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After Hegemony: Transatlantic Economic Relations in the Next Decade

Robert O. Keohane

The liberal international economic system established after the Second World War is currently in difficulty. Large fluctuations in exchange rates have led to calls for a “new Bretton Woods”. Protectionism has increased sharply on both sides of the Atlantic; the European Community, once a force for liberalization, now takes a leading role in imposing restrictions on trade. European and American discussions of the world economy are characterized less by thoughtful consideration of how joint action could relieve the current economic recession and reduce dangers of collapse, than by quarrelling over such issues as subsidies on pasta, alleged dumping of steel, and subsidized credit terms to the Soviet Union.

The frustrations of the present raise anxieties about the future. As other papers presented to this meeting have indicated, the sources of these worries are political as well as economic. Since the “iron law of wages” was repealed, economics has no longer been the “dismal science”: that dubious honor goes to politics, since the greatest dangers for the world economy have their sources in politically motivated national egoism, and in political conflict. Thus in thinking about the future, we need to reflect on what political changes we should anticipate, as well as about economic trends.

I seek to stimulate some thinking along these lines in this article. I begin by considering whether the next decade could witness a revival of American “hegemony”: that is, leadership, based on domination. My conclusion is that hegemony is inherently unstable, and that the conditions that facilitated American hegemony in the 1950s are unlikely to recur in this century. This means that the key political issue for the transatlantic political economy is the problem of cooperation without hierarchy. How could it be possible for several independent, self-interested states to cooperate effectively, without a dominant power to devise a strategy and provide incentives for others to comply with its designs?
Posing this question leads me to sketch three possible scenarios for the world political economy of the 1980s and briefly to examine the likelihood, and implications, of each. None of these scenarios promises an end to conflict; indeed, two of the three would be characterized by significantly greater conflict than the present system, and the other foresees continuation of recent patterns of disagreement, bickering, and weak coordination of policy. In the absence of a dominant power disposed to exercise leadership, interdependence implies conflict, since it gives each country, even small ones, some means by which to force the costs of adjustment to change onto others, if only temporarily. Problems of collective action, so vividly described by Mancur Olson,\(^1\) inherently arise.

Thus the combination of domestic political pressures, economic hardship, and the fragmentation of authority characteristic of international relations will make progress toward greater cooperation extremely difficult. Nevertheless, it makes a great deal of difference whether the present mixed pattern of cooperation and conflict continues in the context of a relatively open world economy, or whether protectionism or discrimination begin to dominate world trade.

Although my projections for the future are not particularly rosy, they are also not deterministic. Politics is constrained by economic and political forces beyond the control of our generation, but it is also characterized by choice. Much will depend on the strategies that leaders devise, on international and domestic institutions, and on the attitudes of citizens who are asked to accept short-term sacrifices for the sake of long-term gains. Perhaps reflecting on these issues will contribute to the selection of wise rather than merely clever strategies, to appreciation of the importance of international institutions, and to greater understanding of the trade-offs that will be necessary if transatlantic cooperation is to be maintained.

**A Revival of US Hegemony?**

Some of the discussions in the conference seemed to suggest nostalgia for the era of American leadership based on dominance. Criticisms of the United States for behaving irresponsibly – for instance, by running huge budget deficits, leading to high interest rates – invite comparison of the current situation with the halcyon days of the Marshall Plan, when the American government took the lead in reconstructing Europe, and establishing a liberal international economy. The contrast between a far-sighted, Atlanticist approach and myopic pursuit of an ideologically defined Holy Grail is evident, and lamentable. But it should not lead us to believe that returning to a US-dominated world political economy is possible. Even with the best conceivable intentions, and the most perceptive analysis of policy options, no United States government during the rest of this century will be able to reconstruct the Americanocentric policy institutions and networks of the 1950s and

1960s. The following brief analysis of the political conditions for, and dynamics of, hegemony indicates why we should not expect a restoration of stable US hegemony during the 1980s.

United States hegemony operated during what I have called the “long decade” between 1947 and 1963. Note that although Henry Luce foresaw an “American Century”, the period of US dominance was collapsed into little more than a decade. One of the most important features of American hegemony was its brevity.

