

**The Political Economy of Global Transformation:  
Susan Strange, E.H. Carr and the Dynamics of Structural Change**

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**Abstract**

The consequences of the 2007/2009 global financial crisis are now making themselves felt on many foundational elements of global politics and the world political economy. In this paper I suggest that some of the ideas of Susan Strange and E.H. Carr, theorists whose work is seldom brought together, provide us with a useful way of considering how two important developments are affecting the structural organization of the global political economy. Both Strange and Carr would have drawn our attention to how the relationship between public and private authority is being recast in industrialized economies, and both would have highlighted the growing importance of key emerging market economies as significant harbingers of structural change. Neither of these developments on their own would have been sufficient to allow that such change is complete, but together they suggest that the global political economy has definitively entered a period of significant transformation marked out by a resurgence of public authority in the context of enhanced state power. One important implication of this change is that transnational modalities of authority will recede in significance as a form of economic governance. The theoretical pay-off of considering Strange and Carr together is therefore that they point towards how political and economic developments interact to form a coherent political economy of change.

## **The Political Economy of Global Transformation: Susan Strange, E.H. Carr and the Dynamics of Structural Change**

Do international relations precede or follow (logically) fundamental social relations? There can be no doubt that they follow. Any organic innovation in the social structure, through its technical-military expressions, modifies organically absolute and relative relations in the international field too.

Antonio Gramsci, *The Prison Notebooks*

In the social sciences, scholarly disciplines can be prompted to re-evaluate the analytical traction of their central concepts by abrupt changes in how the object of their scholarship is organized. The disciplines of International Relations (IR) and International Political Economy (IPE) have long faced such pressure. For example, some see the interwar years and the Great Depression as the precursor not only to the empirical development of American hegemony, but also as a key spur to the emergence of realism as a central method of apprehending power (Carr 1939/2001; Schmidt 1998; Cox 2000). Several decades later, scholars took the breakdown of the Bretton Woods system as a prompt both to re-evaluate the utility of realism as a theoretical lens for IR and IPE, and as a signal that the postwar structure of the global political economy was itself entering a period of 'after hegemony' (Keohane and Nye 1977; Keohane 1984). This last debate over American decline was seemingly resolved in the closing years of the 20<sup>th</sup> century, amid the aftermath of the end of the Cold War, the collapse of the Soviet Union and the re-assertion of American power (Cox 2001). The uni-polar era had arrived even as governance was seemingly becoming globalized (Scholte 2000; Ikenberry, Mastanduno and Wohlforth 2009).

The financial crisis of 2007/2008, which resulted in the harshest contraction of global economic activity since the Great Depression (IMF 2009), has brought this particular resolution into question. I use this crisis as the occasion to ask how the structural organization of the global political economy is changing. Susan Strange and E.H. Carr offer two intriguing examinations of structural change in IR and IPE scholarship, yet they are rarely combined in a systematic analysis. Considered together, I argue that their work can provide a political economy framework that highlights important elements of change coming out of the financial crisis. In different but complementary ways, their work draws attention to the impact and importance of the relationship between private and private authority, and to the interaction of the inter-state political system with how this authority becomes globally articulated. In what follows I will sketch out one way of bringing their work into a fruitful dialogue with each other to advance a framework of analysis that can capture what is of intrinsic and organic significance to scholars of IR and IPE as they work through the implications of the financial crisis. My argument is that such a framework suggests we are now well into a period of significant global transformation which will recast and diminish how transnational modalities of authority form part of the infrastructure of economic governance.

***Power, the state and global politics: integrating Strange and Carr***

The idea that we can measure power in global politics has long been attractive to scholars, even as they have acknowledged the immense difficulties of the task (Knorr 1975; Kirshner 1995; Hardt and Negri 2000; Andrews 2006). Susan Strange is an important interlocutor in these debates, and she developed her understanding of power against prevailing views in the 1980s that saw a sharp and steep decline in the ability of the US to shape the international economic order. At the time, IR and IPE scholars were concerned primarily with the ability of the US to compel its long-time allies to follow American preferences and accommodate themselves to American interests as they had for much of the Bretton Woods period. From across the theoretical spectrum, this was most often articulated as the erosion of international regimes, whose main cause was a decline in American power (Block 1977; Gilpin 1981; Krasner 1983).

In contrast, Strange argued that such measurements of American power were at the very least inaccurate, and at worst entirely misleading (Strange 1983; 1987). She noted that even as the share of American gross domestic product (GDP) in relation to global GDP had declined, the control of American corporations over key international markets remained high and was even (in certain industries such as services) growing. For Strange, the key question was not the weight of the American economy in the global economy, but the control exerted by American corporations and lawmakers over global markets (Strange 1988; cf Nizan and Bichler 2009). Here she pointed out that this control was not under threat from global competition; in fact, global competition was defined and shaped inexorably by the demands, preferences and resources of American corporations. Critical here for Strange was the shift in wealth creation from manufacturing to activities associated with the knowledge economy: in the 1980s she saw these as emerging and important drivers of economic growth, and in these new industries, American firms were dominant. A similar argument might be made today in connection to the ascendancy of American firms such as Apple, Intel, Google and Facebook.

In short, for Strange, the structure of global competition was determined (or controlled) by American interests, even if these interests were sometimes difficult to measure and no longer expressly related to the territorial borders of the US. Rather, she preferred to think of these interests as being articulated in the form of an 'American' empire' (Strange 1988b; 1989), which operated beyond but yet also alongside American governmental authority. It was this ability of private American interests to influence the global economic agenda in conjunction with the American state which counted in the power sweepstakes, not where widgets were actually produced and in what numbers.

