Politics in Hard Times

Comparative Responses to International Economic Crises

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Cornell University Press

Ithaca and London

First published 1986 by Cornell University Press.

International Standard Book Number (cloth) 0-8014-1973-5
International Standard Book Number (paper) 0-8014-9436-2
Library of Congress Catalog Card Number 86-47631
Printed in the United States of America
Librarians: Library of Congress cataloging information
appears on the last page of the book.

The paper in this book is acid-free and meets the guidelines for permanence and durability of the Committee on Production Guidelines for Book Longevity of the Council on Library Resources.

Chapter One

The Politics of Economic Policy

Policy requires politics. Ideas for solving economic problems are plentiful, but if an idea is to prevail as the actual policy of a particular government, it must obtain support from those who have political power. Economic theory can tell us a lot about policy alternatives, but unless our economics contains an understanding of power, it will not tell us enough to understand the choices actually made.

In prosperous times it is easy to forget the importance of power in the making of policy. Social systems appear stable, and the economy works with sufficient regularity that its rules can be modeled as if they functioned without social referent. In difficult economic times this comfortable illusion disintegrates. Patterns unravel, economic models come into conflict, and policy prescriptions diverge. Prosperity blurs a truth that hard times make clearer: the choice made among conflicting policy proposals emerges out of politics. The victorious interpretation will be the one whose adherents have the power to translate their opinion into the force of law.

The 1970s and 1980s have been difficult years, years in which economic problems have made visible the importance of politics in shaping economic policy. Records have been broken. The early 1980s saw the most severe business-cycle depression in fifty years, the late 1970s the worst inflation in thirty years and the most persistent unemployment in the countries of Western Europe for two generations. The 1970s also gave us the most severe shock from a single source in the international economy since the banking collapse of 1931, in the OPEC price boost of 1973–74, and the unraveling of the monetary regime created in the 1940s, starting with the American dollar drop of 1971. As I was finishing this book in the mid-1980s, the American economy had, to the envy of Europeans, created millions of jobs, but the halcyon days of the fifties, when it seemed that economic growth, price stability, and full employment might be realized collectively, had not returned. Over the international economy of the latter 1980s hang the tremendous U.S. budget deficit, sucking in huge amounts of foreign capital, the gigantic debts owed by certain foreign governments, severe international competition, and massive reductions in manufacturing employment—outward signs of acute policy problems.

With economic dislocations have come significant political changes as well. The late 1970s and the 1980s have produced some of the largest swings in partisan politics since the 1930s. In 1981, for the first time in its history, France gave an absolute electoral majority to the Socialists in the National Assembly and elected the first Socialist president ever chosen directly by universal suffrage. In the United Kingdom the two-party system crumbled as Margaret Thatcher and the British Conservatives beat Labour twice while social democrats broke away to form a new party. In 1976 the Swedish social democrats lost power for the first time in over forty years, but in 1982, with commentators predicting a rightward shift in Europe, they came back under Olof Palme to win. In West Germany the governing coalition fell apart when the Free Democrats switched alliance partners. In the United States, Ronald Reagan led the Republicans to strong victories at the presidential level and to strong gains in voter identification at all levels. In Portugal, Spain, and Greece dictatorships fell, and in the latter two countries socialist governments took office.

These political shifts have been accompanied by major changes in economic policy debate. Out of the traumas of the Depression of the 1930s and of World War II the countries of Western Europe and North America had forged a "historic compromise." Bitter enemies had worked out a truce built around a mixed economy, a kind of bounded capitalism, where private enterprise remained the dynamo but operated within a system of rules that provided stability, both economic and political. Demand management to promote full employment, the welfare state, an extensive system of economic regulation, institutionalized industrial relations, free trade—these were the policy approaches of this bounded capitalism, and they departed strongly from the market orthodoxy of pre-Depression days. Political power was shared as well, and to a far greater degree than before the war.[1]

With the crisis of the 1970s this compromise has come undone. As the economy turned sour, so discord grew about causes and remedies, and the policy debate widened. Older interpretations, thought dead, have come back to life, sometimes in new language, while the doctrines of the sixties, once challengers to orthodoxy and then its successor, lost their intellectual predominance. Challenges to the historic compromise—among them nationalization of industry, industrial democracy, protectionism, and industrial policy—have returned to the policy agenda in recent years, and some have been tried in practice. In the first year of François Mitterrand's government, for example, France nationalized more industry than any Western country had done since 1945. Reagan slashed taxes and domestic spending more drastically than any U.S. president in generations and increased military spending dramatically for a nation not at war. In international trade a widespread return to protectionism has pierced the worn fabric of the General Agreement on Tariffs and Trade.

Economic crisis, policy debate, and political experimentation are surely somehow connected, and their connections are the subject of this book. Economic crisis leads to policy debate and political controversy; out of conflict, policies emerge. Policies, whether innovative or traditional, require politics: that is, the responses to the economic crisis require political support. To understand policy choices, therefore, we must understand the politics that produces them.

In this book I wish to gain an understanding of the politics of policy choice through a "political sociology of political economy"—that is, by looking at the politics of support for different economic policies in response to large changes in the international economy. When national economies are interdependent, crises are international. No country escapes, for a crisis is a stimulus to which all must respond. By examining what countries do, by looking at how their responses vary, we can learn something about the countries themselves and about the factors that lead them to choose particular policies.

Comparison is particularly useful for such an enterprise. The current crisis of the international economy is not the first, and two earlier experiences seem especially telling for our era. In the crisis of 1873–96 prices plummeted, levels of employment gyrated widely, production soared, profits were squeezed, some businesses exploded in size while great numbers of others collapsed, millions emigrated from Europe, new parts of the world entered the industrial economy, and countries wrangled over what to do. The crisis of 1929–49, beginning with the Great Crash, occurred in the context of deep problems in the system of payments (with German war debt and reparations for World War I) and that of trade and production (with the emergence of new products and new techniques). Much can be learned by comparing the current crisis to these earlier ones.

The three crises can be seen both as distinct historical periods and as recurrences of similar events. Each crisis combines three properties: a major downturn in a regular investment/business cycle, a major change in the geographical distribution of production, and a significant growth of new products and new productive processes. These three properties operate at an international level that deeply implicates domestic economies and so link conflicts over national policy within each country to international trends.

This book analyzes the response to the three international crises in the choices made by five countries: France, Germany, Sweden, the United States, and the United Kingdom. For at least a century, all five countries have had complex economies, part modern, part backward; part industrial, part agrarian; part oriented toward aggressive competition on a world scene, part oriented toward sheltered home markets. All five have at times converged, at times diverged, in their policy choices; all five have been capitalist through the period that interests me. And, with the conspicuous exception of the Nazi years, all five have had politics at least partly shaped by constitutional procedures.

From a comparison of the choices among policy alternatives which these countries have made, something can be learned about the importance of power in shaping policy. Ultimately, policy choices are made by politicians, by individuals who occupy institutional positions; power comes from the formal authority of those institutions. But somehow political leaders have to get into those institutional positions and hold on to them. And whatever they decide, their policies, to take effect, require compliance or even enthusiasm from countless individuals who work or invest or buy. When politicians make choices, therefore, their choices are constrained by the need to mobilize or retain support. Politicians have to construct agreement from among officeholders, civil servants, party and interest group leaders, and economic actors in society. My goal is to map out the patterns of support which have formed around the various programs of economic policy that countries have adopted in response to severe disruptions in the international economy.

Many accounts of these crisis periods make reference to coalitions that formed in conjunction with policy packages: the marriage of iron and rye, the Weimar coalition, the Populist revolt and the Gold Democrats; the New Deal coalition, the French Popular Front, the Swedish "cow trade" of the 1930s. These coalitions provided the support needed to get policies adopted and implemented. Our understanding of policy choices requires a political sociology of these historical coalitions: Who was in them? Around what substantive terms of trade did they form? How were they put together; that is, to what degree were they assembled by political figures, to what degree did self-motivated individuals converge out of particularistic calculations? Were other combinations possible; that is, could the same coalitions have sustained different policies, could different coalitions have produced the same policies? How loosely or tightly do coalition, political formula, and policy package fit together?

Unpacking what was involved in the formation of past coalitions tells us something about the political sources of policy choice. Several factors interact to bring such coalitions about and to cause their collapse. In an economic crisis social actors, affected by their situation, evaluate alternative policies in relation to the likely benefits or costs. One major analytical tradition of political economy therefore examines policy support by examining the placement of social actors in the economy itself.[2]

Economic conditions rarely operate directly on policy disputes. Other factors mediate them. Those factors include, first, the mechanisms of representation—political parties and interest group associations that try to manage the linkage of economic actors to the state. Second, politics is affected by the organization of the state itself: the system of rules (electoral laws, balance between legislature and executive, legal powers, and so on) and institutions which comprises the bureaucracy. Third, economic actors are influenced by ideology, which provides models of the economy and of the economic motives of other actors. Finally, coalition politics is influenced by a country's placement in the international state system of political-military rivalries.[3]

Each of these factors influences the interaction of societal actors. Each has also acted as a focus for important theoretical traditions of explaining policy and politics, some of them in strong conflict with my own concern for the economic situation and preferences of economic actors. It is, I believe, important to explore these traditions of interpretation to see where they can take us and where they are limited. This book attempts a description of policy choices which evaluates the connections among different arguments currently used to link the international economic environment to national politics.

The Argument in Brief

Each crisis involves a sequence of events which can be summarized quickly. In the prosperous years preceding the crisis, a policy approach and support coalition developed. Then came crisis, challenging both policy and coalition. Crisis opened the system of relationships, making politics and policy more fluid. Finally a resolution was reached, closing the system for a time, until the next crisis.[4]

The Crisis of 1873–96

When the first crisis began, free trade had been spreading across Europe's industrializing countries. Buoyed by growth, those countries had accepted the concept of comparative advantage, which promised greater aggregate wealth if countries specialized according to world market conditions. In 1873, however, prices slumped; they would continue falling for years. Many producers, sorely pressed by new conditions, began clamoring for tariffs and other forms of aid. Of our five countries, only the United Kingdom continued with its free-trade orientation, which dated from the celebrated repeal of the Corn Laws in 1846. Elsewhere protectionism prevailed, and with it the reshuffling or reinforcement of particular alliances among societal actors. In Germany, France, and Sweden both industry and agriculture were sheltered. Agricultural tariffs would have been meaningless in a United States whose farm production was swamping Europe, so in America only industry received protection.

The simplest explanation of these outcomes lies with the way that the new economic environment affected the major groups of industry, agriculture, and labor in each country. As the first industrial nation, the United Kingdom led the world in most industrial products. It pioneered large-scale manufacturing first of textiles, then of iron and steel. With the profits from those industries the United Kingdom developed a very large financial/trading sector deeply attached to world trade. British agriculture had already begun adapting to the pressures of international specialization. Labor, employed by some of the world's leading industries, worried about the cost of food, but after the repeal of the Corn Laws, labor also came to support free trade. When prices fell after 1873, some farmers and some steel producers fought for protection. They were defeated by the larger coalition.

The sharpest contrast to the British case is that of Germany. As a later industrializer, Germany (its industries) faced stiff competition from the British; its banks were linked not to international finance and trade but to industries; and much of its agriculture was quite uncompetitive and poorly structured for adaptation. Industry, led by the heavy industries of iron and steel, and agriculture, led by the grain-growing Junkers, came together in the famous coalition of iron and rye in support of tariffs. An alternative alliance preferred free trade; it brought together export-oriented, high-technology industries such as chemicals and electrical equipment, farmers seeking cheaper grains to feed dairy and meat herds, and labor concerned about the price of food. The free traders lost.

This divergence in outcomes between the United Kingdom and Germany was reinforced by other factors as well. The well-developed Prussian-German state favored protectionist interests, for example, and the system of interest groups and political parties disadvantaged the free-trade coalition there. The German states had a stronger tradition of protection and a weaker tradition of free trade than the United Kingdom. Moreover, Germany's geopolitical situation on the European landmass, without extensive colonies or dominions, made it more vulnerable than the United Kingdom to dependence on the international division of labor.