A necessary condition for American hegemony was a preponderance of United States material power, as reflected by the overwhelmingly superior productivity and competitiveness of the American economy, compared to those of the European countries and Japan, during the first decade after World War II. Yet three other less tangible conditions were also important:

1. Agreement on the structure of order to be supplied by the hegemon to its partners. This presupposed a rough consensus on the maintenance of international capitalism, as opposed to socialism or a pattern of semi-autarchic national capitalism, and on an institutional structure consistent with capitalism. During America’s long decade, international institutions were used in conjunction with, and in close coordination with, American state power. International organizations were not in conflict with American leadership, but provided ways of institutionalizing it.

2. Willingness by the hegemon to supply specific benefits to its weaker partners within this structure of order. Since 1947, the most important of these have been the following:

   a) Military protection against a presumed Soviet threat. American leadership in the world political economy did not exist in isolation from NATO, and in these years, each was reinforced by the other. European anxiety that the United States might withdraw its protection provided an incentive, especially for the German government, to conform to American wishes.

   b) Access to oil at stable prices. This depended both on American dominance in the Middle East (exercised through US oil corporations as well as through American military power), and on excess petroleum capacity in the United States, which was available for emergency use until the late 1960s.

   c) A stable international monetary system, designed to facilitate liberal international trade and payments. This implied that the United States would manage the monetary system in a responsible way, providing sufficient but not excessive international liquidity.

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d) Provision of open markets for goods. The United States took the lead in pressing for the removal of discriminatory restrictions, although it permitted the Europeans to maintain temporary postwar barriers during the period of dollar shortage; and the United States also actively worked to reduce tariffs.

Broadly speaking, the United States invested in influence, by providing more tangible benefits to its allies than it required from them. It thus gained what Albert O. Hirschman has referred to as the “influence effect” of foreign trade.  

3. Willingness by the hegemon’s partners to defer to US leadership. United States leaders required deference to enable them to construct a structure of capitalist order: in that sense, it was a “production good”. But one may also suspect that deference also constituted a major “consumption good” for the American elite, whose members relished the status that came with power.

The importance of these intangible factors suggests that a conception of hegemony based on dominance needs to be supplemented with the Gramscian notion of ideological hegemony. In this conception, hegemony “is based on a coherent conjunction or fit between a configuration of material power, the prevalent collective image of world order (including certain norms), and a set of institutions which administer the order with a certain semblance of universality (i.e., not just as the overt instruments of a particular state’s dominance).  

To understand hegemony, one needs to examine not merely the material capabilities of the dominant state, but also the reasons why it can obtain consent to its leadership. Hegemony rests on the subjective awareness by leaders of secondary states that they are benefitting, as well as on the willingness of the hegemon itself to sacrifice tangible short-term benefits for intangible long-term gains. That is, there must be a high degree of complementarity between the hegemon and its partners.

Such complementarity existed for fifteen or twenty years after the end of the Second World War, but it could not last. It was not just accidental that the structure of American hegemony collapsed. Indeed, there seems to be a cycle of hegemonic decline that operated here as in earlier hegemonies. Other countries grow faster than the hegemon: they tend to catch up as technology diffuses to the periphery, as the hegemon spends more than its partners on military preparations, and as residents of the hegemon benefit from their country’s status by consuming more and working less.  

Note the experiences of Rome, then Britain, then the

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United States, with a shorter cycle each time – from half a millennium, to one or two centuries, to one “long decade”!

As the hegemon’s relative economic advantage declines, it increasingly resists “free-riding” behavior by smaller states. The resulting conflicts have been particularly severe between the United States and Japan – which persists in defining itself as small and seeks to appear inconspicuous – since 1969. As the hegemon’s partners’ positions improve, they may become less willing to defer to the leadership of the hegemon, or to accept its privileges. In American-European relations, this reduction in willingness to provide deference was accentuated by East-West detente, which made American military protection seem less urgently required than previously – and even suggested to some Europeans that NATO constituted more a dangerous liability than a benefit.