At its heart, then, Strange argued that the global articulation of power was constituted by a complicated amalgam of public and private authority. She considered this amalgam through the organization of an iron triangle of inordinate (American) military power, an inter-state system that refracted and radiated America's governmental power throughout its most important elements, and the dominance of an ideational framework that privileged American principles and ideals as they were taken up and pursued by private institutions. Here Strange disagreed with two of the strongest proponents of the argument that America was no longer ascendant. From a realist perspective, Robert Gilpin argued

that American power, measured by its ability to compel its allies to make contributions to the *Pax Americana*, was in terminal decline (Gilpin 1981). And from a critical historical materialist perspective, Robert Cox argued that the US was no longer able to direct a hegemonic structure of world order (Cox 1987). Both Gilpin and Cox, albeit for quite different reasons, pointed to the inability of the US to fashion consensus or accommodate its allies' needs as part of the negotiations necessary to maintain a benevolent (from an American point of view) global economic system. For them, a neo-liberal (or hyper-liberal, to use the term initially coined by Cox) world signalled the end of American dominance.

Strange had a different answer to the question of whether America was in decline, which relied on making a careful distinction between relational and structural power. Relational power was of course above all about the US being able to coerce or compel its allies and competitors to undertake particular courses of action. Here she acknowledged that this form of power waxed and waned with global economic circumstances, and was entirely dependent upon very specific and particular contexts. On this reading, from the early 1970s until the late 1980s it did appear that US relational power was in retreat. The instrumental capacity of the US to exert its willpower seemed to have eroded, or at the very least to be under severe stress.

However, what was significant for Strange's counter-intuitive analysis was the capacity of some states and the private interests under their sovereignty to set the rules by which others would have to play the 'great power' game. In other words, for Strange the key to understanding who actually 'had' power lay not in determining who could prevail in specific decisions, but who could set the rules by which such decisions were made in the first place (Strange 1987; 1988b). In her estimation at the time, it was still American political leaders who had it within their grasp to provide such leadership. Even though not all decisions went America's way, they were made under American rules that reflected and benefitted American-based private interests. This social fact also called attention to the global reach of American domestic political conflicts, which had a disproportionate impact on international regulatory developments. For Strange, the most important facets of 'global' power were of necessity first made in America before being radiated or refracted globally.

In Strange's view, this ability to set the rules derived from several sources, some public or state-centred and some centred more in the nominally private operation of the (capitalist) economic system. For her, the American state still maintained a considerable military edge over its closest rivals, which was reinforced by the continued reluctance of European states to devote adequate resources to defending themselves. But equally importantly, American corporations continued to dominate production systems that spilled across national borders and which were a principal source of high value profits. The superior innovative capacities of these firms, bolstered by government-sponsored military research, bestowed onto certain segments of America's economy an unalloyed competitive advantage. As well, American ideas about how to organize economic activity (and its associated set of political values and ideals) complemented these advantages, and held a global appeal. Finally, and for her critically, the US (through its

government, its markets and its private institutions) had a lock-grip over the organization and operation of the world's monetary and financial system (Strange 1987; 1988; cf May 1996). For Strange, all that was required for America to actually exercise its structural power was a willingness to act politically in a manner congruent with its underlying power capacities.<sup>1</sup>

This understanding of power ties together the capacity of the state with the operation of private institutions and the inter-state system to provide for Strange a structural reading that suggests where power actually resides in the global political economy. Because power is about the capacity to decide agendas, it is not directly related to the ability of A to compel B to undertake a particular course of action; rather, it is related to the context of agency, which has two levels: 1) the capacity of A to convince B that its menu of choice involves X, Y and Z and nothing else; and 2) the capacity of A to influence this menu of choice either directly, through its own ability to compel the acceptance of the menu, or indirectly, because the majority of the elements of the menu remain in a dependent relationship to A. In other words, the exercise of such power could be either active or passive, as for example when what she called 'non-decisions' were taken (Strange 1986). Understood in this way, such structural power belonged as a property to the US throughout the entire period of supposed American decline.<sup>2</sup>

It is my claim that the work of EH Carr deepens Strange's understanding of structural power and global transformation in three important ways.<sup>3</sup> First, Carr's approach complements and extends Strange's own deeply historical approach to IPE and IR in general. She was introduced to IR at the LSE during her undergraduate days by a diplomatic historian (Strange 1989: 20), and it is clear from her own writing that many of the formative figures in her own intellectual development were historians such as Fernand Braudel or scholars for whom history was a living subject such as Robert Cox and Albert Hirschman. Indeed, there are few of Strange's works which are not book-ended in some way by a deeply considered historical narrative. In this context Carr is a happy intellectual traveling companion, and two of Strange's citations of him involve approving references to support her claim that all facts are selected and that we need an

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<sup>1</sup> By the end of her life, Strange had concluded that the US was in fact unwilling to act in a manner congruent with its own 'structural' interests (Strange 1998).

<sup>2</sup> Strange used the international debt crisis of the early 1980s as a good illustration of how structural power operated (1988b). Although several countries ran into significant debt repayment problems, only those countries with close ties to the US were able to work towards a resolution that involved creditors booking losses on their assets within the framework of an overall IMF-sanctioned debt recovery scheme. It was the US which was able to dictate these rules of engagement, and it was these rules which all indebted countries had to follow if they wanted debt relief on a multilateral scale. American power here was omnipresent but structural, reflecting its pole position within the inter-state system rather than a calculated exploitation of its own instrumental resources.

<sup>3</sup> Interestingly, Strange herself rarely cited Carr's work, and he did not once cite her work. I have tracked down in total only four references to Carr by Strange (1988: 191; 1996: 150; 1998a: 5; 1998b: 104), and in the last citation (in a work published posthumously) she lumped Carr in with those IR theorists who had systematically ignored the impact of finance on the distribution of wealth and power among states.

interpretive framework within which to situate our facts before we can even attempt to construct an explanation of them.<sup>4</sup>

As Strange recognizes, Carr's most complete discussion of facts comes in his 1961 classic text *What is History?*. Here Carr acknowledged that facts, once established, exist as unalterable data points that can only be contested under special circumstances. But he goes on to point out that not all facts are enlisted in the enterprise of historical explanation. When we provide interpretations and explanation, we are organizing and using a more selective category of facts which he calls 'historical' facts. It is this category of facts which is critical for the creation of knowledge about past events, because it is historical facts – as opposed to facts in general – that are used to arrange past activities into a meaningful pattern or narrative of development (Carr 1961: 8-20; 1951/1957: 9-10).<sup>5</sup> And it is the historian (or social scientist) who stands at the epicentre of determining which facts become 'historical' facts. This claim places Carr quite close to Strange, who repeatedly points out that either that we are not using the best 'facts' to explain our arguments (which was the problem she saw with many scholars chronicling the supposed decline of American power), or that facts do not speak for themselves and cannot be considered apart from an interpretive context which gives them meaning. The way in which both Strange and Carr embrace the use of history and an historical approach, I would contend, makes them integral members of what Benjamin Cohen identifies as the British School of IPE (Cohen 2008).

