy.

Although the power of central banks over interest rates and the money supply has been somewhat diminished, as long as cash and bank reserves remain the ultimate means of exchange and of settlement of accounts, central banks can still retain control over the money supply and hence of the economy. In fact, even if everyone switched to electronic means of payment but credit issuers still settled their balances with merchants through the banking system (as happens with credit cards now), central banks would still retain overall control. However, one day, e-money could displace other forms of money. If and when this develops, financial settlements could be carried out without going through commercial banks, and central banks would lose their ability to control the economy through interest rates. Such a development could lead to the "denationalization" of money. However, it seems reasonable to believe that some public authority would still be needed to control inflation and monitor the integrity of the computer system used for payments settlements.

With respect to *reserve requirements*, intense competition among international banks has induced some central banks to reduce reserve requirements in order to make the domestic banking industry more competitive internationally. Japanese banks, for example, have long been permitted by the government to keep much smaller reserves than American banks. One of the major purposes of the Basle Agreement (1988), was to make reserve requirements more uniform throughout the world. Rumor has it that this agreement was engineered by the Fed to decrease the international competitiveness of Japanese and other foreign banks vis-à-vis American international banks. Whatever the underlying motive, the agreement has been described as a response to financial globalization, and the establishment of uniform international reserve requirements has largely reestablished their effectiveness as instruments of policy.

The most important constraints on macroeconomic policy are found at the domestic level. If an economy were isolated from the international economy, fiscal policy would be constrained by the cost of borrowing. If a national government were to use deficit spending to stimulate its economy, the resulting budget deficit would have to be financed by domestic lenders. In that situation, an upper limit would be placed on government borrowing, because as the budget deficit and the costs of servicing that deficit rose, bond purchasers

would become more and more fearful that the government might default on its debt and/or use monetary policy to inflate the money supply and thus reduce the real value of the debt. Increased risk as debt rises causes lenders to stop lending and/or to charge higher and higher interest rates; this then discourages further borrowing by the government. Also, another important constraint on monetary policy in a domestic economy is the threat of inflation; this threat places an upper limit on the ability of a central bank to stimulate the economy by increasing the money supply and/or lowering the interest rate. At some point, the threat of inflation will discourage economic activity. In short, there are limits on macroeconomic policy that have nothing whatsoever to do with the international economy—and these domestic constraints existed long before anyone had heard the term "globalization."

Economic globalization has made the task of managing an economy easier in some ways and more difficult in others. On the one hand, globalization has enabled governments to borrow more freely; the United States in the 1980s and 1990s borrowed heavily from Japanese and other foreign investors in order to finance a federal budget deficit and a high rate of economic growth. However, this debt-financed growth strategy, as Susan Strange pointed out first in *Casino Capitalism* (1986) and again in *Mad Money* (1998), is extraordinarily risky and can not continue forever. Fearing collapse of the dollar, investors could one day flee dollar-denominated assets for safer assets denominated in other currencies.[11] The consequences of such flight could be devastating for the United States and for the rest of the world economy. Thus, although economic globalization has increased the latitude of governments to pursue expansionary economic policies through borrowing excessively abroad, such serious financial crises of the postwar era as the Mexican crisis in 1994–1995, the 1997 East Asian financial crisis, and the disturbing collapse of the Russian ruble in August 1998 demonstrate the huge and widespread risks associated with such a practice.

Economic globalization and the greater openness of domestic economies have also modified the rules of economic policy. Certainly, the increasing openness of national economies has made the exercise of macroeconomic policy more complex and difficult. This does not mean that a national government can no longer guide the economy around the dangerous shoals of inflation and recession, but it does mean that the risk of shipwreck has grown.

[11] Susan Strange, *Casino Capitalism* (Oxford: Blackwell,1986); and *Mad Money: From the Author of Casino Capitalism* (Manchester, U.K.: Manchester University Press, 1998).

The Need for a Historical Perspective

The globalization thesis lacks a historical perspective. Those individuals who argue that globalization has severely limited economic sovereignty appear to believe that governments once possessed unlimited national autonomy and freedom in economic matters. Their argument assumes that nation-states have enjoyed unrestricted ability to determine economic policy and manage their economies and that governments were free because they were not subordinate to or encumbered by transnational market forces. As proponents of the globalization thesis contrast economic policy in the twenty-first century to this imagined past, they conclude that nation-states, for the first time ever, have become constrained by the increased integration of national economies through trade, financial flows, and the activities of multinational firms. In effect, having assumed that states once had complete economic freedom, these individuals misperceive the reality of the fundamental relationship between the state and the economy. When viewed from a more accurate historical perspective, the relationship of state and market in the contemporary era is neither particularly startling nor revolutionary.

In the decades prior to World War I, national governments had little effective control over their economies. Under the classical gold standard of fixed exchange rates, governments were more tightly bound by what Barry Eichengreen has called "golden fetters" than they are in the early-twenty-first century world of flexible rates. Moreover, as Nobel Laureate Arthur Lewis has noted, prior to World War I the economic agenda of governments everywhere was limited to the efforts of central banks to maintain the value of their currencies.[12] As Keynes pointed out in *The Economic Consequences of the Peace* (1919), national economic policy did not concern itself with the welfare of the "lower orders" of society.[13] This minor and highly constrained role of the state in the economy changed dramatically with World War I and subsequent economic and political developments.

Throughout the twentieth century, the relationship of state and market indeed changed significantly as governments harnessed their economies for total war and to meet their citizens' rising economic

[12] Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression* (New York: Oxford University Press, 1992); and W. Arthur Lewis, *Growth and Fluctuations, 1870–1913* (London: Allen and Unwin, 1978).

[13] John Maynard Keynes, *The Economic Consequences of the Peace* (London: Macmillan, 1919).

expectations. The world wars of the twentieth century, the Great Depression of the 1930s, and the immense economic demands of the Cold War elevated the state's role in the economy. During periods of intense concern about security, national governments used new tools to manage their economies and began to exercise unprecedented control over their economies. The Great Depression, the rise of organized labor, and the sacrifices imposed on societies by World War II led Western governments to expand their activities to guarantee the welfare of their citizens. For some years, the perceived success of the communist experiment also encouraged governments to help Keynes's "lower orders," and after World War II, governments in every advanced economy assumed responsibility for promotion of full employment and provision of a generous and high level of economic welfare.

Conclusion

The argument that the nation-state is in retreat is most applicable to the United States, Western Europe, and perhaps Japan. The end of the Cold War represented the end of a century and a half of rapid economic development and political/military conflict. Since the American Civil War (1861–1865), the Franco-Prussian War (1870–1871), and the Russo-Japanese War (1904–1905), the forces of nationalism, industrialization, and state-creation had driven the industrialized powers of Europe, the United States, and Japan. World War I, World War II, and the Cold War forged the modern nation-state as an economic and war-making machine. During these decades of interstate rivalry, the economy was often harnessed to the needs of the national war machine. This bellicose epoch appears to have ended, and the industrialized countries may be retreating to their more modest late-nineteenth-century status. Yet, one must ask whether the forces of nationalism, industrialization, and state-creation might not be causing a repeat of the tragic Western experience in the developing economies of Asia, Africa, and elsewhere! Thus far, there is little evidence to suggest that these countries will avoid repeating the mistakes made by the industrialized world.