When we bring the other countries into the comparison, however, we diminish the importance of these factors. France and Sweden had their equivalents of the iron-rye coalition, with industry and agriculture both facing stiff foreign competition and seeking protection. Yet the French state after the early 1870s was a rather weak republic open to social pressures, and Sweden lacked the powerful army and bureaucracy that made the German state so distinctive. In France and Sweden, indeed in all the countries including Germany, economic ideology appeared to shift rather rapidly with changes in economic conditions. In all could be found a range of viewpoints about policy, each view struggling for political primacy. In the United States, state structure, economic ideology, mechanisms of representation, and international situation were all quite different from their Continental counterparts. Nonetheless, protectionist groups in all four countries managed to prevail; in the United Kingdom they lost.

The influence of societal actors in this period appears to have been relatively naked and raw. To win policy debates, societal actors certainly had to operate through parties, the state, and ideology, and they certainly had to deal with international military considerations. But in this period these appear to have been instruments used as the societal actors saw fit. Whatever the system in which they operated, producer groups seem to have been able to get their way. It seems likely that even a republican Germany with a weak state, or an authoritarian France with stronger leadership, would have adopted the same policy. What makes the United Kingdom different from the rest is the profile of its national groups and their views; that is, sectors convinced that an open world economy operated to their advantage.

From these various policy battles emerged certain patterns in the interrelationships among societal actors. Though all industrialists had their conflicts with labor over wages, unionization, and other issues of property and power, some industries showed a higher propensity than others to make alliances with labor. High-technology sectors, for example, well placed in international competition, forged alliances with cheap-food-oriented labor groups. Heavy industry, faced with massive capital requirements and a need for stabilization of demand, as well as other industries facing stiff foreign competition, opposed free trade. They were more hostile to labor and to progressive political demands. Agriculture split between commodity crop producers and the growers of high-quality foodstuffs who used grain and other commodity crops as inputs. In Europe the latter had sympathy for free trade and industrial development, the former were protectionist. In America the commodity producers were antiprotectionist and also mistrustful of industry; the high-quality food producers were sympathetic to industry and accepted protection. Labor was a passive though not useless ally in these agreements. Unionized labor tended to be concerned with keeping down the cost of food; in Europe it tended to oppose tariffs, but in America, where food was cheap, it supported industrial protection. Nearly everywhere agriculture and labor found it difficult to cooperate.

In this first crisis, therefore, the international economy played a considerable role in shaping domestic politics. It did so by working through domestic actors, shaping their policy preferences and their propensities to conflict and to align with other groups. Elements of the national political system were the instruments through which group pressures made themselves felt.

The Crisis of 1929–49: The Depression

The crisis that began with the Great Crash of 1929 produced a massive attack, even greater than its predecessor's, on the classical economic views that dominated policy, and it led to the construction of new political formulas for supporting changes in policy. Long-standing relationships among social forces crumbled. Cut loose from their moorings, economic actors floated on a sea of confusing incentives, opportunities, and dangers. Policy and political experiments were tried, and some combinations, in particular that of Nazi Germany, led to disaster. Others produced a formula that became generally adopted around Europe and North America, though only after the cataclysms of totalitarianism, war, and occupation.

When economic depression spread after 1929, the universal policy response was the orthodox, classical prescription of deflation: cut all costs to encourage sales and investment, which meant cutting wages, taxes, and spending. But deflation failed to produce the desired result. Many alternatives were tried, among them socialization, protection, fiscal stimulus, and mercantilism. Every country gave up on deflation, but the degree of departure from orthodoxy varied.

The United Kingdom reversed its historic devotion to the classical line by devaluing the pound, reviving tariffs, developing subsidies and market regulation for agriculture, and granting some limited aid to industry. But the United Kingdom did not experiment directly or even rhetorically with demand stimulus. Sweden, Germany, and the United States adopted all of these measures, but they also began experiments with demand stimulus and macroeconomic management. Nazi Germany went farthest with deficit-led stimulus; Sweden and the United States experimented with it more loosely. France, after pursuing deflation much later than the others, tried fiscal stimulus under the Popular Front. When that collapsed, the country moved toward a less dramatic break with classical orthodoxy. In Germany political repression altered economic relations, because the destruction of labor unions changed the functioning of labor markets. The shift to military spending in the mid-1930s led to a much greater nationalization, albeit hardly of the kind desired by the left. Corporatist market regulation was tried in many countries; in Germany it became highly authoritarian.

Even in the horrors of the Nazi regime, then, it is possible to see some resemblances to the trajectories of other countries. The classical position held that deflation produces the best result in the long run. The willingness to sustain the long run varied, however. Agriculture everywhere turned desperate early, seeking some kind of substantial state aid. So did labor, both union and nonunion. Fairly soon, business fragmented in its attitudes: some stuck to orthodoxy, others agitated frantically for state action.

As the collapsing international economy disrupted older relationships among economic actors, new combinations became possible. Mass discontent created new opportunities for some elites, new constraints for others. Some capitalists wanted to abandon the deflationary prescriptions of the classical school but met strong resistance from their orthodox brethren. This resistance could be overcome by using the support of labor and the discontent of agriculture. By linking the various instruments of mass power (ballot box, workplace, street) with the various instruments of business (capital, ownership, legitimacy), coalitions formed which had considerable potential for action.

Such coalitions were also polymorphous—there were different ways they could come together and different uses to which they could be put. The three experimenters with demand stimulus—Nazi Germany, Sweden, and the United States—were able to experiment because politicians fashioned new support coalitions. But the three experiments linked fiscal stimulus to different types of economic policy instruments and to different types of mass support.

It was in Sweden that the bargaining among social forces was most explicit. The Agrarian party and the Social Democrats formed the cow trade: subsidies for the countryside while retaining levels of unemployment compensation for the cities. Business groups were shocked by the deal, but when the election of 1936 demonstrated the failure of efforts to break it up, the high-tech, internationally oriented business groups struck a deal. In the Saltsjöbaden Accord of 1938 labor gave up its demands for socialization and agreed not to strike; business accepted high wages, labor union rights, and labor power in government; agriculture kept its subsidies. The whole accord was oriented toward international markets, whose discipline would be allowed to enforce concern for productivity and profitability. Macroeconomic policy would keep demand at levels high enough to prevent unemployment, and retraining would move labor from declining to growing companies.

In the United States the bargaining was far less clear and much more contorted. Labor and agriculture joined together around the Democrats, but the relationship of these two groups to business shifted. The first New Deal drove the internationalists out of their historic linkage to these groups, while their old enemies, the more nationalist industries that served domestic markets, combined with agriculture and labor to create the corporatism of the National Recovery Administration (NRA). Within two years that approach had disintegrated over its various internal tensions: business resistance to corporatist controls, antipathy to labor claims, tensions over foreign economic policy. The second New Deal put the pieces back together in a different way. It gave bigger concessions to labor in the Wagner Act, which helped promote and institutionalize trade unions, and Social Security, and it salvaged the agricultural programs from the wreck of the NRA. For business, it moved back toward internationalist foreign economic policy, stabilized markets through various regulatory devices, and contained radical agitation for the socialization of ownership. When the effort to balance the budget produced the severe slump of 1937, this new coalition provided support for an economic experiment—the first deliberate deficit, in the demand stimulus budget of 1938.

The Nazi coalition also broke with economic orthodoxy, and it also drew for support on the intense discontent to be found in agriculture, labor, and business. But it drew on a sharply different *type* of labor support, and that difference was important to the gigantic difference in political formulas and program used to stitch the coalition together. Where in the constitutional countries the reformist coalitions used the existing representative organizations of union labor, in Germany the Nazis turned to the unorganized masses, to a wide range of groups including numbers of people working for wages. As an integrative ideology the Nazis used instead of social democracy a *völkisch* populism laden with racism and nationalism. Business was drawn in not as a part of a compromise among existing social categories but around a program of nationalism and imperialism. The new policy departures of demand stimulus and corporatism were thus linked to a very different political base and an authoritarian structure. Where in the United States and Sweden the need of governments for mass support led to a strengthening of trade unions, in Nazi Germany the need for mass support was used to destroy unions. A different political formula gave the Nazis not only the freedom to experiment with economic policy, including coercive corporatism, state enterprises, and strict control of foreign economic relations, but also the freedom to destroy peoples and countries.

In this crisis, as in the first, the policy preferences and coalitional proclivities of economic actors were strongly affected by their situation in the international economy. By contrast, the role of associations in mediating relations among social forces appears to have grown. In response to the first crisis a mass of organizations developed to handle the representation and governance of societal actors. As the organizational space of society "filled up," these organizations came to shape the way their members understood options and the way in which these options were expressed through politics. Specific decisions by organizational leaders loom large in the politics of the second crisis period: the willingness of the Swedish Agrarians to ally themselves with the SAP, the rejection by German and British labor parties of the deficit-financed public works proposed by the unions, the willingness of American and Swedish business groups to make alliances with labor and the rejection of such projects by their German counterparts. In some cases existing associations proved durable and adaptive, in others they were brittle and weak. New organizations rose up able to mobilize people in new directions; the Nazi party and its organs are the most spectacular example.

Differences in state structure also affected policy debates. The German case shows this most conspicuously: the weakness of the Weimar

Republic in the army, the judiciary, and other elements of the state bureaucracy contributed to the failure of constitutionalist accommodations. The weakness of the Weimar and Third Republic cabinets contributed to policy stalemates that ultimately favored the far right in both Germany and France. American federalism and loose party organizations weakened the labor-reform elements of the New Deal, facilitating the formation of a South-agriculture-Republican coalition that limited change.

Associations and state structure both played important roles; we can conceive of them as prisms through which the pressures of societal actors were refracted. It is hard to understand the policy debates without reference to them. Yet it also seems clear that their effects were not independent of the societal context in which they operated. There seem to be no characteristics of associations or state structure that can stand independently of social factors in explaining policy outputs. It is not the formal attributes of institutions which account for the outcomes, but the way in which formal structures interact with the objectives of societal actors and group leaders. Political context also strongly affected the differences in economic ideology and relationship to the international system which can be found among these countries during the Depression.

In crucial ways, then, policy and its political context turned on the accommodations that societal actors did or did not work out. Response to organized labor appears to have been pivotal. Where labor-allied parties and trade unions were drawn into coalitions, economic policy innovation could take place, and in a constitutionalist context. Where organized labor was repressed but another source of mass support was tapped, policy innovations occurred, but under fascist dictatorship. Where organized labor was excluded but not repressed, as in the United Kingdom and in France before and after the Popular Front, policy changes were more limited. This much is description. The explanatory problem arises in sorting out how different elements contribute to the packages of coalition, policy, and organization which prevail.

The Crisis of 1929–49: The Postwar Reconstruction

The Depression of the 1930s contributed to World War II by shaping the coalitions that took power in dealing with it. The war then reopened issues of political economy by shaking loose the political settlements of the 1930s. In the postwar years the policy debate resumed, augmented by the titanic consequences of the war itself. This time the countries of Western Europe and North America converged in their approaches to politics and economic policy, building in effect a compromise to end the battles of the thirties. They built accommodations, de facto or de jure, among societal actors.

Labor accepted capitalist management of an economy run on the basis of market incentives (even for nationalized industries) in exchange for a welfare system, high wages, employment-oriented macroeconomic policy, and constitutional protection of organizing rights. Agriculture kept the extensive system of market stabilization in exchange for its support of broad programs for labor and business. Business accepted these policy shifts in exchange for maintenance of many of the regulatory mechanisms that stabilized markets and control over investment and management. Under American leadership the compromise was attained in the context of an open world economy.