The second reason to integrate Strange and Carr is because they have complimentary views on the importance of domestic authority relations within great powers for IPE. For Carr as for Strange, it was critical to understand how domestic social and political relations were evolving in within great powers order to gauge what international political negotiations between them could actually accomplish. In this sense it was the domestic social and political arrangements within great powers that set the basic parameters of politics between them. Although perhaps for slightly different reasons, both Carr and Strange would echo Antonio Gramsci's claim in *The Prison Notebooks* that international relations followed logically from fundamental social relations as they are organized and expressed within nation-states (Gramsci 1971: 176).

Carr himself considered the centrality for world politics of changing relations of private and public authority most closely in a series of publications written between 1944 and 1951. He organized his thinking in terms of the immense transformations underway in the principal political institution of the time, the nation-state. Early in this period Carr examined how the nation-state had evolved as a result of the profound social changes unleashed on society by the industrial progress of the 19<sup>th</sup> and early 20<sup>th</sup> centuries (Carr

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<sup>4</sup> Like Strange, Carr did not draw a strict distinction between history and the social sciences in terms of their modes of analysis. They were for him part of the same branch of learning (Carr 1961: 84-85).

<sup>5</sup> For Carr, what distinguishes historical from unhistorical facts, or what he also refers to as facts about the past versus facts of history, is not their authenticity but rather their use in historical explanation: historical facts are those facts which have been recognized as relevant to the development of an argument about an event or development by an historian (Carr 1961: 12). On Carr's reading here, one of the tasks of the historian is to extract, from the nearly limitless range of available facts about the past, a more precise and manageable number of facts relevant to a specific explanation.

1945; 1951/1957). His main premise here was that the liberal state and its international analogue – the harmony of interests – could no longer respond to the pressures and needs of mass society. The very idea of (individual) liberty was being recast, while the prospects of central planning, as evidenced by advances in both New Deal America and Soviet Russia, were slowly but inevitably becoming consolidated. This in many ways comprised the heart of Carr's historical form of political economy, and it led him to view the economic question as the dominant singular problem facing the world in the mid-20<sup>th</sup> century.

For Carr, the overriding problem to which politics had ultimately to respond at this time was a set of political economy deficits: how to reconcile individual liberty with mass democracy, and how to reconcile the expansive social welfare demands of politically-mobilized citizens with the material inequality generated by the capitalist market economy. Like contemporary scholars, he fully recognized the increasingly integrated world economic structure and the pressures it brought to bear on these deficits; but unlike many he did not see a commensurate world political organization – what today we call global governance (Murphy 2000) – as a viable solution to these pressures. For Carr, as for Strange, the only viable political solutions to these economic problems ran through the political structures of the state as they worked through the prevailing balance of inter-state power. It was these structures which had to be transformed and made relevant to the problems of the time, rather than the erection of new, untried arrangements and institutions which in his view had only a poor chance of negotiating the pressures of the era.<sup>6</sup>

His answer to both of these deficits was most forcefully articulated in the lectures published as *The New Society*, and they were predicated upon increased state involvement in all aspects of economic and social life. In relation to the individual, only an extension of what he identified as the welfare or service state could deliver the enhanced expectations that citizens had developed for their governments, and which were a direct consequence of nearly three decades of privation and war. In relation to political institutions, the quaint constraints of property-based democracy were everywhere giving way to new forms of political mobilization organized around mass political parties which could no longer be controlled by landed elites. And in relation to the economic realm, Carr saw that the competitive small-holder market economy had *de facto* given way to an economy dominated by very large cartels, for whom the idea of genuine competition had become anathema. In short, for Carr, every aspect of social, political and economic life had been utterly transformed over the previous 150 years, and the world's political organization had to respond to these changes in relations of authority if it was to meet the demands of this 'new society'. Transposed to the contemporary period, when a similar wide-ranging set of transformations appears to be underway under the rubric of

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<sup>6</sup>In this the contrast with his contemporary – David Mitrany – is clear and powerful. An early advocate of functionalism, Mitrany sought to insulate the administration of international affairs from political pressures through the development of international organization as a rational and technical set of protocols and arrangements. In this view, the promise of functionalism was precisely that it isolated the political nature of international problems and prevented politics from intervening in international public administration (Mitrany 1943; 1975). Carr's views run entirely in the opposite direction.

globalization, it is hard not to see how Strange would concur with the argument that the starting place for world political organization remains the domestic political and social arrangements of the great powers.

This leads to the third and final complementarity between Strange and Carr, namely the role of international organization in negotiating fundamental changes in social and political arrangements. Although one of Strange's principal themes over the last 10 years of her life was the ebbing of state power, she refused to place faith in international organizations as an antidote to staunching this retreat. In her eyes, not only were international organizations relatively compromised institutions in terms of their accountability and resources, but they had consistently abdicated their responsibilities in the face of the pressures of financial globalization (1986: chs. 6-7; 1996: ch. 12; 1998: ch. 9). Paradoxically, Strange was adamant throughout her career that it was nation-states in general – and the US above all – that had to lead the way politically if order was to be re-imposed on the global political economy.