Changes also take place within the hegemon. In particular, its egoism will sooner or later assert itself. Hegemony, after all, derives from the relative immunity of the great power to what others can do to it, while it can have a great impact on the fortunes of others. That is, power results from asymmetrical interdependence. But to have power means that one need not adjust to change, but can (at least temporarily) force those adjustment costs onto others. Since there are always domestic pressures to distribute more resources to groups within the country, we can expect that hegemons will tend to try to make their partners pay adjustment costs. This is particularly the case for hegemons with democratic political systems, especially when the government is highly responsive to pressures from the society. This leads, naturally enough, to resentment and discord.

The closing years of the Bretton Woods System provided an example of this. The United States sought to force some of the costs of the Vietnam War onto its allies. The allies resisted, refusing to revalue their currencies according to American wishes. The United States then broke up the Bretton Woods regime in order to create more autonomy for itself – to reassert the freedom of action that its underlying dominance made possible but that it was no longer able to exercise under the rules of the system as established in 1944. In the early years of Bretton Woods, the regime’s provisions favoring creditors helped the United States; when those same rules began to weaken the American position, they were shattered by the exercise of state power.

What this did was to allow President Nixon to pursue an egoistic policy. To an Italian audience it is worthwhile to recall his comment, recorded for posterity in 1972 on the Watergate tapes, that “I don’t give a ... about the lira”. What Nixon did care about was increasing the money supply in order to increase growth in the American economy to achieve his re-election.

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Rather than investing in leadership or influence, Nixon used the American power position to pursue personal political, as well as national, advantage. Thus stable hegemonic leadership, which requires a degree of reciprocity, was not restored.

This example does not merely reflect Nixon’s peculiarities, although they were an important part of the story. Power tends to corrupt, for states as for individuals. A hegemon does not face effective countervailing power and will thus eventually abuse its power. Hegemony is inherently unstable. Kindleberger may be right that as long as hegemony lasts, it provides a stable basis for international order. But it cannot last, especially when the hegemon has a democratic political system, responsive to demands from within.

So what has happened as a result of the instability of hegemony? We have seen the erosion of international rules and principles governing trade and finance: that is, decline in what political scientists in the United States call “international regimes”. The demise of institutionalized regimes has led President Mitterrand of France to call for a “new Bretton Woods”. When leaders do this, however, it is difficult to know what they mean. Surely, President Mitterrand does not want a return to the hard-fisted creditor’s regime that the United States Treasury desired at Bretton Woods, and which was largely reflected in the rules as written there. He seems to desire not the Charter of the International Monetary Fund as actually written, but the vision of the agreement that Keynes had in 1944, which cast the United States in the role of benign provider of funds to weak social democratic governments dedicated to policies of full employment at home. The script was fictional even when liberal Democrats were in power and the United States had excessive gold reserves and a huge margin of economic superiority. It is a fairytale now.

The political basis no longer exists for a return to Bretton Woods, much less to a romantic vision of what Bretton Woods was, or could have been. The United States is no longer sufficiently dominant in the world political economy. It no longer controls access to oil as it did in the 1950s and 1960s. Its dominance of world trade no longer exists, although it remains the most important single participant. The dollar is still the world’s key currency, but many of those dollars are outside of American control. Equally important, the United States is less willing than formerly to define its interests in terms complementary to those of Europe and Japan. The Europeans, in particular, are no longer willing to defer to American initiatives, nor do they believe that they must do so in order to obtain essential military protection against the Soviet Union. Thus, the subjective elements of hegemony have been eroded as much as the tangible power resources upon which hegemonic systems rest.

Cooperation Without Hegemony?

Several years ago, Marina von N. Whitman suggested “leadership without hegemony” as a policy prescription for the United States. This is an attractive aspiration, but the preceding argument suggests how difficult it may be to attain. Leadership without hegemony requires cooperation among relatively equal egoistic actors in a state of interdependence with one another: that is, in a Hobbesian world.