The path to this accommodation differs. In Sweden and the United States it came from internal political debates about the international system; in Germany it depended upon massive foreign interventions to restructure the society. But the end point was roughly similar. Studies of the postwar period usually pit the United States and Sweden against each other as polar opposites. Yet compared to the era before 1929, these two countries (and the others examined in this book) clearly appear after 1945 to be part of this historic compromise. Although policy mixes vary substantially, the character of state activism in economic management from 1945 onward diverges strongly from both the classical and the protectionist policy patterns that predominated in earlier decades. The system produced by this compromise sustained prodigious economic growth, and successes strengthened the accommodation—until things began to go sour.

The Crisis of 1971 to the Present

The very successes of the postwar boom sowed the seeds of subsequent difficulties. The revival of the West European and Japanese economies, the spread of industrial capacity to developing countries, and the emergence of new products and new processes, all paved the way for a wide-reaching crisis of international competition which can be dated to the early 1970s. This crisis has destroyed the compromise forged after World War II. Labor, agriculture, and business are having an increasingly hard time managing the terms of their accommodation. More precisely, those elements which forged the compromise are losing ground within each category to elements that dislike it.

The policy mix of demand management, regulation, and corporatism is no longer dominant either in rhetoric or in reality. Even where labor continues to participate in governing, policy has shifted toward the neoclassical. State intervention remains extensive, but the policy mix is changing. The interventions espoused by labor and stabilization-oriented industries are under challenge. Countries continue to vary widely in policy, but market considerations are pressing all of them to adapt in ways contrary to the patterns built up over several decades.

In the present crisis labor has lost its historic allies within business and agriculture. Business collaborated with labor in the postwar reconstruction to promote stabilization mechanisms and an open international economy, against the opposition of protectionists and nationalists. Now all business groups have accepted the interpretation that their international problems are caused very largely by labor costs, labor behavior, and the regulatory instruments that labor has supported. The principal way to modernize and rationalize national economies, business groups argue, is to improve profitability; hence they urge lower taxes, lower social charges, less regulation. The internationalization of production has thus reduced the link between domestic producers and domestic labor while at the same time it has moved international industry away from labor.

To agricultural interests, similarly, labor support is no longer necessary. Business no longer contests the system created in the 1930s. Instead, business now is willing to compete with labor in buying agrarian support with all sorts of subsidies. If it allies itself with business, agriculture can get these subsidies without having to pay for subsidies for labor. In the thirties, agriculture provided the fight against the classical approach not only with numbers but also with legitimacy: farmers are property owners. Without the farmers, labor has to fight against the core principles of the capitalist economy from its weakest ground, the claims of wage earners. Farmer support in the 1930s provided a populist base, not a socialist one. Today, as it was in the first crisis, the populist sensibility is quite antilabor.

Without these allies, labor has become defensive. Its policy approach seeks to defend existing positions in wages, social services, and jobs. But labor has difficulty in formulating a vision of how best to modernize a national economy in the face of new international economic conditions so as to allow it to mobilize broader support while retaining its own internal solidarity.

All social categories face the same general problem in devising political strategies—each has to balance the task of managing the economy as a whole against the task of asserting the particularities of its own situation. When business solidarity fragments under such conditions, as happened in the 1930s and 1940s, labor, agriculture, and other social fragments are able to play a considerable role in shaping policy. In the 1970s and 1980s, however, business strategies have converged on a neoclassical revival, and it is labor that has fragmented. This is likely to remain the case until policy problems in the international economy draw out intra- and interbusiness conflicts.

These changes in political relationships operate to constrain governments and to limit policy experimentation. The French Socialists under Mitterrand shifted away from nationalization, equalization, and fiscal stimulus, and toward austerity in state spending and the importance of market cues. These same pressures have constrained the Swedish Socialists and have contributed to fragmentation in the British Labour party, the Democratic party in the United States, and West Germany's SPD. At the same time the realities of contemporary electoral politics set limits to the application of market principles. Ronald Reagan and Margaret Thatcher have both drawn back from cutting the welfare state below levels that are considerably higher than prewar norms. Both countries continue to use considerable government intervention in the economy, albeit in untraditional forms.

Policy has fluctuated between the neoclassical revival on one side and market regulation and social welfare on the other. Between those two extremes there exists a considerable range in country responses. Sweden, though accepting the cues of the international market, intervenes far more than the United States does in labor markets and industrial restructuring, and it uses mechanisms of consultation to help along the process of adjustment. The West European systems of social services and labor-market restrictions remain far more highly developed than those in America. France uses industrial policy far more than the United States and the United Kingdom. The United States under Reagan has used far more than the Europeans the fiscal stimulus of massive deficits and the industrial policy of military procurement.

These differences can be partially understood in terms of the different relationships among societal actors country by country. By a number of measures the Swedish labor movement is far more powerful than its American counterpart. American financial, trading, and manufacturing groups, with the world's largest economy and the world's reserve currency, have resources and face incentives that differ from those of most of their European counterparts.

But we cannot understand the different relationships among societal actors without examining the organizations that represent these societal actors, the state structures, and the ideology. The strength of Swedish labor is intimately linked to its organizational forms, in particular the centralization of the Swedish trade-union organization and its links to the Swedish Social Democrats; participating in the government provides resources and incentives that then, in an interactive process, reinforce governing. In France the importance of nationalization as a policy option is linked to the position of the Communist and Socialist parties and trade-union movements; the absence of such parties and movements contributes to a different definition of alternatives in the United States. Thus the forms and the ideologies of the organizations themselves shape the ways in which societal actors choose options.

The strategies of societal actors are also shaped by the institutional frameworks created out of the second crisis. The five countries examined here differ considerably in the pattern of corporatist linkages which they developed to manage relationships among functional groups. Sweden may be less corporatist than Austria, but it is considerably more so than the United States. And the five countries differ considerably in the powers and mechanisms of intervention available to the state: France and the United States are the two extremes. The mere existence of these mechanisms does not serve to explain their use, of course, but it does affect the politics of policy alternatives involving their use.

In all three crises the military rivalries among states played a role in economic policy debates. In every case considerable increases in military spending accompanied certain policy approaches. And each time there has been a linkage between the advocacy of military spending and the advocacy of conservative political goals at home. The international system thus contributes to domestic debates about policy and politics. Rarely, however, has it been able by itself to explain the victory of one perspective or another.

Conclusion

Over the course of three crises in the international economy one can observe relationships changing among societal actors within countries and among the factors that shape economic policy. Societal actors divide and combine over time in ways that relate to their changing situations in the international division of labor. Critical realignments occur during crises, not only in the electoral arena but in the terms of trade among various economic actors.

In the first crisis, three types of coalition developed: an anti-corn-law pattern, typified by the United Kingdom, in which productive forces from industry, finance, agriculture, and labor sustained a policy of liberal adaptation to the international economy; the iron-rye pattern, exemplified by Germany, in which elements of industry and agriculture combined to interpose a stratum of protection against the international economy; and the antipopulist coalition, exemplified by the United States, in which industry and labor combined against commodity agriculture and traders.

In the second crisis, realignments took place. The social democratic pattern brought together labor, agriculture, and elements of business around the constitutionalist historic compromise through policies of demand management, welfare, and stabilization. The fascist pattern, by contrast, involved a different mixture of mass support, agriculture, and business which excluded organized labor and led to a savagely repressive regime. In its early days, nonetheless, the fascist variant pioneered policies that would spread to other countries after the war. Military intervention eventually destroyed the fascist pattern, opening the way to the spread of the social democratic model.

In the third crisis, tension has grown between the partners of the historic compromise. Business groups have drawn together in opposition to labor costs and extensive services, social agriculture finds little need for labor support, and pressure has built up to curtail state spending and interventions. Whatever the differences in partisan outcomes, all governments have been pressed in the same general direction. The differences in policy response have been strongly affected by differences in the mediating institutions, through which societal actors mobilize and apply power.

The descriptive element of these trajectories can be charted by following these relationships over time. More difficult is judging among alternative explanations of why these bargains occurred rather than some others and of the status of various factors in explaining the different bargains. Through all three periods, it appears, we must have some understanding of the impact that international and domestic economic situations have upon groups and their policy preferences. This need is surely constant. At the same time the relationship of economic situation to mediating institutions and ideologies does not appear constant. In the late nineteenth century parties and interest groups were relatively unformed. They congealed around that crisis, and they became forever after part of what societal actors had to pass through. The second crisis both challenged these structures and considerably expanded them. State and society penetrated each other in exceedingly complex ways, making it difficult to judge how each shaped policy. When the third crisis began, the arrangements brought about during the second were in place to influence policy conflicts. Because these arrangements differed considerably across countries, however, their impact on politics varies as well. The relationship among causal factors thus varies across countries and within time periods.

The historically careful appreciation of contingency and balance specific to each case thus conflicts to some extent with the search for generalizations. Nonetheless, with careful pairings or triangulations of cases it is possible to explore some of the strengths and difficulties of the various analytical approaches. One can find limiting examples, comparisons that bring out a linkage, others that point another way. And so the tension between parsimony and elegance on the one side, accuracy on the other, remains powerful.

My epistemological claims, I stress, are limited. I have a healthy appreciation of the contingent. My mode of presentation, therefore, is the theoretically guided historical account. Systematic accounts of policy debates and choices allow the presentation of a story in such a way that the informed reader can evaluate the understandings of reality that lie behind broader generalizations.

I prefer to study crises rather than stable periods because I am interested more in comprehending the open moments when system-creating choices are made than in unraveling the internal workings of systems themselves. This book is intended to help us understand the range of choices, present and past, from which new systems emerge.

Chapter Two

Explaining Policy Choices

In each crisis countries "choose" a policy or a sequence of policies. This is an anthropomorphic way to put it. The notion of choice implies consciousness, and the notion of policy implies coherence. Frequently in decision making we find neither consciousness nor coherence, though for the purpose of analysis we must use both notions. To compare what countries do, to find similarities or differences in their behavior, we need two sorts of frameworks: a typology of policy alternatives, and a set of explanations for interpreting choice among policy alternatives. These are constructs that we, the observers, impose. Policy options are generally messy, with fuzzy boundaries, and the same is true of explanatory modes. Only when options and explanations are made orderly can we chart disorderly reality, describe what happened, and then attempt to interpret it.

Defining Policy Options

The goal of this book is to examine how and why countries chose particular policies in response to major disruptions of the international economy. Policy options must be defined, therefore, in ways that encourage comparisons across countries and across time periods. In looking at several countries, we need to conceive of the policy options in a general manner, as a set of possibilities from which any country might choose. In looking at several time periods, we need to pose the policy options in ways that make them, at least analytically, options for any of the periods. So we cannot define the policies in specific periods contextually, as orthodoxy versus radicalism, because the meaning of these descriptive labels may change from one period to another: the radicalism of demand stimulus in the thirties, for instance, may become the orthodoxy of the eighties, when radicalism may come to mean the free-market ideas of the era preceding 1929.

Finally, we need to recognize that comparison requires some clear sense of the object to be compared, the outcome or the endpoint or what positivistic discourse would call the dependent variable. Without at least a rough sense of the object of comparison, we will find it impossible to engage in debate over explanations of policy choices. It is necessary therefore to simplify—brutally, deliberately, and at the cost of distortion.

There are two ways of constructing a typology of policy alternatives so as to meet the needs of comparison: deduction and induction. The deductive approach derives from economic theory a tightly formulated set of alternatives. This is the ideal method: theory permits precision in the determination of categories and their boundaries. Unfortunately, the deductive approach generates too many possibilities. Economic policy has many dimensions (fiscal, monetary, commercial, industrial, and labor are only the most obvious), and within each a number of alternative positions can be taken. These elements can be combined in so many ways as to make impossible any meaningful comparisons.

The number of combinations can be reduced to some degree by identifying theoretical contradictions: a free-trade commercial policy conflicts with intense government planning and nationalization in industrial policy; an encouragement of investment through low taxes conflicts with a need for high taxes to finance social insurance programs. But the conceptual limits are rather less strict than one might imagine—in Western Europe, for instance, free-trade countries in recent times also practice high degrees of corporatistic management of employment, investment, pricing, and marketing, and the private economies of some small democracies there also have very high taxes for welfare.