This is an argument with which Carr would easily have concurred. His war-time writings (Carr, 1939/2001; 1942; 1945; 1946) devoted great attention to two developments that had dominated world politics for nearly two decades. The first development is his well-known description of the deep-seated breakdown in the system of inter-state relations (Carr 1939/2001: 38-39). Like Strange when she dissected the dysfunctionality of 'casino capitalism', Carr refused to attribute the breakdown of international politics to the mere existence of despots and dictators, although obviously their personal actions very much contributed to the precise trajectory of those war-torn years. Rather it was the entire structure of inter-state politics that had become bankrupt, including very critically its inter-subjective core, which Carr identified as the doctrine of the 'harmony of interests': 'the inner meaning of the modern international crisis is the collapse of the whole structure of utopianism based on the concept of the harmony of interests' (Carr 1939/2001: 58).

Carr's brilliant insight was that 'have-not' states no longer agreed with the distribution of political and economic resources sanctioned by the 'have' states, and the acquisition of some measure of power by the 'have-not' states had thrown the entire inter-state balance of power into turmoil. Effectively it was the organization and operation of that order itself, and not its *dramatis personae*, which generated the inter-war crisis (Carr 1939/2001: 209). From this basic proposition flowed all of Carr's policy prescriptions concerning postwar planning and how the West should work with the newest Great Power, the Soviet Union (Carr 1942; 1945; 1946).

The second development that Carr drew attention to was the way in which we should understand the potential of international organization within the parameters and operation of the inter-state balance of power. His main line of argument here is not that international organizations are the playthings of powerful states, although in certain respects this might be the case. And neither is it that international organization should be abandoned altogether because it has no role to play in the inter-state system. Rather, it is that with respect to what Carr sees as the most pressing *political* questions of the day



(which for him were completely *entwined* with economic questions), international organization offered a false hope that both misidentified the nature of the world's problems and obfuscated which actors were intrinsic to achieving sustainable solutions to them (Carr 1945: 59-60). His central claim was that it remained states – or more accurately, states that are also Great Powers – which had to act politically to solve the inter-war period's deep structural problems.<sup>7</sup> By looking to the League or any of its offshoots for decisive action in this respect, opportunities to make real even if limited progress were being missed.

Neither Strange nor Carr was completely downcast on the role and potential of international organization in the overall structural organization of international politics and the global political economy. Both saw clear roles for these institutions to play, ranging from data collection to communication facilitation to providing fora where differences between nation-states could be articulated, negotiated and perhaps on occasion even mediated. However, given that both saw relations of authority between public and private actors as a central axis of political conflict, and that this axis was most fully engaged within the domestic social relations inhering to great powers, it should not be surprising that neither looked to international organizations as likely mediators at the global level between these powerful contending forces. Rather, both looked inward, to how domestic authority relations were evolving within ascendant and established great powers, and then to the consequences of their refraction outwards towards the broader global political economy. In this sense their work should be considered part of a coherent and integrated framework of political economy.

At the same time, their views are not without problems. On Strange's side, we could take her to task for developing taxonomies rather than theoretical insights (Cohen 2000); for not working through the tension in her work between materialism and idealism (Guzzini 2000); for failing to overcome the *de facto* analytical barriers between economics and politics (Cutler 2000); and for refusing to socialize adequately her fundamentally empiricist reading of knowledge, ideology and ultimately power itself (Tooze 2000). What these critiques of Strange's view on power suggest is that she offers an insightful but yet truncated conception of power, which only partially connects the foundations of power to the way in which it is exercised. Most importantly, Strange seems oddly reluctant to reflect theoretically on her insights, and determined to restrict her theoretical reflections to the terrain of empirical falsification. This is perhaps due to her ambiguous

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<sup>7</sup> Carr's own prescription for the most appropriate form of post-war political organization shifted quite considerably between 1939 and 1946. In the *Twenty Years Crisis* he points to a future with fewer but larger political units (Carr 1939/2001: 213). In the *Conditions of Peace* he adds to this by highlighting the necessity of establishing a form of sovereignty that recognizes divided but not incompatible loyalties, and which could be harnessed to the differing needs of the world's military and economic organization (Carr 1942: 60-66). Just three years later, in *Nationalism and After*, he advocates a kind of league of regional multi-national states (Carr 1945: 60), while less than a year after this, as the outlines of the Cold War emerged, he returns again to the determining role of large political and economic states acting in a kind of new age Concert of Europe (Carr 1946: 83-85). By 1951, when the lectures published as *The New Society* were delivered, he considers America's relations with Europe to be the key political axis through which the social and colonial revolutions could be addressed, as these had become the paramount *political* questions of the day (Carr 1951/1957: 98-99).

acceptance of the place of positivism within the social sciences, and to her ultimate unwillingness to modify its evidence-based evaluative precepts (May 1996; Palan 1999; Cutler 2000; Tooze 2000).

On Carr's side, issues have been raised at his own use of historicism as an avenue of creating historical knowledge, with the argument being made that he essentially lapsed into a version of relativism that denied him the ability to level a moral critique on historical action (Jenkins 2000; Jones 1999). Perhaps even more significant was the fact that Carr got his future wrong: the analysis that he developed just after World War II about social transformation and the need for increased state involvement in the economy ultimately misread the belated triumph of a renewed liberalism and ultimately neo-liberalism.<sup>8</sup> One might further claim that he misread the future role of international organization. At any rate, as the Cold War developed into a stable pattern of inter-state political relations, and economic growth in the West took off, the political economy deficits that occupied Carr receded in significance. The economic question that preoccupied Carr was resolved not through recourse to redistribution, which Carr emphasized, but through growth, or what Charles Maier (1977) called the 'politics of productivity'. And as the integration of global markets proceeded after the formal demise of the Bretton Woods system, and neo-liberalism (the contemporary expression of the 'harmony of interests' doctrine) as a doctrine took hold, a form of governance for the world economy emerged that was increasingly formulated around a set of international oversight agencies such as the IMF and OECD. Towards the end of the 20<sup>th</sup> century, the problems that presented themselves to nation-states and authoritative actors prompted the development of technocratic global networks and strengthened international institutions. As a result, the questions asked by Carr fell out of favour and became less relevant to contemporary needs.