To state the problem in this way indicates the difficulty of solving it. Nevertheless, how to achieve cooperation without hegemony is the crucial political issue for contemporary transatlantic economic relations. It is thus worthwhile to examine this issue – first abstractly, then in the context of the contemporary world political economy.

First let me sketch the abstract analysis. How could cooperation emerge in a situation when there is no hegemon: that is, where several countries have reciprocal influence over one another? An answer to this question at the abstract analytic level can be obtained by reference to game theory. In particular, four conditions must be met for cooperation to be feasible:

1. There must be a payoff structure that rewards cooperation as compared to a situation of discord. That is, mutual cooperation must be superior for both players to failure to agree. This does not mean that cheating does not pay: as in the famous game of “prisoners’ dilemma”, it may be best to defect from an agreement while one’s partner abides by it. But it does mean that mutual cheating must be suboptimal for both parties.
2. It must be possible to monitor the situation so that others’ behavior is known – in particular, so that cheating can be punished.
3. Actors have to expect continuing interaction in the future, and they must have sufficiently long-term time horizons that the future is important to them. Otherwise, in a game such as prisoners’ dilemma they will not be motivated to cooperate, since cooperation in this game is never the best strategy in the particular instance (it is preferable to cheat whether or not one’s partner will cooperate or defect). It is only sensible if mutual cooperation will thereby be facilitated in the future, and if the rewards of such cooperation are meaningful.
4. Actors must follow appropriate strategies. These strategies should be “nice”, meaning that players should be willing to be the first to cooperate; but they should also be “non-exploitable”, thus giving one’s partner incentives to cooperate as well. Axelrod has shown that the strategy of “tit for tat” – beginning a sequence by cooperating and then simply doing on a given move what the other player did on

the previous one – is the best strategy over the long run in competition with a wide variety of other plausible strategies.

Given the presence of these four conditions, cooperation is possible but not inevitable. Institutions are also important, since they reduce transaction costs, provide information, and may increase the probability that the same actors will continue to interact with each other in the future. International institutions are important in the world political economy not merely because they can occasionally enforce rules on governments, but because they monitor behavior and provide information. By reducing uncertainty and risk, they facilitate cooperation.

Consider the role of the International Monetary Fund in recent negotiations on debt rescheduling to overextended developing countries. The IMF exercises some authority over debtor countries, since it makes loans to them only on condition that the governments of these countries follow IMF approved policies. Yet much IMF behavior is oriented not toward the debtors, but toward creditor banks, which the Fund cannot threaten with a cutoff of lending. By monitoring the performance of debtors, the Fund provides information to creditors about the debtors’ future policies. Recently, it has helped (along with leading banks) to monitor behavior of creditor banks so that they will not defect by withdrawing loans, or lines of credit, from the country in financial difficulty. Banks that attempt to be “free riders” by withdrawing their funds while others provide resources are threatened with publicity that could damage their reputations.¹³

Even where there is a basically cooperative payoff structure, it is difficult to ensure cooperation. But despite what Kindleberger¹⁴ has claimed, it is not, in principle, impossible. The key requirement is that there be frequent interaction among a relatively small number of key players, who know each other and have high levels of information about each other’s patterns of behavior. International institutions help to create such conditions.

Yet when international regimes are eroding, securing cooperation is more difficult than an abstract, static view might imply. Governments become increasingly uncertain that their partners and competitors will behave according to an established and fair set of rules. A vicious circle develops in which breakdowns in international regimes may contribute to economic difficulties, which in turn make those regimes more difficult to reconstruct and the task of leadership more burdensome. Effective policy coordination, or collective leadership, thus faces formidable obstacles.

The most optimistic scenario worthy of serious consideration thus falls far short of the emergence of coherent collective leadership. The best that liberals can hope for is not much better than a continuation of the situation of the 1970s, in which

¹⁴Kindleberger, *op. cit.*
a basically open system was maintained despite a great deal of disagreement and argument. In this scenario states may threaten trade or monetary wars – indeed, they have incentives to do so in so far as such actions may lead to concessions from their partners – but they pull back from the brink when disaster appears imminent.