Defining policy packages by deduction (the logical combination of policy alternatives) thus will not work for our purposes here. We need to supplement deduction by induction, by looking at actual debates to find the limited number of combinations around which activity focuses. The clustering of options into policy packages, we find, derives from political circumstances. From the historical record, we can identify policy packages of a general sort which appear to form the focuses of political and intellectual debate. Countries, again speaking anthropomorphically, have usually argued about a specific set of policy responses to sharp changes in the international economy. Within each of these options are many nuances of detail, and the broadness of the following categories does not capture them—nor will the explanations pursued necessarily do well in explaining variance within the categories. Nonetheless, the important policy packages have been rather limited in number, both across countries and across time periods. There have been few identifiable schools, few lines of reasoning, few interpretations of what is wrong and what is to be done. Relative strength may rise and fall across countries and time periods, but the options themselves have some uniformity.

We may identify five major policy alternatives: liberalism or neoclassicism, socialization of ownership and planning, protectionism, demand stimulus, and mercantilism. Each is a general approach to the problems of political economy, dealing with a large range of questions under a diverse set of circumstances. Our interest here is with the policy prescriptions with which these approaches respond to a severe disruption in the international economy—what to do when profits fall and international competition becomes especially severe, how to allocate resources to cope with severe shifts in the international division of labor. For some approaches, the formula for bad times follows the same logic as that for good times. For others, the two circumstances are quite different.

Option I: Classical Liberalism or the "Neoclassical Option"

Classical liberalism holds that the untrammeled free market—decentralized decision making in response to the incentive for private gain—yields the greatest output and hence the greatest total wealth. Because the greatest efficiency comes from private calculations, the task of the government is to leave the market alone. The government provides, at most, some services that are necessary for the market to function properly but are in no one's private interest to supply. Defense, security, education, infrastructure, indeed a rather extensive array of government services can plausibly be claimed as necessary for the market, but by and large those who use the language of Adam Smith seek instead to curtail the role of government action.[1]

In good times or bad the neoclassical solution to international distress is to allow the market to reallocate resources, and to allow it to do so cheerfully. While the market destroys, it also creates. It knocks out the inefficient but rewards the competitive. The revolutions in technology which drop prices, wipe out production lines, reorganize the structure and the location of production—these are positive contributions to the creation of wealth. They are changes that contribute to increased productivity, which means more output per unit of input, and hence more for everybody. The manufacture of buggies collapses because the manufacture of automobiles increases; slide rules give way to pocket computers, dial watches to digital ones, and so on. The decline of one use of resources happens because another one grows. A contraction of employment here leads to an increase in employment there.

Any effort to interfere with this process restricts the capacity of wealth, defined as the aggregate output of goods and services, to grow. If one protects the manufacture of phaetons and landaus, then one locks up resources, raising the cost of those resources to other uses that would produce more and absorbing a larger share of consumer purchasing power which could otherwise go to other goods.

The story is easily told for new products. For existing ones made by the same technology, the logic is the same: the shift in the geography of production from high-cost to low-cost areas. High-cost areas may feel a loss of jobs, say of shoes and clothing from New England to the South, but New England will be better off if it can shift its productive resources into products that the South still needs, such as education, computers, and research. Letting the South manufacture some products raises its income, so that it can indeed purchase goods and services in which New England remains competitive.

The rise and diffusion of a product follows a pattern modeled as the product cycle. A product is developed in a particular place that has the complex skills and markets to sustain it. Dominating the technology, manufacturers capture the market in their home country, then begin to export. Next the originating manufacturers begin to locate production in other countries, providing local substitutes for imports from their own core plants; other companies in other countries may also take up manufacturing. As the technology becomes standardized, requiring lesser skills, so it becomes easier to copy and diffuse. Production spreads widely, and the originating country ceases to be the cheapest producer.[2] Technological improvements may recapture the product, or the originating country withdraws from production, leaving the product to the developing countries and shifting resources into new products.

This is the concept of comparative advantage: everyone benefits from specialization. The classical formulation took two countries, A and B, and two products, wheat and wine. Country A may be more efficient than country B in producting both, but it will still be more productive with one than the other. The welfare of both countries would therefore be maximized if A agreed to specialize in one product and import some of the other from B. It is to the advantage of prosperous, technologically advanced countries to import products from less developed countries: buying goods from abroad puts money in the pockets of foreigners, who are then able to buy more domestic goods. The exclusion of imports deprives domestic exporters of potential markets and reduces the total output of the nation. To interfere with international specialization is thus to lose optimality.

This concept was developed by the British during the first part of the nineteenth century, when the United Kingdom was the world's dominant industrial economy. It has come to be used as a theoretical standard for all countries: developed and developing countries (and all the different kinds of each), agrarian and industrial, first-generation industrial and third-, fourth-, or n-generation, large and small.

It is also a standard used for all situations, good times and bad. The problem to be solved, it will be recalled, is how to absorb factors of production which have been dislocated by competition. In good times the message is clear: in a growing economy the expanding production of goods and services offered by efficient, competitive producers will absorb unemployed resources. Workers and capitalists can both find new employment because expansion creates demand for their resources. Ceding the production of some goods to foreigners (shoes, clothes, even cars and radios) helps promote the happy cycle, sending ways to generate revenue to those who are thereby enabled to buy more advanced products in which they have no particular advantage. Under these conditions the unemployment caused by foreign competition should be not feared and resisted but applauded and accepted as part of the intensification of the international division of labor, which, like all specialization, increases wealth.

What should be done, according to this model of political economy, in bad times? The classical answer is to let the market do its work, to let competition force readjustment even at the cost of unemployment and business failures. Bad times are part of the process that produces good times. From fruit trees, next year's crop can be increased by skillful pruning this year, and so too from the economy. In good times money and labor are drawn into creating a capacity for production which eventually outstrips demand, but in the meantime the inefficient are rewarded along with the strong. Business cycles knock out the weak and force factor prices back down.

Unemployment caused by shifts in the international division of labor is to the classicists no different from that of business-cycle shifts:

if another country or region can produce goods more cheaply, it can do so because its factor prices are lower, which means that the first country's prices have gone too high. Wage earners and the owners of capital in the first country are expecting too much: if they wish to regain markets, their prices have to come down.

The classical school thus has a policy prescription for a depression: *deflation*, helping the market force down factor prices. In periods of unemployment government should cut spending and cut taxes. It should balance the budget, and at the lowest possible level, to cut costs to business, because when business has fewer taxes to pay, it can allow prices to fall. Resources flow into private hands, and private actors can then respond to the incentives of lower factor costs. The pressure of unemployment will force wages to respond to market forces, and wages will go down. Prices fall to the point where the demand, by investors as well as by consumers, is revived, and the economy starts up again out of its downward spiral.

In commercial policy there can be no question of protectionism, for protection would interfere with the ability of international market forces to increase world efficiency. Currency values, however, must be preserved. For exchange rates, there can be no pure market, because a pure market would eliminate the discipline that avoids inflation. Government must intervene to sustain a fixed parity with gold or other currencies, guaranteeing the predictability of values needed to sustain international trade. With this single exception, interference with market forces, such as industrial policy or socialization, is of course excluded.

This policy stance is *procyclical.* It requires that government move with the business cycle, not against it, and that the disciplinary effects of falling demand be encouraged, not resisted. It admits of no government effort to provide compensation or to smoothe out the extremes of the downturn. Any such effort, it is presumed, will eventually have to be paid for, because it hinders efficiency. Surely deflation exacts costs, in unemployment and forgone profit, but these costs are necessary because the alternatives would cost more. Any reallocation of resources necessarily imposes costs, but it is the market that provides the best cues.

The interaction of many private, self-regarding actions thus produces a collective benefit greater than any that may be fashioned out of efforts to interfere with the market. To allow the market to regulate itself, to avoid using public policy to bring about alternative outcomes, such is the essence of the classical option.

Option II: Socialization and Planning

The classical socialist alternative to the classical liberal position proposes to replace private control of investment by public control and to replace the market by planning. The socialists reject classical liberalism on two grounds, its cost in noneconomic values and its suboptimal economic outcomes.

Capitalism is costly in social terms, the socialists argue, because it rewards only what is profitable to the investor. Other values, including community stability, family, solidarity of work and social relationships, aesthetic goals—a cluster of values that may be summarized as "organic"—are shunted to one side. Capitalism transforms human labor into a commodity. It treats each individual as an object whose social situation depends entirely on whatever he or she is able to sell in the labor market. Individuals must accept whatever wages the market offers for their skills, however weak the demand, however low the sum.

The second line of the socialist critique of capitalism turns against classical liberalism its own prime criterion, that of efficiency. The market, the socialists argue, is wasteful. The sum of particular, private decisions is a range of collective irrationalities: overinvestment chasing the lure of the big financial kill, financial manipulation, advertising. The logic of uncapped rewards to investors produces waste, in luxury goods, in pollution, in waste of natural resources. The privatization of profits goes hand in hand with the socialization of costs; so taxpayers pay for education, roads, and research, while investors get the profits from inventions produced and marketed by their companies. It is difficult to get done those things (health and education services, for instance) which all actors require for the system to work but which are not profitable for any one of them.

The socialist solution to the ills of waste and the damage caused to organic values is nationalization and planning. Nationalization gives the state power; the plan tells it what to do. If the state tries to plan without nationalization, it leaves private investors free to make other decisions. Nationalization without the plan, conversely, may lead to a different version of the market, one where only the identity of the shareholders has changed. In practice, socialized industries can be forced to operate under market conditions, and privately held companies can be forced to operate in a highly planned environment. These are relatively recent nuances, however, for historically planning and nationalization have gone hand in hand, paired features of a thorough rejection of the application of market principles to society, collective decisions, and the operation of the political economy.[3]

Socialism, like capitalism, has changed considerably in the postwar era. The power of the Bolshevik model—centralization in the economic sphere, authoritarianism in the political sphere—has weakened greatly among the socialist parties of Europe. To many socialists now, nationalization and the plan are no longer enough, nor, indeed, are they necessarily primary concerns any more. These democratic socialist reformers argue for democratization in both the economy and politics. In the economy they support industrial democracy, the active participation of workers in the governance of factory and firm combined with decentralization of decision making. In politics these reformers believe in constitutionalist political forms.

What unites the supporters of the socialist option is criticism of the unrestrained free market. Compared to other advocates of government intervention, the socialists support a greater degree of public ownership (especially of the "commanding heights" of the economy) and of centralized planning. Although the market has important functions, it should operate, the socialists believe, within redefined patterns of power and incentives.

Classical Liberalism vs. Socialization and Planning

Nationalization and planning have been socialist orthodoxy and an exact mirror of bourgeois orthodoxy since the last third of the nineteenth century. Where the latter urges that all social arrangements follow the logic of the market conceived as private accumulation, rewarding the decisions of private investors, the former wants to subordinate the market to objectives determined by constitutionally elected governments and, for one branch of socialists, workers' councils.

Each orthodoxy rejects the other, and each economic analysis (and, as we shall see, its political ramifications) requires sacrifices from the other. Both analyses are, in this respect, zero-sum. In times of crisis the bourgeois orthodoxy of deflation insists that the high wages and welfare benefits of the working class threaten profits. Owners of capital are discouraged from investing or even producing because wages and taxes eat up profits and prevent national production from competing with foreign goods. Wages and taxes must therefore be cut. Conversely, the socialist orthodoxy calls for the elimination of the owners of capital. If capitalists are unwilling to raise employment, or keep investment at home, or produce socially useful products, they must be replaced by decision makers who will.

Each position has political implications. In extreme cases, to attain the desired economic objective, it may be necessary to destroy the constitutional system. The deflationists may be tempted to try authoritarian government as a way of destroying labor's ability to resist wage cuts through strikes and its ability to resist reductions in welfare benefits through the ballot box. Conversely, the socializers may seek authoritarian government as a way of breaking private capital's hold on the economy (in particular, its ability to engage in a "capital strike") and of forestalling political moves by capital against labor organizations.