Notwithstanding these criticisms, my claim here is that the consequences of the financial crisis have returned a frame of reference modelled on Carr and Strange to empirical and theoretical relevance. This frame of reference directs our attention to two key developments: 1) the changing role of the state in regulating financial markets; and 2) the rise of emerging market economies and their new role in setting the agenda of global economic decision-making. On both counts, what emerges from such a consideration is the recognition that established patterns of decision-making are unravelling, even if new patterns have yet to be firmly established. Each development will be briefly reviewed below.

### ***Power and the state: financial regulation***

Historically, the key authorities involved in global financial regulation are American and European officials together with their counterparts in international regulatory institutions. What is noteworthy from the perspective of considering the effects of the financial crisis is to observe how systematically these states are now moving forward to intervene more forcefully in the operation of financial markets under their jurisdiction. States are renewing their authority to set the agenda of global finance.

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<sup>8</sup> See Gilbert (2012) for an engaging discussion of the reception of Carr's work among his peers.

In the US, two major directions of change are developing: in the organization and logic of supervision; and in the range and extent of supervision. Each of these regulatory changes will increase the degree of state intervention in its financial system, and thereby encourage other states to intervene more forcefully in their financial systems. The first major change concerns the organization of financial supervision and in particular the question of whether such supervision should be sectoral or unified in scope and scale. While the US may be an extreme case with its plethora of financial regulatory bodies, the logic of sectoral supervision has a considerable historical record (Russell 2008).<sup>9</sup> The financial crisis has brought into sharp relief how problematic such a fragmented regulatory apparatus is when set within the context of an integrated set of financial markets.

Here the financial crisis has unquestionably tipped the balance in favour of a more strongly unified supervisory framework. In the US, the Obama Administration's efforts to recalibrate US financial regulation have resulted in the passage of the Dodd-Frank bill, which among other things identifies the Federal Reserve Board (Fed) as the principal overseer of systemic risk. A combined council of regulators will further close many of the remaining gaps within the US system. Equally important are new powers given to regulators to wind-up insolvent firms, and to compel banks to limit or restrict their proprietary trading units under the so-called Volcker Rule. This rule prescribes how banks are to capitalize their special investment vehicles, and how much they are allowed to invest in hedge funds and private equity firms. Together with the vetting powers which the new Consumer Protection Agency will have for financial instruments, the Dodd-Frank bill will push the government to cast a much heavier footprint over the organization and operation of the American financial system.<sup>10</sup>

A heavier footprint is also taking shape in Europe, where British and EU authorities are moving to give the state a much stronger presence within their respective financial systems. In the UK, a major reorganization of financial supervision has been undertaken to strip the Financial Services Authority of its supervisory role and to relocate it within the Bank of England.<sup>11</sup> This has been further supported by the recommendations made

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<sup>9</sup> Financial markets have historically been differentiated by the kinds of instruments that comprise them and their institutional makeup. Regulation has evolved in line with how these markets operate and what kinds of products they generate. This has traditionally been understood in terms of key pillars, most importantly banking, equities, insurance and pensions. Almost everywhere each pillar has spawned its own regulatory apparatus, together with a few more recent developments such as organized futures markets. See Germain (2010) and Porter (2005) for an historical account.

<sup>10</sup> Other provisions in the 'Wall Street Reform and Consumer Protection Act' include bringing all major financial institutions – whether bank or non-bank – within the purview of federal regulation, more closely regulating derivatives trading and hedge funds, limiting the proprietary trading prerogatives of banks, and providing the federal government with a more clearly specified way of closing down insolvent financial institutions. See <http://www.opencongress.org/bill/111-h4173/show> (accessed August 6th, 2010).

<sup>11</sup> Among the proposals published by the British government in July 2010 were to return both macro- and micro- prudential supervisory responsibilities to the Bank of England, and to create a new consumer protection agency to absorb the institutional responsibilities of the Financial Services Authority (which will effectively be gutted). These proposals arise out of the Turner Review – the official enquiry into how the UK's supervisory arrangements failed

by an independent commission struck by the new British government to examine how to strengthen the British financial system in light of the financial crisis (*Economist* 2011: April 16<sup>th</sup> – 22<sup>nd</sup>). This commission – known as the Vickers' Commission – has recommended that British banks organize themselves to insulate or ring-fence their domestic UK retail arms from their investment and commercial banking operations. In other words, the (British) state looks set to intervene more forcefully in how financial institutions active in the UK are actually run. Similar albeit weaker trajectories are underway in the EU.<sup>12</sup>

Of course, none of these developments have yet to be fully implemented, and there are some who doubt that their impact will be as argued here. Such scepticism however should be treated with caution, for two reasons. First, across Europe and the US, banks have been recapitalized and are being forced to hold much more capital in relation to their lending and proprietary operations than prior to 2008. Swiss banks, for example, are being compelled by their government to hold nearly 20% capital buffers whereas prior to 2008 they were capitalized at nearer to 7%.<sup>13</sup> The British and Dutch governments are arguing strenuously with the EU that they should be allowed to impose higher capital requirements than the new Basel III rules. Here, minimum Tier 1 capital ratios are being raised from a pre-crisis requirement of 4% to at least 7%, with a further tranche of easily accessible capital at 3%. Furthermore, nearly 30 globally-active financial institutions have been categorized by the Basel Committee on Banking Supervision as 'Global Systemically Important Financial Institutions', or G-SIFIs, and they need to hold extra capital buffers above and beyond normal operating guidelines (between 1.5-2.5% depending upon their perceived level of systemic importance). It is through the mechanism of increased capital ratios that major banks are having their activities more closely supervised, and similar consequences are in train for other regulatory developments.<sup>14</sup>

The second reason why sceptics should be cautious relates to the politics of financial regulation. For much of the postwar period, financial regulation in the rich economies has been debated and conducted in a kind of segregated, insulated bubble, removed for the most part from popular (and democratic) pressures (Helleiner 1994; Strange 1998;

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to contain the fallout from the financial crisis – as well as the political preferences of the Conservative and Liberal-Democrat partners in the new coalition government. See [http://www.fsa.gov.uk/pubs/other/turner\\_review.pdf](http://www.fsa.gov.uk/pubs/other/turner_review.pdf) (accessed May 04, 2009) and [http://www.hm-treasury.gov.uk/consult\\_financial\\_regulation.htm](http://www.hm-treasury.gov.uk/consult_financial_regulation.htm) (accessed August 06, 2010).