This “optimistic” scenario is not necessarily favorable to everyone. In fact, it has disturbingly negative implications for political movements that seek suddenly to alter the shares of rewards between labor and capital, and the political influence of business, within their societies. “Social democracy in one open economy” has been achieved to a considerable extent by small countries such as Sweden and Austria, aided by corporatist policy networks and continuous social democratic rule over long periods of time. But it is very difficult to achieve in countries not characterized by these peculiar institutional configurations and historical experiences. The international pressures on a would-be socialist regime in France, or on a Labour government in Britain, are more severe than those on conservative regimes in the same countries. When Thatcher or Reagan induces a recession through tight monetary policies, as part of a strategy to control inflation through reducing the rate of wage increases, the pound or dollar appreciates and funds flow into the country; at least in the short run, this appears benign and no help need be sought from other governments. When Mitterrand tries to stimulate demand and to nationalize selected industries, by contrast, the franc declines, France’s foreign reserves are jeopardized, and assistance may be needed from the IMF or selected governments of wealthy countries. Socialist and social democratic governments are thus induced to maintain openness. The experience of Britain’s Labour Party illustrates the dilemma. In the face of international economic problems, reflected in payments deficits, Labour has attempted to resolve these contradictions by abandoning socialism, and even some elements of its plans for social democracy, in the interests of maintaining business confidence. In 1976, for instance, a Labour Government adopted more conservative policies in order to obtain an IMF loan.

The result is something of a “ratchet effect”, which tends to reinforce an open capitalist world financial system. When pro-capitalist governments are in power, they have strong incentives to promote openness, for the sake of not only efficiency and gains from trade, but to reinforce the power of capital vis-à-vis labor. They also find that reinforcing economic openness helps their own political fortunes, since the web of interdependence thus created makes it more difficult for subsequent left-wing governments to achieve their purposes. When socialist and social democratic governments come into power, they soon find that to avoid runs on their

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currencies, and financial crises, they need to gain the confidence of the business “community”, and that this may require that they abandon some of their more socialist objectives. In the absence of short-term costs, they would be tempted to reduce their links to the world economy, thus increasing their freedom of action and strengthening the relative bargaining power of labor. France may not have to go so far, but to stay in the world system, the French socialists will have to make concessions.

The pressures of world capitalism may lead would-be socialists to abandon their ambitions and their ideologies. But they could also lead to increasing estrangement between socialist and conservative regimes in the West. One side or the other might begin to define its interests as opposed to, rather than complementary to, those of the other. That is, there would no longer be any positive sum solution – the game would not be “prisoner’s dilemma” but rather “deadlock”. In a situation of deadlock, actors prefer discord to cooperation on any politically feasible terms. The United States in 1933 preferred to follow an independent monetary policy to any agreement consistent with the orthodoxy of the times – so Franklin D. Roosevelt torpedoed the London Economic Conference. Certain elements of the French Socialist Party may prefer discord now, in which they can erect protectionist barriers and attempt to construct their own industrial policy, to any conceivable arrangement for macroeconomic coordination that could be made with the Reagan administration.

When governments are deadlocked, no amount of international policy coordination is likely to help. The issue becomes not one of communication and information but one of a lack of agreement on common interests. Deadlock – at least between France and the United States – is a real possibility, although probably not likely. Since the United States is so much more powerful than France, and since conservative governments are also in power in Britain, Germany and Japan, international economic regimes are still defined in a fundamentally capitalist, monetarist way. Thus the French have to decide whether to collaborate on capitalist terms or to define the game as deadlock. Neither of these alternatives is attractive. Collaboration means capitulating to the pressures of international markets by abandoning major elements of the socialist program, tightening monetary policies, and seeking to rebuild business confidence: that is, following policies similar to those pursued by the British Labour government in 1976. To pursue socialist policies on its own, France would probably have to resort to protection and attempt to impose severe capital controls. This would pose extremely serious problems for the European Community and would lead to incalculable costs for France. The French dilemma indicates the severity of the contradictions between pursuit of “socialism in one country”, through nationalization and other measures aimed directly and suddenly against capital, and continued integration into the capitalist world political economy.