Economic ideologies, in short, carry with them considerable political meaning. They frame the sketch map of political objectives and requirements, of political friends and enemies, of political alliances and coalitions. As we shall see, political goals produce a need for economic ideas that induce coalitions to form in support of them, while economic ideas generate a need for political ideas to produce support. The two may, of course, be in tension.

The two economic orthodoxies of political economy which emerged in the nineteenth century polarized intellectual, political, and social relationships. Proponents of both argued that their view was not group-specific, that society as a whole would be better off if their view prevailed. But both perceived the economy in class terms—the socialists explicitly, the bourgeois theorists de facto. Capitalists and workers formed the group basis of the economy, and investing and selling labor power were the economy's key functions. It was not easy in the nineteenth century, nor is it easy in the twentieth century, for either group to mobilize mass support in a democracy around a pure version of its approach.

Other conceptions of policy posed the economic problem differently and thereby changed quite drastically the political implications of policy solutions. These other views called for "mixed games" instead of games that were zero-sum in relation to class; instead of pitting workers against capitalist, they allowed for compromises and conflicts across the boundaries of class.

Option III: Protectionism

Although liberalism came to embody the essence of nineteenth-century capitalist thinking, it was by no means able to preclude the development of other ideas, and even when intellectually hegemonic, it could not prevent the political triumph of other policies. Protectionism was an older idea, one that had preceded the liberalism developed by Adam Smith and the utilitarians. It had been policy everywhere until the middle of the nineteenth century, when first Britain and then other countries adopted free trade. When the international economy turned sour, in the last third of the century, nearly everybody abandoned free trade; of the large countries, only Britain adhered to free-trade principles, along with a handful of smaller producers such as Denmark. Most nations experienced a revival of economic nationalism that led to the erection of rather high national tariff barriers. So prevalent was protectionism, so willing were the staunch supporters of capitalism to adopt it, that we may call it neo-orthodoxy—the orthodox deviation from free-market orthodoxy which is permitted in times of severe distress.

Protectionism operates most obviously through tariffs, though in the twentieth century countries have been ingenious in finding non-tariff forms of protection as well. Tariffs raise the price of foreign goods in relation to domestic ones. For some domestic manufacturers, those which are high-cost producers in relation to international competition, the tariff prevents bankruptcy. For others, even highly efficient and internationally competitive manufacturers, the tariff provides the stability of a larger, more assured domestic market against which the amortization of extremely expensive investment can be planned.[4]

The boundary between tariffs and other forms of aid is often unclear. Tariffs and quotas both raise the price of foreign goods; so does devaluation of the currency, but it is not usually analyzed as a form of protection. In the thirties, for example, John Maynard Keynes argued that governments could choose one of three options—devaluation, protection, and demand stimulus—and *each one* would have much the same effects. The same is also true, we might add, of various forms of mercantilism, among them overt subsidies, marketing arrangements, regulation, sponsored research programs, and the building of new infrastructure.[5]

Devaluation was a heresy to the classical liberals, as bad as tariffs if not worse. The market could not operate well, the marketeers argued, without a strong confidence on the part of investors in the stability of economic values (profits and costs). Because these relationships are measured through an exchange medium, that medium must above all else be maintained at a fixed parity. This argument speaks against inflation at home, just as it opposes any cheapening of money in the international sphere, where the greater uncertainties of trade require a greater stability of currency values.

Protectionists need not necessarily be advocates of devaluation or of fixed exchange rates. Examples can be found in the case studies that follow of protectionists who supported devaluation and those who opposed it. Devaluation is nonetheless a break with orthodox market doctrine, a type of intervention which arises alongside of tariff protection, and for that reason I have placed it within this typology of policy alternatives.

Another boundary problem in defining these alternatives arises with cartelization. Tariffs and devaluation both provide shields against unstable prices and foreign competition. Cartels provide another, as producers combine to fix prices, share out production by allotting quotas to each company, coordinate sales by means of marketing boards, and make other, similar arrangements, either by direct collaboration among producers or through the medium of government sponsorship. The latter has the disadvantage of allowing government intrusion but the large advantage of providing the authority of the state to enforce rules against those who are tempted to break the agreement (the constant problem of cartels). Mild forms of private cartelization and loosely corporatistic government arrangements may be seen as an extension of the logic of protectionism to the domestic market. More intense versions involve something else—mercantilism, or industrial policy, or corporatism, addressed below.

Protectionism, like any economic policy, gets its justification partly out of formal intellectual arguments, partly out of particularistic self-advantage. Advocacy of the latter often fuels the creative imagination, leading to the articulation of the former. Those who are threatened by foreign competition, for instance, argue that without protection they will be ruined, and often that argument is sufficient—avoiding the ruin of business is widely seen as a legitimate end of government, requiring no further apologia. If this defense is challenged—as it is likely to be by those who are threatened by economic barriers—then other arguments will be necessary.

These come in two main varieties: arguments that work within the framework of economic efficiency, and those which turn to other values. Market theorists have always accepted that some conditions can justify protection. One obvious instance is the situation of infant industries—companies that are just opening their doors and launching the domestic production of certain goods. Start-up costs may create some period of time during which such firms cannot be competitive with older foreign producers, but after that period ends they will indeed be free-standing enterprises, needing assistance no longer. The wider policy implication of this line of reasoning is that selective protectionism may be legitimate if it is for specific products and for limited periods of time.

This line of reasoning has been expanded into a general argument about the special situation of whole countries that are seeking to industrialize in an environment where more advanced economies are already operating. Classical market theorists argue that specialization allows any country to develop its economy fully. Theorists of what was called nationalist economics in the nineteenth century and dependencia in the twentieth argue instead that the environment of the international economic system in which newly industrializing countries operate differs so profoundly from that of the earlier industrializers as to change drastically the character of development. If the newcomers throw themselves open to the world market, they run the risk of their development pattern becoming badly skewed. They may finish by exporting raw or basic materials and importing finished goods without their ever developing the capability to sustain industrial growth.[6]

Several policies may be derived from such reasoning, one of which is protectionism. For the newcomer to advance broadly, in a diversified manner, toward "self-sustained" growth, it needs some period of general autonomy from international market forces. Broad tariffs across a wide range of goods help by promoting the development of a dense network of forward and backward linkages within the national economy. After some considerable period of time the economy may develop the internal strength necessary to compete in a more open world market.

An extension of this argument focuses more explicitly on values other than those of economic efficiency: national strength, national power, national security. Because military strength is related to economic strength, the national economy must provide those capabilities which military strength needs, even at some cost to economic efficiency. In the late nineteenth century it was clear that military power required a great iron- and steel-making capacity, able to build weapons, railroads, and navies. Countries had to have this capacity even if foreign iron and steel were cheaper and could be delivered faster than the domestic market could provide them (whence stemmed the mercantilist justification of a state role even more active than sheer protectionism). More generally, imports might become difficult in times of war, and military planning therefore required advance consideration of which products should receive state policy directives in order to guarantee self-sufficiency for the nation.[7]

Military arguments were also made in support of agricultural protectionism. Food in wartime would surely be one of the most vital products in which to be self-sufficient. To many, moreover, and particularly to political conservatives, peasants and agricultural laborers made better soldiers—more suited to obedience and discipline, less ridden by disease and malnourishment, and radical political ideas, than their urban, industrial brethren. Agriculture could also draw strongly upon nationalist sentiment that defined the collective identity in attachment to the soil, to a specific, traditional, pastoral way of life.

One important characteristic of protectionism, vital to our understanding of the politics surrounding it, is that protectionism keeps the state's involvement in the economy at a distance: although the purity of the market has given way to government interference, that interference still works directly through the marketplace. Government action changes the structure of incentives through action on prices, but the state does not seek to change the way that economic actors respond to incentives. And though the market is affected by tariffs and devaluation, the government itself adheres to the traditional standards of household management: a balanced budget, a limited state, and restricted powers.

The relationship of protectionism to classical liberalism as a policy alternative is thus double-edged. Of the various policy alternatives available, protectionism is the most legitimate, the most orthodox in relation to the capitalist ideal. Though it deviates from that ideal, it does so less than other possibilities do. It can be understood as a second-best option, one for which a logic and theoretical underpinnings can be elaborated, without too much difficulty, inside the framework of capitalist economics. At the same time, of course, it does interfere with the market, and hence with the centerpiece of capitalist thinking. And the political-emotional charge of orthodoxy has been very intense, particularly, as we shall see, in the interwar period. Deviation from the ideal was understandable but a sign of weakness, of underdevelopment, of lack of maturity—it was something that only banana republics and emerging economies did.

The second interesting political element of protectionism is that it avoids a zero-sum political game with respect to the class divisions of society. In economic terms it pits domestically oriented producers against internationally oriented ones, and this is by no means a cleavage that brings capitalists and workers to confront each other. Rather, it joins the two groups together in conflict against another cross-class coalition. As an argument with a noneconomic base, moreover, protectionism is also able to appeal to ideals and emotions such as nationalism and national defense, which cut across class and other economic cleavages. Protectionism is not unique in this respect, but as an argument it combines the smallest deviation from capitalist orthodoxy with a substantial degree of collective, nationalist appeal. It is an argument that can be taken up by people at different points on the political spectrum, and it can be advanced in many different political contexts.

Option IV: Demand Stimulus

The fourth policy package, demand stimulus, is the most recent to have been theoretically elaborated, as it was worked out in the 1930s.[8] After World War II demand stimulus became so prevalent that it replaced classical market doctrines as the reigning orthodoxy of political economy among political decision makers, though perhaps not among managers and owners in the private sector. This political prevalence is what made demand stimulus vulnerable to the various economic shocks of the seventies and eighties; the doctrine now is paying the price of incumbency, being blamed for whatever goes wrong.

Demand stimulus consists of deficit spending by the government in order to prime the pump of a stagnating economy. Keynes's theoretical formulation stressed the insufficiency of the attention that market orthodoxy paid to the problem of demand. Keynes argued that equilibrium could be reached at a point considerably below the full employment of resources. In a deep business-cycle downturn, unused capacity grows. New investment is discouraged no matter how cheap money becomes (that is, no matter how far interest rates fall), because there is little point in building new capacity when so much old capacity is still available. The problem is thus not too little capital, as the classical school argues, but too much capital and too little demand. Keynes saw savings as plentiful, not scarce. The dearth was on the demand side: those who were willing to buy goods had no money. In this liquidity trap the economy could stagnate for many years. In the long run, as the classicists said, the economy would right itself, but, as Keynes's celebrated riposte noted, "In the long run we are all dead."

The proper response to severe stagnation was to reflate the economy by means of government deficits. Spending in excess of receipts would pour currency into the economy, increasing the demand for goods. Through a multiplier effect this spending would work its way through the economy, raising the overall level of demand, thereby triggering a beneficial, upward spiral of demand, leading to sales, leading to profits, leading to new incentives to invest. If this increased government debt, then so be it: the critical indicator was not a fixed policy norm but wealth, wealth defined as growth of gross national product (GNP), fall in unemployment, greater use of resources. Keynes "desanctified" policy instruments, turning them back into mere instruments again, into tools to be used to achieve economic goals rather than ends in themselves. Against the charge that their tactics would cause inflation, the demand stimulus theorists stressed the tremendous underuse of capacity in the economy. Not until full employment arrived would government budget deficits cause inflation or bottlenecks in production.

In some versions of demand stimulus, such as the ideas developed in Sweden during the 1920s, the notion of budget balancing was retained as a virtue but was "stretched out"—budgets were to be balanced over a longer period of time, in essence the rise and fall of the business cycle. In prosperous periods the government would run a surplus, building up reserves; in the downswing those reserves would be tapped for public works, thereby combining the production of useful public goods with the stimulus of deficit financing. Over the whole cycle the budget would be in balance. In practice, however, hardly any governments build a surplus during the good times.