<sup>12</sup> The EU struck a high-level committee to examine the crisis and how to respond to it, chaired by Jacques de Larosière, a former Managing Director of the IMF who also played a leading role in preparing the EU for monetary union. In addition to proposing EU-wide risk and supervisory councils, this panel recommended reviewing accounting standards and Basel II (especially its capital adequacy requirements), tighter regulation of derivatives trading and the shadow banking system, and the harmonization of deposit insurance schemes on an EU-wide basis. See [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf) (accessed on July 29, 2009).

<sup>13</sup> See <http://online.wsj.com/article/SB10001424052748704631504575531222507779044.html> (accessed October 15, 2010).

<sup>14</sup> A summary of the Basel III can be found at <http://www.bis.org/press/p100912.htm> (accessed October 15, 2010).

Porter 2005; Wood 2005; Germain 2010). This is no longer the case. From the Tea Party phenomenon in the US to the role played by populist and nationalist political parties in Scandinavia in addressing the 2010/2011 European debt crisis to the refusal of Icelandic voters to sanction an IMF bailout, financial supervision and the politics of finance have moved to center stage in national politics. And while this development has yet to fully play itself out, all indications are that the relatively insulated nature of financial politics has for the moment become impossible to maintain (Thirkwell-White 2009).

And yet a word of caution is in order. The state that is at the center of this reassertion of authority is not itself entirely distinct from private authority. In all three jurisdictions examined here, private financial institutions have over the 1990s won a strengthened degree of involvement in the debate over how the financial system should be regulated. In the US this is because of the porous and fragmented nature of the American political system, which has long been open to lobbying efforts from private firms. In the UK this is because of the historic ties between the City, the Exchequer and the Bank of England, and the single-minded determination of successive governments to maintain London's role as a leading international financial centre. And in the EU, although the influence of the private sector is not as strong as in the US or UK, it has grown over the years due to the sheer increase in the weight of financial affairs in the overall economy of Europe, as well as the organizational efforts of Europe's leading banks to lobby on their own behalf in Brussels (Underhill and Zhang 2008; King and Sinclair 2003). Geoffrey Underhill (2000) is surely correct to note that there is a growing *condominium* between state and market in today's global political economy.

Here, it is helpful to follow Susan Strange's understanding of the intimate relationship between public and private forms of authority, as she recognizes that this relationship is part of a continuum whose balance changes over time. In her last major publication, she argued that markets and private authority had outrun state authority to the point where only an almost complete collapse of confidence in the capacity of private authority to effectively organize global finance could catalyze state authorities to reassert their traditional grip on financial systems (Strange 1998: 190). This collapse came upon us in 2008, when it fell to public authorities alone to stem the tide, which was estimated by one respected analyst to cost nearly US \$14 trillion (Haldane and Alessandri 2009). So, while the precise nature of the new balance between public and private authority has yet to be stabilized, there should be no questions about the direction of change: in each of the world's major financial markets, the role of the state is being up-scaled, with the result that state authority is being re-articulated to exert more structural power over how financial markets are organized. We may say that the agenda-setting capacity of the state has been re-asserted over financial markets, even if this reassertion is uneven and subject to private sector push-back.

### ***Power and the state system: emerging market economies and the balance of power***

Many scholars and commentators have observed that global politics, understood primarily through the lens of the inter-state system, has been in a period of transformation (eg Jacques 2009; Halliday 2009). On the debit side of this ledger is the weakening grip

of western powers, symbolized by the economic troubles of the US. On the credit side of this ledger are the emerging market economies, symbolized most importantly by the rise of the BRIC countries but including other non-G7 countries whose economies and international profiles have been growing rapidly. For these countries the early years of the 21<sup>st</sup> century have at last brought dynamic economic growth and public sector reform that has enabled them to acquire the material vestiges of real power: their economies have hummed; their trade has skyrocketed; their companies have gone global; their reserves have been bolstered; and their armies have become better equipped. In short, enough emerging market and other non-G-7 economies have grown in relation to the historically-powerful countries that talk of a new and emerging international balance of power is warranted.

Following from our earlier analysis, however, we can ask whether scholars are not committing the same analytical error that Strange reprimanded her peers for making over two decades ago? A critical example is the accumulation of international reserves by the BRIC countries, which is often considered a key barometer of the growing power of emerging market economies. For Strange, this would be a clear example of how structural power works, because the stockpiling of foreign currency reserves denominated in US dollars confirms three important features of American structural power: 1) America still has the world's confidence as the pre-eminent provider of global liquidity; 2) there are at this time no serious rivals to accumulating and using US dollars as an international reserve currency, even if those accumulating such reserves complain about the injustice of it; and 3) whereas BRIC and other countries have to *earn* their liquidity (which are what such reserves represent), America can simply *create* its liquidity. It is hard to think of a better indicator of structural power than this, what Strange (1987: 569) in her own time called *super-exorbitant privilege*.