A third scenario is one of collective discrimination by the developed countries, at least those of Europe and North America, against less developed countries’ exports, especially those of the East Asian newly industrializing countries (NICs), or “gang of four”\textsuperscript{18}. Although some Europeans have been sympathetic to this course of action, there is little likelihood of American support for it. US trade is increasingly oriented toward the NICs\textsuperscript{19}.

Furthermore, the international debt crisis can only be resolved if the debtor countries are permitted to export to the advanced industrialized countries, which precludes systematic and widespread discrimination. Needless to say, American interests – and not just banking interests – make a smooth resolution of the debt crisis imperative. Finally, for political-military reasons, the United States is unlikely to support discrimination against countries such as Korea, Taiwan, or Mexico.

Elites in the West as a whole, not just in the United States, will oppose discrimination against the NICs for liberal trade reasons and because of the debt crisis. This means that discrimination is unlikely, but it does not guarantee that it will be avoided. NIC exports to the industrialized countries force adjustment costs onto groups that are weak economically but often strong politically. The very openness of industrialized countries, and the rapidity of change, create political pressures for protection. Liberalism, carried to an extreme in the contemporary world, undermines its own political basis. Thus, exceptions to liberalism are likely to proliferate, and may even be necessary to maintain basically liberal policies: even capitalists can take one step backwards for the sake of two steps forward. As Professor Berthelot argued in his paper, a decline in the rate of increase of economic interdependence may be a necessary condition for avoiding a strong protectionist reaction that could be politically as well as economically disastrous.

\section*{Conclusion}

A return to hegemony is unlikely during the next ten years. Partly this is due to the decline in the US share of the economic resources at the disposal of the advanced capitalist countries as a group, but it also reflects political factors. Although considerable agreement remains on the desirable nature of the international political-economic order, the USA is less willing than formerly to provide benefits to its allies, which are less inclined, in turn, to show deference to the United States. Furthermore, America and Europe no longer see the “Soviet threat” in the same light. Thus the linkages between military and economic issues no longer reinforce the international economic order as they did in the 1950s.


Two other possible scenarios are also improbable. A new era of international cooperation is unlikely to dawn, despite the hypothetical possibility of developing cooperation on the basis of common interests even in the absence of hegemonic power. The incentives for self-centered national governments to force costs of adjustment onto others or to reinterpret agreements to their own advantage, will prevent an outbreak of international harmony. On the other hand, schemes for discrimination against the NICs run up against the reality of huge Third World debts, which can only be serviced if exports from the debtor countries continue to grow.

So the realistic range of policy in the transatlantic political economy lies between a continuation of openness plus disagreement, as in the 1970s, and a slide toward protectionism and trade wars. Interdependence will persist, and it will continue to create conflict. Shibboleths about preserving free trade will be less and less effective, as countries develop industrial policies in competition with one another.20

Whether the outcomes are more or less cooperative, and more or less liberal, depends in the first instance on how governments interpret their interests – as “prisoners’ dilemma” or “deadlock” – and secondly on how they make decisions about long-term versus short-term gains.

If situations are defined as deadlock, international negotiations will accomplish little. Yet even if governments continue to believe that they can gain from cooperation, spirals of reciprocally damaging actions are possible. They can no longer be halted by the exercise of hegemonic power. Rather, they must be limited by developing expectations, institutions, and rules that provide independent, self-interested governments with incentives to cooperate. Thus the demise of hegemony increases the need for international regimes and institutions, while it also makes them more difficult to supply. Institutions are particularly important in so far as they increase the chances that frequent future interactions will take place, reduce transactions costs that may hinder agreement, and provide information that allows governments, and transnational actors, to make mutually profitable bargains. The Organization for Economic Cooperation and Development, International Energy Agency, International Monetary Fund and European Community may be feeble, and they may prove insufficient to prevent acrimony and discord. Their efforts may also be overtaken by events – for instance, by collapse of the fragile international debt regime, or by domestic political movements that lead to policy conflict and deadlock at the international level. But if these admittedly weak international organizations did not exist, they would have to be invented.