Demand stimulus in the postwar era has been associated with the name of Keynes, but it has a healthy range of forebears; indeed, it was tried as public policy before Keynes published his famous theoretical elaboration, *The General Theory,* in 1936. A number of intellectual and popular traditions in Europe included notions of "underconsumption," an idea that stressed the maldistribution of income. Concentration of wealth left the mass of population unable to buy the output that modern production techniques made possible. Tremendous poverty limited consumption to basics (food, clothing, and housing). No income was left for products of higher quality, for newer products, or for the range of consumption goods that the factories of the industrial world were pouring onto national and international markets. Poverty was thus a limit on profits. If the poor could not buy, they would not stimulate the flow of profits leading to the incentive to invest, leading to employment, leading to the ability to buy goods which contributed further to the happy spiral. Some observers, John Hobson notable among them, believed that this tension led to imperialism, as the capitalists sought profits abroad instead of granting the higher mass purchasing power that would develop growth at home.[9]

Other ideas supported not only the redistribution of income but the notion of government spending to promote employment, public goods, and the general welfare. On the side of conservatives, European countries had long traditions of *noblesse oblige,* of elite responsibility for the welfare of the community, even its least important members. Bismarck and Disraeli represent two politically different versions of this notion, and their counterparts can be found in a wide range of doctrines and political contexts. On the side of radicals and liberals were other traditions that proclaimed the equality of all believers, the democracy of the primal community, the rights of the individual, the nobility of the worker, the claims of class and group. Public spending for socially useful projects, which also helped generate employment, has existed since the beginning of recorded history.

Like other policy packages, demand stimulus comes in many versions. Spending can go in quite different directions, to military or consumer goods, to government purchases or transfer payments. And budget deficits can be more or less intentional, more or less managed.

In contrast with both orthodoxies, classical liberalism and classical socialism, but similar to protectionism and mercantilism, demand stimulus has the capability to slice across class boundaries. It defines a collective game between labor and capital. Like all the options except mercantilism, it shies away from microeconomic issues. It does not call for interference with or even consideration of the internal organization of firms, markets, or industries. Demand stimulus at its core is a broad policy instrument, focusing attention on levels of aggregate demand.

Option V: Mercantilism

"Mercantilism," as I use it here, means state action in aid of specific industries or even specific firms.[10] Such action can take various forms: subsidies for individual firms, legal regulation of markets (through production quotas, price fixing, manufacturing standards, price supports, or marketing boards), reorganization of companies or industries, regulatory agencies for companies or industries, credit allocation, foreign marketing arrangements, and government purchases. Unlike other policy options, mercantilism can intervene at the microeconomic level, the level of the specific firm. The other policies operate at the level of the market; mercantilist policy, by contrast, concerns itself with problems of organization and of industrial structure.

Mercantilism is an old label with a historically specific meaning that is more restrictive than its usage here. In the seventeenth century it was linked to a bullion view of wealth. There was a fixed amount of wealth in the world, the argument went, states sought to get as much of that wealth as they could, and active state policy to create productive capacity as well as military capability was the best way to do so. Mercantilism thus predates laissez-faire capitalism as a theory of political economy. Indeed, it was mercantilism against which the theorists of the market economy, Adam Smith among them, railed in the eighteenth and nineteenth centuries; it provided the focal point for their arguments against the costs to optimality of the favoritism, corruption, and mistaken self-confidence to which they thought mercantilism inevitably led.

Despite their criticism, however, the policy has never disappeared. It began in association with luxury goods such as Dresden china, French tapestries, silks, and other textiles, and with military goods such as firearms, cannon, uniforms, and other war-related products. It continued through the nineteenth century as a way of doing important things quickly. British and some French railways may have been built privately, but most Continental railroad construction resulted from an act of state, either indirectly through financing or directly through government-owned companies. Military production has generally taken this form everywhere.

In the twentieth century mercantilism has taken other forms and other labels. Wartime production boards sprang up everywhere during both world wars. In the interwar period many countries tried a sort of mercantilist corporatism; the American National Recovery Administration, for example, sought to fix prices, standards, and production quotas, and industries have been regulated everywhere. Since 1945 the government's policies toward the condition of specific industries have increasingly come to be called *industrial policy.* The French distinguish between indicative planning, referring to informational elements, and industrial policy, referring to more explicit financial subsidies and organizational interventions. Japan has become famous for industrial policy, to which many ascribe the Japanese postwar boom. In the United States public and private officials deny that an industrial policy exists, yet to foreign and domestic observers alike it is plain to see in numerous mechanisms, from defense contracts to regulated industries, tax breaks, and research grants. It has existed since the days of public works at the beginning of the Republic, through the massive land grants to private railroad companies in the nineteenth century, to the research and defense contracts of the present day.

The concept of mercantilist policy need not be restricted to industry. In the 1930s nearly all countries adopted for agriculture such measures as price supports, production quotas, marketing boards, storage schemes, and education, training, and research programs. Some of these measures predate the 1930s (one thinks especially of land grants to agriculturally oriented universities, agricultural extension services, and health-related inspection schemes), and nearly all countries continue them down to the present. Even the budget-slashing British and U.S. governments of the 1980s have touched agriculture least of any interest.

The rationale for mercantilist policy is that the market by itself is inadequate to the economic task at hand. The reasons for this inadequacy vary. They include highly complex, expensive, perhaps unstable technology, carrying too much uncertainty about profits to support investment; a need for speed, as with defense production; structural inadequacies, where the rationality of individual gain leads to outcomes insufficient for the collectivity; and individual or cultural inadequacies, where private decision makers lack the skills or the intellectual outlook to make effective decisions.

The last point is often raised when it is argued that national capitalism is somehow defective. Entrepreneurs, the class of capitalists, may hold a set of ideas derived from earlier experiences, ideas that are no longer suited to contemporary economic needs. In France, for example, it has been argued that traditions derived from the aristocracy, the importance of land, and the mercantilism of Louis XIV and Colbert together produced an economic culture highly averse to risk, highly concerned with stability of market share and survival of the family firm, a culture in conflict with twentieth-century needs for rationalization of production and management, for the virtues of growth, for mass production on a high volume and low markup. What enabled the French economy to do so well after 1945 was the active intervention of the state in reorganizing the economic structure of several industries and replacing individuals who dominated the major economic levers of society with growth-oriented, dynamic modern managers.[11]

A recurrent theme in the justification of mercantilism is the specific problems of capitalism in different national situations. In Japan, for instance, mercantilism is seen as a response to Japan's acute backwardness at the time of its insertion into the world economy. In general, the argument holds, the later the industrialization in relation to others and the more backward the society when industrialization begins, the more inadequate are private forces or society as a whole to achieve modernization and the greater is the need for the state to play an active role. (Alexander Gerschenkron, Immanuel Wallerstein, and others have developed for us a set of propositions about this historical relationship among the timing of industrialization, the evolution of the international economy, the degree of backwardness of civil society, and the institutional and political base of the state.) Entering the game rather late, Japanese elites used the state to promote growth in ways that the market or straight protectionism could not have done. With a careful, complex policy that mixed the pressures and inducements of market forces with state planning, analysis, incentives, and penalties, Japan built up a highly diverse, advanced economy. In the twentieth century the country has come to exemplify the practice of contemporary mercantilism.[12]

Mercantilism requires very complex institutional mechanisms compared to the other policies (with the exception of the socialist alternative). The selective targeting of rewards and constraints requires an institutional machinery capable of making discriminations. If they are to reward winners and compensate losers, governments need to be able to figure out which are which. If government is to avoid conflict by organizing prior agreements, it must have the consultative mechanisms needed to do so. And if it is to enforce agreements, it must have regulatory powers. As the literature on democratic corporatism shows, the institutions devised to perform these tasks differ considerably from country to country.

In mercantilism, as in the other options, both form and substance affect the politics of policy quarrels. Policy alternatives stimulate controversy over their immediate content, that is, over who is helped or hurt. They also stimulate controversy over the effects of the mechanisms of implementation on the distribution of power in society, that is, over how they are to be carried out.

The Five Policy Options

To permit comparison across countries and across time periods, I have outlined five policy packages: (neo)classical liberalism, socialization and planning, protectionism, demand stimulus, and (neo)mercantilism. These packages differ in the policy prescriptions that they make for dealing with major stresses in the international economy, and they provide different answers to a common set of questions. What is the source of the problem, and what can be done about it? Who wins and loses from each policy, and who are thus potential allies and opponents? What institutional requirements are there for the implementation of the policy, and which patterns will thus be rewarded and which will cause controversy? These questions and themes that they raise have helped organize the case studies in subsequent chapters.

During any of the three crisis periods countries were, from an analytical point of view, free to adopt any one of these policy alternatives. As we shall see, however, countries, like individual decision makers, rarely canvassed all five possibilities at each moment of choice. Debates generally focus on two or three options in each period, although in each period all five positions had their advocates everywhere. To explain the choices that were actually made, then, we need to know something about power, about the resources available to advocates in the policy debates. The second section of this chapter examines the varying explanatory approaches available to us for exploring the linkage between policy position and power.

EXPLAINING POLICY CHOICES: SOCIAL COALITIONS, REPRESENTATION, AND THE STATE

There is a famous story about the Hawley-Smoot Tariff Act of 1930 which bears repeating. About a thousand economists, virtually the entire American community of professional economists at the time, signed a petition opposing the tariff on the grounds that it violated the principle of comparative advantage and thus hurt the general welfare. Congress ignored their advice. Hawley-Smoot raised tariffs on virtually everything manufactured within the United States, and a distinguished political scientist, E. E. Schattschneider, wrote an important book on role of interest groups in bringing the act about.[13] Economic theories prevail, the story tells us, only when they have mobilized political authority, that is, only if those who believe the theories get the resources that enable them to take authoritative action.

To explain economic policy choices, we need to link policy outcomes to politics. Our explanatory approaches must have some way of accounting for the connection between policy and choice—between what could be done and the various factors that shape what decision makers actually choose to do. I have simplified the vast universe of theories provided by modern social science into five families of argument. The *production profile* explanation stresses the preferences of societal actors as shaped by their situation in the international economy and the domestic economy.[14] The *intermediate associations* explanation stresses the role of such organizations as political parties and interest groups in linking social preferences to state institutions.[15] The *state structure* explanation stresses the role of formal institutions, bureaucracies, and rules in mediating interests and, indeed, in defining both interests and intermediate associations.[16] The *economic ideology* explanation stresses the role of perceptions, models, and values in shaping the understandings of economic situation and political circumstance which influence preferences and behavior.[17] Finally, the *international system* explanation stresses the impact of war, security issues, military procurement, and other elements of the state system in shaping economic policy.[18]

Each of these families of argument is sketched out briefly in this chapter, and together they shape the later presentation of material on the three crisis periods and structure the explanatory debate. At this point some readers may want a full elaboration of each theoretical approach. I have not provided one, however, partly because the relationships among the arguments are historically grounded and change from period to period, situation to situation; and partly because I believe that too much attention to theory before exposure to at least one case distorts the interactive way in which most people absorb and reflect on material. Thus I present a short version of the different explanatory approaches here and later probe their characteristic strengths and weaknesses in historical context.

The Production Profile Explanation

The production profile explanation concentrates on the preferences of societal actors as shaped by the actors' situation in the international and domestic economy. In an interpretation of policy making centered on interest groups, economic actors, whose preferences are shaped by their economic situation, apply pressures on governments. Desirous of a particular policy outcome, these actors form coalitions, involving bargains and tradeoffs, to mobilize the consent needed to prevail. Politicians act as the brokers of such coalitions, thereby having some impact on the shaping of the outcome. The options available to politicians turn on the pattern of social wants, and so to understand these options, it is vital to have a social "map" of the society with which politicians deal.