Nevertheless, since 2009 Chinese officials (often but not always supported by other BRIC countries) have stepped up calls for the development of a non-dollar-denominated international reserve currency unit. What would be needed for such a development to occur? On the government side, it would require holders of large dollar-denominated reserves to make their own currencies completely convertible in order to allow for their use abroad as trade and investment vehicles. In other words, emerging market economies such as China, Russia, India and Brazil need to liberalize their current and capital accounts to the point where others will have the necessary confidence to diversify into these currencies and use them as genuine reserve currencies. As these governments tighten their hold on undesired movements of capital into and out of their economies (as indeed many emerging market economies are doing), such a possibility seems more remote today than at any time in the past twenty years.<sup>15</sup> Indeed, one only has to look back to the experience of Japan during the 1980s and its antipathy towards

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<sup>15</sup> Over the past two years, countries including China, South Korea, Singapore, Brazil and Turkey have joined Russia and India to implement controls on the inflow of capital as an important tool in the battle to protect their economies from currency appreciation and, to a lesser extent, over-heating. These controls are now supported by the IMF, which has shifted its long-standing blanket opposition to capital controls (Gallagher 2011).

internationalizing the yen to understand the deep political forces that constrain governments which otherwise might challenge existing reserve currencies.

But on the private or market side of the equation the forces supporting the continuing use of the US dollar are equally powerful. Private firms and market actors demand not just that governments relinquish control over currencies in order that they may be used for purposes dictated by the interests of private accumulation, but also that there be ample liquidity in order that the temporary use of a currency (as a store of value, for example) does not become a permanent and unwanted long-term investment. For this condition to obtain, governments need to adopt a *liberal* view of their currencies, most importantly by freeing their use abroad and by abjuring their use as a developmental tool. There also needs to be an adequate supply of the currency in question. Absent suitable liberalization and an ample supply, private firms and markets will not have the confidence to use a currency (or facilitate its use), and will therefore minimize how they employ it.

And this is where we are in 2014 with respect to the future of the American dollar as an international reserve currency. Many countries (and not just BRIC countries) are uncomfortable with the international role of the US dollar. By making it cheap for the US to fund its budgetary and current account deficits (what economists often call *seigniorage*), using the dollar as the international reserve currency retards the adjustment process the US needs to undertake to bring its trade, current and capital accounts into a more sustainable balance. It also prolongs the vulnerability other countries experience with respect to having to follow or react to America's monetary policies. Yet, the world is not rushing out to adopt the rouble or the rupee or the yuan as reserve currencies, simply because they cannot. And neither can they freely use the pound sterling, Japanese yen, Swiss franc or, most significantly, the euro. There are simply not enough of the former to be thrust into this role, while the political mismatch between the issuance of euro-denominated debt and who controls its value ultimately means that an enormous question mark hangs over precisely how robust an international role the euro can play. By default, the dollar will be required for use as an international reserve currency until well into the middle decades of the 21<sup>st</sup> century.

So, the accumulation of a mountain of US dollar-denominated reserve assets by BRIC and other countries such as Japan does not *prima facie* indicate the decline of American power. In relational terms, to return to Strange's argument, it may indeed appear that the US now has serious rivals to its monetary power. However, in structural terms, its challengers are hobbled by the framework of practices that have developed over the past decades that have been entirely centered on American interests and needs. The US has held a firm grasp on monetary and financial power since 1945, and this has allowed it to build up an historic reservoir of influence and power that will not be easily dislodged.<sup>16</sup>

Yet, the balance of economic power has not been entirely static over the post-war era, and even though American firms and indeed the American government together

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<sup>16</sup> Many of the themes canvassed in the above paragraphs can be found also in a recent volume on the future of the US dollar (Helleiner and Kirshner 2009). Interestingly, the experts in that volume agree to disagree on the future of the dollar.

constitute a significant element of the world's monetary and financial system, they are not as ubiquitous an element as they once were. The US has been to a certain extent de-centered from the structure of financial governance over the past decade and a half, so that even though it is still an immensely powerful actor it must now negotiate the framework of this structure with other actors and their concerns (Germain 2010). It is this political fact which marks out the salience of current governance developments, where the interaction of international political relations with the demands of regulatory change are generating a set of issues whose importance is both novel and potentially long-lasting.

### ***Conclusion: structural power and global transformation***

The financial crisis has set in train two sets of developments that suggest we are entering a period of significant global transformation. One development revolves around the role of the state in the global financial system. As states – in both the developed and developing economies – move to re-calibrate how they intervene in the organization and operation of financial systems, their centrality within the globalized structure of financial governance will grow. The nation-state is not simply important here because it is the instrument through which all regulation actually gets implemented. Even more critically, it is the only institution which can generate financial regulation that is appropriate and suitable for its own economy. Emerging market economies – and the BRIC countries in particular – will here take their cue from what the US and EU states actually do to impose tighter regulations on financial institutions; a slightly less globalized financial system has been and will continue to be the outcome (DHL 2012). This is so because higher capital requirements, more capital controls and more tightly circumscribed operating environments will inevitably generate a global financial system less hospitable to what I have elsewhere described as *deep globalization* (Germain 2010). This does not mean that globalization as we know it is coming to an end, merely that there will be less of it going forward. We will move from a highly globalized world to a world in which the pull of the nation-state away from deep globalization is more clearly felt.

Intersecting with the strengthening of the state is the second development, namely the refashioning of the inter-state balance of power. We have seen how this works in terms of the role of the US dollar as an international reserve currency: its role is being eroded and brought into question, yet with no alternative in sight. In other words, one of the critical foundations of political order for the global political economy is entering a period of intense uncertainty. We have not witnessed such a situation since the inter-war period. Strange might have observed here that the structural power of the US is changing only very slowly, while its instrumental power to shape decisions directly is increasingly haphazard, reflecting the volatility of circumstances (including significantly an increasingly unstable domestic political landscape). What is especially important at the current moment, however, is that the global economic decision-making agenda does not yet appear to have ceded substantial power to emerging market economies, despite for example their accumulation of enormous reserves of US dollars. This is a situation with strong parallels to the inter-war period, as Carr would have observed. Structural power



remains asymmetrically concentrated in American institutions and subject to American rules.

How much longer will this remain so? If we return to Strange's conceptual formulation of structural power, we can recall that it relied on American military dominance, the continuing dominance of American ideals and values, and the place of American financial institutions, markets and government in the global financial system. If these fundamental elements of the global political order become further constrained or even undermined, then anyone adopting Strange's position would have to concede that the structural power of the US is weakening. What is the status of these elements of global political order?

The US continues to outspend the rest of the world combined on defence, and it continues to be the only state with the military capacity to fight a two-front war. Yet, its military might is no longer unrivalled, and the build up of military assets by China could be viewed by some as a significant challenge. But it must be acknowledged that the only potential military rival to the US is China, and so long as European states continue to reduce their military spending and rely disproportionately on American security via NATO it is unlikely that the military dominance of the US will collapse any time soon. While the idea of a uni-polar moment may be overstating the case, we are in many respects well short of a genuine multi-polar inter-state system (cf Ikenberry, Mastanduno and Wohlfarth 2009).

What should be of more concern to scholars of global power is the condition of American values and ideals, which support in so many ways the entrenched American-centered global economic agenda. Here it is interesting that one of the consequences of the financial crisis has been the severe questioning of liberalization as the default ideational template for global capitalism. As Carr recognized with the harmony of interests doctrine after the Great Depression, it is now flirting with a form of bankruptcy that undermines its global appeal. Of course, there are still no serious alternatives to organizing the global economy along capitalist lines. What has changed, however, is the degree to which capitalism needs to be organized along liberal (or neo-liberal) lines. Here liberalization as an ethos is now subject to two important charges: 1) it is unsustainable as a form of economic regulation; and 2) that state-organized capitalism is in fact more stable than liberal capitalism. And while neither of these charges are categorical or themselves without controversy, they have undermined the persuasive power of liberalization's ideologues to spread their gospel. From Europe to Asia to Latin America and Africa, liberalism is in retreat, and this has undermined the ideational supports for the operationalization of American structural power.

Finally, the financial crisis began in the US financial system, even if it was aided and abetted by global forces and dynamics. Has it also challenged the centrality of the American financial system to the global financial system? This question is difficult to assess at this moment in time. On one hand, even with the carnage wreaked by the financial crisis, American financial markets remain the deepest and most liquid in the world. And while American banks and financial institutions no longer remain the

world's largest by some ratios, they continue to be among the most profitable and innovative, and equally important they continue to provide unparalleled access for foreigners to American capital markets. Their centrality to the organization and operation of the global financial system will not soon disappear. And because both US markets and financial institutions remain key components of the global financial system, the American state remains similarly privileged. Its image and halo may be tarnished and dented, but it continues to possess a definite and considerable weight in how the global financial system runs.

This sets up an interesting scholarly debate between those who now emphasize the extent of change in the landscape of global political economy, and those who remain impressed by the continuity of capitalist relations as the key factor that explains current trajectories. At one level this is a debate about the relative weight to assign to competing explanatory variables: are we focusing on state versus class; public versus private; or global versus national? At another level it is about the grounds of adjudication: does more regulatory control also mean that state authorities are somehow in ascendancy, when in fact the dividing line between public and private authority may be impossible to identify? And at still another level, it is about the means used to understand and verify the categories we are using: do we appeal to 'evidence' or 'theory' ('beliefs'?) when it comes to establishing the fundamental basis of our arguments? There are no easy or clear answers to these questions; thus such debates will long maintain their traction.

Yet here again it is worthwhile to return to the work of Strange and Carr, for they offer at the very least a way of negotiating some of the hurdles thrown up by these debates. For Strange, who understood that there were several ways of apprehending all important events, the question of the significance of current changes would need to be addressed within the context of *cui bono*, or for whose advantage? This context almost always provides a clear causal chain to follow, even if the measurement of 'advantage' can be a bit messy. In the case of changes to financial regulation, it appears that the biggest beneficiaries of higher capital requirements, increased capital controls and less liberalization are states in general and major developed states in particular, because it is they who will have to spend less to bail out their financial institutions if regulatory reforms are successful. Of course, private financial institutions should also benefit from these reforms, but the weight of advantage lies with states. Similarly, the unevenness of the changes outlined above regarding the inter-state balance of power, while not directly challenging the structural power of the US, certainly begin to undermine the ideational core of that power. Over time, this will have the effect of eroding from within the dominant position of the US in the global political economy.

A world in which nation-states more strictly regulate financial systems, and where the inter-state balance of power is less asymmetrical (from the perspective of emerging market economies), might also become a world in which financial systems are less likely to implode and dispense harm in an almost random manner. It might also be a world in which the organization of democratic politics within many of these same nation-states once again becomes more responsive to the wishes of citizens. Here we might further observe, as did Carr many years ago in connection to the economic role of the League,

that such a world is not likely to be one in which international institutions figure prominently, either in the work of developing and implementing financial regulation (although perhaps there is a role for these institutions to spread such regulation beyond the financial great powers) or in the development of democratic oversight within nation-states. As Carr suggests through his analysis of the foundations of mass society in the middle years of the 20<sup>th</sup> century, when society exerts pressure on the operation of government, government in turn becomes much more involved in society, including the economy and its financial system. I would suggest that it is very likely that we are once again heading in this direction, and that state intervention in the world's financial systems (and economy) is intensifying and will continue to do so.

Following a framework informed by the work of Carr and Strange, then, suggests that the global articulation of power within the world's political economy is entering a period of uncertainty as established patterns of power erode and new patterns emerge unevenly. There is no question that the relational power of the US is eroding: firms from emerging market economies are challenging American firms in some areas, while the ability of the US state to dictate its preferences onto a pliant world no longer holds. At the same time, the agenda setting ability of American authorities, both public and private, has not entirely deteriorated, and in some areas remains substantial. This is what continues to generate America's current degree of structural power. The interesting aspect of this situation, from the perspective of scholars of IR and IPE, will be how it plays out over the medium term, when the economic and security capabilities of the US seem to be moving in opposite directions. The prediction I would make in early 2014 is that as nation-states reassert their authority over their financial systems and intervene to blunt the advance of globalization, the entire fabric of the global political economy is becoming rebalanced, ushering in a new inter-state balance of power and a new era in the history of global politics that is no longer centrally defined by the hegemonic position of the US.

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