This mode of reasoning is a venerable tradition of political economy, and it exists in many versions. Between social pressures and policy outcomes are many steps dealing with the way these various traditions conceptualize society and the connection between societal actors and power. Where much of the literature examines pressure groups, I consider *societal actors* first and come to pressure groups after. Where much of the literature considers either very large aggregations (labor and capital) or very small ones (individuals or firms), I focus on a middling disaggregation (or aggregation), *sectors* or *branches*. Where many look at organizational forms of groups, I consider the *content* of the situation and preferences of groups. And where many look at the domestic situation of economic actors, I focus on the *international* context of their situation.

When questions of public policy arise, the people affected by the decision to be made surely ask of any alternative, *Qui bono?*—Who benefits, and how will it affect my own situation? The answer to that question has a powerful effect on the policies that people prefer. What people want depends on where they sit, as theorists have argued since long before the time of Bentley and Marx.[19]

My interest here is in how countries respond to changes in the international economy. If we are looking at the policy positions that domestic actors take toward the international environment, then it makes sense for us to consider the situation of actors in that economy. Society may be disaggregated in two steps: first, between business, agriculture, and labor; and then, within each of those three broad categories, among sectors or product families (for the first two) and type of employment (for the third).[20]

For business, five main considerations appear relevant in shaping attitudes toward economic policy. The first is competitiveness in the international economy. Economic actors at the cutting edge of international competition are likely to support policies that promote open trading, not only for their own products but more generally for intensified specialization in international trade. Actors less well placed in international competition are more likely to support protection or modes of shelter or subsidy.[21] The second is vulnerability to fluctuations of demand. Economic actors exposed to wide and wild gyrations in market conditions are likely to want policies that shelter them from such swings. Companies with massive capital requirements, such as steel in the late nineteenth century, or oil in the 1930s, or mass-production industries in recent decades, may support tariffs or other government interventions that stabilize markets and allow more orderly planning of debt amortization.[22]

The third main point for business to consider is the role and character of labor needs. Industries requiring large numbers of relatively low-skilled workers will have intense conflicts with labor over wages, union rights, and social services. Industries that need fewer workers or a more diversified labor force may have an easier time accommodating labor demands.[23] The fourth point is the source of demand. The producers of mass-consumption goods have a concern for macroeconomic conditions, in their case the ability of the public to buy, quite different from that of the producers of capital goods who sell to other companies or to governments.[24] Finally, the structure of capital markets is important. Banking is an industry with its own sources of profit. Bankers' situation varies according to type: banking systems oriented toward commerce, capital flows, and reserve currency management are likely to be strongly internationalist, while industrial bankers are likely to split according to the situation of the industry to which each bank is allied.[25]

These various considerations do not necessarily converge to define a business situation in the economy: high labor costs may push one way, a desire for strong purchasing power for labor another. Other variables may have relevance; one need think only of industrial organization and marketing systems, for instance. Nor are these factors easy to operationalize. Nonetheless, to bear these considerations in mind will be of some use when we observe the preferences and political behavior of business in policy debates.

If the business category embraces manufacturing, trade, marketing, and finance, then the land embraces the rest. Like business, agriculture can be disaggregated, and two dimensions are important for our purposes. One is the market for products in terms of the buyers. A distinction can be noted between the world market for commodities (such as grains, cotton, tobacco) and more localized, urban industrial markets for high-value-added products of direct consumption (meat, dairy products, fruit, vegetables). Commodity producers conflict with the industrial economy over the terms of trade for their products; consumption producers do best as rising industrial incomes allow more people to consume more of more expensive products. The other dimension concerns the organization of production and adaptability to market changes. Between the agriculture of large estates (landowners with masses of laborers) and the agriculture of the family farm (owner-proprietors) lie many possible combinations. Some prove to be more rigid than others, less adaptable when swift changes in the international economy threaten organizational forms.[26]

The third term, labor, the sellers of labor power in the marketplace, can also be divided up. Two considerations are particularly noteworthy. The first is the scale and character of the enterprise and workplace. Those who work in large-scale, relatively standardized industries, on the one hand, and those who work in highly particularized, fragmented industries, on the other, appear to have different proclivities. Usually, the former are more likely to unionize, and as we shall see, the presence or absence of labor unions makes a considerable difference to behavior.[27] The second consideration for labor is the situation of the enterprise in the international economy. Workers employed in sectors at the cutting edge of international competition are likely to have attitudes toward policy issues different from those of employees in factories whose competitive position is deteriorating. All of the factors that influence business policy preferences are likely to affect those of labor as well.

Business, agriculture, labor—the definitions of these three elements can spread to embrace all of society. Of services, retailing, and the professions modern social theories have made much, but for our purposes, these are likely to resemble banking in that their situation is a function of how they relate to other elements of the economy. This treatment is surely unsatisfactory, but it will have to serve, because for analytical purposes, the modern economy could be disaggregated endlessly.

Our interest here is in policy preferences and political alliances. The behavior of economic actors is affected by preferences, and these in turn are affected by situation. The interaction of preferences and situation involves reciprocal effects as well as direct ones: tariffs on grains raise costs for industrial producers because they are then pressed to raise wages, which hurts the producers' competitive position. Agricultural producers buy industrial products and so prefer cheap goods, but they sell on industrial markets that need income to buy agricultural produce. Thus identically situated actors may adopt different policies depending on the preferences of other actors in the political system of which they are a part—workers in cheap-food countries and those in high-cost-food countries may think differently about tariffs.

So far, we have identified some categories of societal actors and some characteristics of their situation in the international economy which are likely to affect their policy preferences. These distinctions will allow in the historical case studies a systematic approach to sketching out the trajectories of alliance formation and the policy packages that go with them. Between sketching these trajectories and accounting for policy choices, however, quite a number of steps remain. Knowing preferences and coalitions is not the same as knowing power. Controversies turn on this point. After all, reductionism, by which I mean the reducing of politics to something else (here societal preferences), is at heart the overlooking of the question of transformation, of how preference through power becomes policy. Circularity is easy: advocates of the successful policy had the power because they won, and we know that because if they had not had the power, they would not have won.[28]

Where does power come from? In a significant way power is linked to economic situation; it *is* empirically circular. Economic situation arises from the functions that groups play in the economy. The economy operates by means of these functions—investment, management, labor, buying, professional services. Individuals and groups perform these functions, and power depends on the importance of the function to the economy and the resources that control of the function provides. Thus transportation workers and employees in power plants have far greater power over certain matters than do unskilled laborers, button makers, or dry cleaners. Control of capital, management of large corporations, practice of vital professional services such as medicine, all involve distinctive and considerable forms of power. Governments may chose a policy only to have economic actors reject it in the marketplace, thereby forcing a change in policy direction. The experience of the French Socialists, described in Chapter 5, provides one recent example of this process.

The people who actually perform each of these functions, vital to the economy, can be called societal actors.[29] I use this label in preference to the more frequent "interest group" or "class." Interest group generally refers to the associations that represent the functions (unions, business associations), but functions and institutions (or structures) are not the same. Capital, for instance, is a force independent of any association of investors; it does not take an association of investors or of speculators for capital to flee a currency when devaluation is feared. Although organization certainly does matter, it is not the same as function. Class directly expresses a type of function; the simplest formulation distinguishes between owning and managing capital on the one side, selling labor power on the other. This distinction is real but too general; there are too many conflicts among members of one side of the term, too many intraclass conflicts, for class to be analytically useful in many situations.

In sum, then, to explain a country's policy choice requires us to do some mapping of the country's production profile: the situation of the societal actors in the international economy, the actors' policy preferences, their potential bases of alliance or conflict with other forces, and the coalitions that emerge. When countries converge (or diverge) on economic policy, they are likely to do so because of the similarity (or difference) in the pattern of preferences among societal actors.

This line of reasoning has great power, because it calls our attention to an obviously important element in the political sociology of economic policy—the preferences of major societal actors in the economy itself. Yet the production profile approach also has difficulties. The danger of circularity has already been noted. The ambiguity of interests causes problems: preferences may derive from situations, but what if situations are unclear? Also troublesome are the roles of organizations (interest groups) and institutions (state structures): who or what connects preferences to actual policy outcomes, and how do these organizations and institutions mediate the process of "aggregation"? Finally, in the international sphere, alongside economic factors are political-military ones, the problems of security and rivalry. The problems of the economic interest approach thus lead to several other types of argument, which may solve many of the problems that the approach poses.

The Intermediate Associations Explanation

Functional position in society confers considerable power on societal actors, but position alone is often too blunt an instrument to achieve results. There are many other ways of shaping decisions, from influencing elections to lobbying, and these take organization. Between politicians and societal actors lies a vast network of associations designed to represent societal actors and to handle the linkages between government and society.[30] Political parties manage the presentation of choices to the electorate and the translation of those choices into policy. Interest groups manage the evaluation of options, the articulation of opinions, the mobilization of collective action, and a variety of functional tasks, some in the economy, some conferred by the state.

Such organizations have an effect upon policy which can be understood as autonomous from the individuals, groups, or forces that they represent. As Michels and other theorists have observed, parties and interest groups, in mediating the preferences of societal actors, acquire their own identity, their own existence, interests, perspectives, and concerns; they thus have their own impact on policy. Another problem is the ambiguity of interests. In Weimar Germany, for example, the fragmentation of the party system contributed to policy stalemate. In contemporary France the influence of the Communist party among trade unions contributed to François Mitterrand's decision to nationalize industry.

Countries differ in a variety of ways concerning their representative associations, and these differences have been used to devise whole theories of policy and politics. Particularly important are the linkages between interest groups and parties, the degree of centralization or dispersion of policy networks, the intensity of corporatist structures, and the internal organization of parties and interest groups. Other differences pertain less to systems than to the particularities of each party or group; they focus around ideology, leaders, and specific historical experiences.

The strength of the argument based on intermediate associations lies in the importance of organization for translating preferences into effective action. Associations obviously warrant our close attention. The difficulty for the argument is the problem for any mediating variable—its effects require linkage to the terms on either side, to society and to the state.

The State Structure Explanation

Societal forces and representative associations must act through the state to attain policy objectives. The structure of the state, its rules and institutions, can therefore have a very substantial effect on outcomes.[31] Rules shape the process of aggregation, and different rules favor different mixes. In fighting for tariffs, for example, the Junkers were favored by the three-class voting system of Prussia. Proportional representation in Weimar Germany, federalism and the separation of powers in the United States, the dual executive of the French Fifth Republic are all examples of rules that can affect the distribution of power. The institutions of the state—the bureaucracy, instruments of coercion and intervention, the judiciary, and so on—all affect the possibility of authoritative action. The powers and skills of the officials who occupy positions in these institutions allow them to aid one side or another in policy quarrels and to take the lead in mobilizing pressure and shaping opinion.

Countries obviously differ in the character of state structure, and policy similarities (or differences) among them derive from the similarities (or differences) among their state institutions. Arguments of this sort draw our attention to the differences between authoritarian and constitutional regimes, between centralized and dispersed systems, between highly developed bureaucracies with wide-ranging instruments of intervention and poorly developed or loosely integrated bureaucracies with limited modes of intervention, and, eventually, between "strong" states and "weak" ones.[32]

In pursuing the politics of policy formation, we began with a portrait of societal actors, then moved to the associations that represent them, then to the state institutions through which they work. The three elements clearly interact. Institutions and policy shape organizations, as the laws governing industrial relations indicate. Associations may shape the understanding that societal actors have of their own economic situation, and they may also play an important role in defining options. Many analyses collapse the three elements into two—a pattern of societal forces, and a pattern of associations or policy networks that mediate between state and society. Such simplification has virtues, but it has its costs as well. In constitutionalist systems, and in most authoritarian ones, society and the state have some autonomy from each other, and there must always be mechanisms for linking the two. These mechanisms remain distinct. State institutions, intermediate associations, and societal actors move somewhat separately. At times societal actors abandon the intermediate associations that seek to represent them; at times state officials bypass intermediate associations and turn directly to societal actors for support, while at other times they may use the associations to control society; at times social revolts run roughshod over both state institutions and longstanding intermediate associations. There is, therefore, some analytic utility in keeping the three as distinct categories.

The state structure explanation derives its force from the effects that decision-making mechanisms can be shown to have on the actual outcome of the aggregation of societal preferences and the lobbying of interest groups and parties: if society and associations are held constant, then different rules and institutions produce different outcomes. The weakness of the explanation is the great role it assigns to context. Just how rules and institutions produce varying outcomes turns on whom they affect, on the identity of the groups, with particular preferences and resources, that seek to work through the state. Rules and bureaucracies favor one side or another; state agents may shape social structure and representative associations. Rules can be changed, bureaucracies created or dismantled, authority generated or demobilized. The same institution can be used for quite varying purposes, as the example of German bureaucracy under the Nazis makes clear. Thus the impact of state structure, however great, cannot be shown independently of some understanding of the society it is meant to effect.

The Economic Ideology Explanation

Societal actors, I suggest, evaluate an economic crisis in terms of their own situations in the international economy. But often those situations are by no means clear. There is considerable ambiguity about economic reality, and ambiguity permits different interpretations. Different understandings or models of a situation shape to different ends calculations of the costs and benefits of action, its opportunities and disadvantages, and hence of behavior. Economic ideology may shape political calculations as well, by influencing understandings of who the actors are, what they want, and what they will do.

Countries have varying traditions of economic analysis, not only among specialized elites but more broadly in the population. Some have traditions of active government involvement to promote economic development; others emphasize laissez-faire. In some countries traditions of free trade are strong, unemployment is feared, and social services are accepted. Other countries are protectionist, fear inflation more than employment, and dislike social service systems.

The economic ideology interpretation of economic policy choices explains outcomes in terms of national traditions and values concerning the economy. Its strength lies in the reality of ambiguity. To the extent that economic reality is uncertain—which in real life is nearly always—cognitive elements affect decision making. The difficulties of the approach lie with comparisons with the rapidity of change. To compare countries in crisis is to suggest that similar traditions have supported different outcomes, different traditions have supported similar outcomes. Rapid changes within countries, moreover, such as the Junkers' Germany from 1872 to 1879 or the United States of Coolidge contrasted to the United States of FDR, undermine arguments that, like those of the economic ideology approach, stress constants over time.

The International System Explanation

Arguments that explain policy or politics by pointing to factors internal to a country are, in Kenneth Waltz's apt phrase, second-image explanations.[33] It is quite clear that the effects of the international environment run in the other direction as well. The third image, that is, or the international system, has a strong influence upon the factors that comprise the second image, or the domestic system. Hence it is important to reverse second-image reasoning and examine how international phenomena influence domestic ones.[34]

Two sorts of theorizing about the reverse of the second image can be distinguished; one stresses economics and the impact of market power, the other stresses political-military rivalries and the impact of force. The work of Gerschenkron and dos Santos, Cardoso and Wallerstein, illustrates the first approach;[35] that of Otto Hintze provides a classic example of the second.[36] The political economy school examines countries' differences in relation to their position in a sequence of international development. Thus Gerschenkron developed the concept of early and late development to distinguish the roles played by the state in Britain, Germany, and Russia: the later the timing of development, he suggested, the greater was the importance of the state in economic development. The reason lay in the problem of competition. Development, Gerschenkron argued, is not a repetition of the same pattern, as W. W. Rostow and many Marxists have suggested, but rather a historical sequence of cases, because the existence of competitors changes the environment for those who follow. Development thus is like a market in that it rewards and punishes certain economic and institutional forms according to their utility in a process that is constantly changing.

Military theorizing at the system level examines the impact of war and preparation for war on the distribution of power in society. Hintze contrasts Britain and Germany, navies and armies, arguing that because armies allow for domestic intervention in ways that navies do not, the army tilted German development toward authoritarianism in a way inconceivable with Britain's navy. French centralization derives from the wars of Louis XIV, the Revolution, and Napoleon; the American state emerged with the Civil War and then World War II and the Cold War. As countries are drawn into military rivalries, in sum, they develop military machines that alter their political systems.[37]

The strong form of this type of theorizing, whether it concentrates on political economy or the military, sees the international system as totally constraining, leaving little as to choice for the units within it. In the dependencia literature, for example, country development is tightly constrained by the country's placement in the system, and nations have little choice over what to do. Those in the process of developing buy and sell in markets dominated by far richer and more powerful core countries. As a result, their development trajectories are shaped by the core countries, not by their own choices.[38]

It is not hard to find fault with the most sweeping versions of this argument. Rarely is international situation so perfectly clear, so totally unambiguous, as to be so completely constraining, rarely is there no range of alternative responses. Generally, it is clear, countries do have some choice over how to deal with their position in the international system. They may make alliances with one country or another, promote import substitution or commodity exports, stress agriculture over industry or vice versa, give free rein to foreign economic activity on their soil or seek to mediate or even control it. Such decisions require explanation that cannot come from the international system itself. Nonetheless, the line of reasoning based on study of development patterns captures important points. Sweden's divergence from German patterns of development, for example, was certainly affected by the limits that its small size imposed on autarkic or imperialist opportunities. The development of democratic corporatist elements in the small countries of Europe since the 1930s is certainly linked to the narrower tolerances that the international system allows those countries.

The issue, then, is not whether the international system shapes domestic politics but how and through what mechanisms. Unless the international situation is completely coercive, as may be case with foreign occupation, countries do have choices. The selection they make from among those choices depends on domestic politics, on the distribution of power within countries and the various factors that influence it—societal forces, intermediate institutions, state structure, ideology. The international economy affects national policies by acting upon domestic actors. As the international price of wheat falls, for example, it stimulates domestic producers to seek tariff protection or some other form of subsidy. As opportunities for export grow, on the other hand, other producers come to favor open international regimes. The system may be international, then, but in terms of national policy the effect of the system is felt through actors operating within the individual nation. Foreign companies may coopt comprador elites, but the more important point is that they have to find someone to coopt.

This book is about the impact of international crises upon domestic policy. To unravel that impact we must, according to the reasoning just formulated, examine the responses of domestic actors. Effects from the international economic system I therefore include in the first of the types of argument examined above, that of societal actors. International political-military effects do not appear directly in that category, however, and I shall consider them separately as a fifth line of analysis. As we shall see, international security concerns also operate through domestic actors and also impose some considerable objective constraints. Clearly Sweden can never defend itself in the same manner as the United States can. Nonetheless, Norway belongs to NATO but Sweden does not; interpretation varies by country as to what is appropriate behavior. Thus we need to consider the effects of international security considerations on domestic politics.

Security issues and domestic politics are linked also by the connection between military spending and economic policy. Ronald Reagan justifies U.S. budget deficits in part through reference to the imperative of defense. Victorian Britain's support of free trade has been explained by some through reference to the preeminence of its navy, which provided the security that allowed the country to depend on foreign food and markets.

Relationship among the Explanations

Factors that plausibly may affect policy outcomes are legion, and the five summarized above could easily be expanded in number. The difficulty lies in establishing the relationship among them. The testing of alternative explanations and specifying their relative weights, a model derived from the physical sciences, cannot be used here, because satisfying the conditions of experimentation is impossible. So my task must be different. It is to clarify the nature of different arguments, their logic, and their internal characteristics. Then, having gathered the sorts of evidence appropriate to each explanation, I examine events from the arguments' points of view. At that point it becomes possible to clarify the relationship among the arguments, by careful patterning of comparisons among the cases. By judicious, focused comparisons, by select pairing of country behaviors, it is possible to obtain some leverage on the choice of policy outcomes.[39]

The relationship among the variables is not a constant. Relationships alter with circumstances and with periods; that is, they are not theoretical but sociological. The world changes the balance between ideology and force, between institutions and economic interests.

Each historical case study starts with the relationship of societal actors within countries to the international economy. Economic changes do affect economic actors, of course, and, moreover, I found strong support for the approach in looking at the first case, the late nineteenth century. I then became interested both in how well the argument would work for later cases, and in what happened to the relationships established in that crisis as the economic environment developed.

By giving pride of place to explanation based on international economic situation, I have both privileged and disadvantaged it. It is privileged because the ranking suggests priority of attention, but this priority also disadvantages it, because priority will attract criticism. Valuable books could be written to tell the same story beginning not with the international economy but with ideology or with the state. Wherever the story begins, though, there the attacks will be sharpest, for the first point can always be shown to be underdetermining.

I shall specify at the start, therefore, that ultimately all the arguments presented here are underdetermining. The historical reality of each case is too open, too uncertain, too plastic to sustain the reductionism involved in tracing outcomes back to one feature or even one combination of features of the system. Crises are particularly plastic—indeed, that is what makes them interesting. It is why I have chosen to focus on them rather than on the patterns of stable systems. Just how the elements that shape policy choices actually combine in a given historical situation turns on conjunctural variables—leadership, entrepreneurship, circumstance.

This book is an examination of the conditions in which political entrepreneurship and circumstance operate. It aims to specify materials, the constraints and the opportunities, from which politicians forge outcomes. Any political outcome involves the variables that I consider here: the support of societal actors, the linkages among intermediate associations, state structure or organization, ideology, and international military influences. How those variables combine turns on what individuals in actual historical situations are able to do with them.

The Choice of Countries and Crises

Following the usages of macrohistorical comparison, I have chosen countries with reasonable similarities in what I wish to explore. Since the 1870s, the first crisis I examine, all five countries have had complex economies—part modern, part backward; part industrial, part agrarian; part oriented toward aggressive competition on a world scene, part oriented toward sheltered home markets. Thus all five have had economic actors with rough similarities of placement in the world economy. Countries that made similar policy choices can be compared to see if there are similarities in the social attributes of their winning coalitions, in their intermediate associations, in their state structures, economic ideology, and position in the international state system.

My choice of countries is related to these variables. Because of the importance of international-domestic linkages that express the relationship of societal actors to the international economy, I wanted countries that had comparable mixtures in industry, agriculture, and labor. All, that is, had to have some industry in the late nineteenth century involved in export, agriculture split between grains and high-quality foodstuffs that consume grains, and labor involved in both industrial production and consumption. Second, I wanted countries that differed in outcomes during the crisis periods. Third, I wanted differences in other variables of importance, especially state forms, economic ideology, and international military situation. Fourth, I wanted countries both with some openness in political process (so that the role of societal actors, ideology, institutions, and the like could be examined) and with market economies.

Rather few countries fit all these requirements, but others could have been included. Japan, Italy, Spain, Canada, and Australia would have made particularly interesting additions; I omitted them only for reasons of economy. Several Latin American countries might also have made for interesting comparisons, but they were primarily agricultural in the first crisis and thus lacked the diversity of societal actors whose effects I wished to explore. I did not include Soviet-style regimes because the distribution of economic power there makes politics so different. Interest groups and societal actors exist in those countries, but they are so much weaker than state-party institutions in the West as to change the pattern of political advocacy.

In the case studies that follow, the treatment of the countries within each crisis period is not equal. Some countries get longer analysis than others, and different one are favored for each period. This tactic is deliberate: focusing comparisons on pairs or trios of countries allows an accentuation of specific elements in the explanatory discussion in order to sharpen the debate. Unequal as well is the space given to discussing the explanatory issues in each crisis period. The character of each type of argument is discussed at length in the context of the first crisis period, establishing the analytical groundwork for the next two, though the interpretative points are reexamined in the Conclusion.

Three great crises in the international economy affected these five countries: the downturn of 1873–96, the Depression of the 1930s, and the economic disruption that started in 1971. These crises involve an interaction between changes in the business cycle and changes in the basic structure of domestic economies. The first process involves regular swings between boom and bust following an investment cycle. The second involves major changes in the products that countries produce, in the organization of their production, and in the geographical distribution of efficient production within and among countries.[40] Although each crisis has its own characteristics, all three crises saw major changes in both processes.

Five countries, three periods—we seek to know what policies these countries selected, and that is our descriptive task. Simultaneously we seek to understand the application of different interpretative traditions to that selection, and that is our explanatory task.