

Putting Political Economy into Geoeconomics:
Comments on Clayton, Maggiori, and Schreger,
“Putting Economics Back into Geoeconomics”

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International economics and international politics have always been intricately interrelated. The resurgence of geopolitical tensions and the growing use of foreign economic policy as a tool of foreign policy have recently brought this relationship to the fore with vengeance. The study of geoeconomics, as Chris Clayton, Matteo Maggiori, and Jesse Schreger (henceforth CMS) aptly call it, is not new. But as it has taken on renewed urgency, so has the need for theoretically and empirically rigorous analysis of the phenomenon. CMS have done a great service both in a series of papers that make important strides in this direction, and in this excellent *tour d'horizon* that introduces the topic and their work to a broader audience. My principal purpose here is to comment on some of the thornier issues in the analysis of geoeconomics, and to suggest where research might fruitfully develop in this area.

CMS start with the central observations that geoeconomics, like war, is a bargaining problem, that bargaining power is a function of the outside option, and that the outside and inside options can be manipulated.¹ A “sending” government can use

economic tools to affect the outside and inside options available to a “target” government. It can offer aid, or threaten to deny access to resources, up to the point where compliance is superior to resistance. The broad point can be summarized as *linkage is leverage*: linking one issue to another provides bargaining leverage.² CMS make a series of important related points as they develop their arguments. Here I expand on one of them, the different purposes to which power can be put – including for global welfare improvements. I also raise several other issues, in particular the difficulty of analyzing geopolitics when “national” geopolitical utility functions are elusive, potential tradeoffs between geopolitical and political-economic goals, and the centrality of domestic political-economic constraints in the formulation and analysis of geoeconomic policy.

Geopolitical utility: what do we mean when we talk about national security? I

think it likely that one of the reasons economists largely abandoned the study of geopolitics to political scientists is that it is exceedingly difficult to know how to think about a government’s geopolitical utility function. This Ψ , the weight the government places on geopolitical utility (as opposed to consumption), is central to CMS’s analysis. Indeed, a fundamental geoeconomic problem is calculating the cost of using geoeconomic tools, that is, what the government is willing to sacrifice to gain geopolitical leverage on other governments. This in turn requires knowing how heavily the governments weighs its geopolitical utility. But how can we know this weight? How

do we even know what's in a geopolitical utility function? Is it the extent of national territory – or is that (future) consumption? Is it natural resources – or is *that* (future) consumption? Is it sovereignty – meaning what, exactly? Is it religious freedom for co-religionists, or ethnic solidarity, or national pride? Some of these concerns can be manipulated by politicians, which makes the question particularly complex. Whether and how geoeconomic tools are used depends on features of *both* the target and the sender, so understanding their respective utility functions is crucial.

We cannot infer geopolitical goals from government behavior or statements, of course, because behavior incorporates strategic considerations. And there are no easy answers to these questions, although I suggest some modest paths forward below. Nonetheless, it is important to highlight that the analysis of geopolitics requires defining government goals in an environment where these goals may be effectively unknowable.³

Can a superpower use its superpower for good? One arena in which a powerful (hegemonic) country's goals play a major role is that of affecting global (or regional) equilibria – what CMS refer to as the hegemon acting as a global enforcer.⁴ This can mean the hegemon enforcing rules of membership in its alliance, in ways that serve only members of the alliance (club). It might also, however, mean the hegemon facilitating the production of global public goods. The logic here is clear. A very large country may internalize enough of the effects of global public goods provision to make

it worthwhile for it to lead the way, especially inasmuch as global public goods can be provided in ways that afford differential benefits. Concentrated interests and power can be crucial in overcoming collective problems in general, and in public goods provision. In a classic article whose subtitle is “Life on the Pareto Frontier,” Steve Krasner pointed out that a hegemon can enable a Pareto improvement while ensuring that the point chosen on the Pareto frontier is as close as possible to its own ideal point – without, of course, as CMS emphasize, violating the participation constraint (Krasner 1991).⁵

The structure of the post-war (Western) world order can be seen in this light. The United States built an international economic and political system that almost certainly was a Pareto improvement over what came before, but built it in a way that addressed central American economic and geopolitical concerns. At the same time, it constructed a range of multilateral institutions that served as commitment devices to ensure that the United States would not unduly exploit its privileged position – to satisfy the participation constraint. The current Trump Administration appears to believe that this system does not sufficiently satisfy American interests, which takes us back to the question of how the national (geopolitical or other) interest is defined.

To be sure, a superpower can use its superpower for evil. A powerful state can exert its power to affect selection among multiple equilibria, and there is no guarantee that the equilibrium selected will be a Pareto improvement, let alone optimal. Indeed, Albert Hirschman’s pioneering 1945 book *National Power and the Structure of Foreign*

Trade, which CMS rightly cite as the foundation-stone of the modern study of geoeconomics, was motivated by the Nazi regime's use of geoeconomic tools to create a central European equilibrium that served to strengthen the Nazi war machine.

Analytical progress requires a better understanding of the potential equilibrium selection mechanisms that might lead powerful countries to pursue more or less other-regarding (Pareto improving) goals. History is full of examples of the exertion of geoeconomic power for all sorts of purposes and with all sorts of broader, even global, effects – both positive and negative. To some extent, of which more below, domestic political-economic factors may play a central role in conditioning possible equilibria.

Political economy vs. geoeconomics? Much of the geoeconomic literature focuses solely on the manifest *benefits* of the use of economic tools to achieve geopolitical goals, but these tools have costs as well. Bargaining power comes from linkage, but linkage typically involves forgoing – or threatening to forgo – valuable economic activities. Export controls limit access to profitable markets, tariffs tax consumers, foreign aid is paid by taxpayers. The Trump Administration has argued that the benefits of the bargaining power tariffs afford are greater than their costs, but this calculus presumably rests on a consideration of the relative importance to the Administration of the domestic economic and political costs of the tariffs and the countervailing benefits of the bargaining leverage so achieved (or hoped for).

A government's ability to pursue its geopolitical goals is almost certainly limited by domestic political-economic constraints. CMS recognize the role of domestic politics and political economy usefully in section 3.5; it is worth elaborating on and extending some of their observations.

Domestic political economy and geopolitics may indeed be in conflict. As an example, in the canonical Grossman-Helpman model of trade policy formation tariffs are expected to be decreasing in the elasticity of import demand; Ramsey taxation principles dictate that a government concerned about welfare should tax (tariff) most heavily goods for which there are fewer substitutes. In CMS, however, the elasticity of substitution across intermediate goods has the opposite impact: the more inelastic, the greater the threat to a welfare-maximizing government. Put simply, while political economy might lead the government to tariff inelastic goods more heavily, geopolitics might lead it in the opposite direction.⁶ More generally, a good that is particularly important to the target economy may be particularly profitable for exporters in the sending economy, so that geopolitical and political-economy pressures may clash.

Arguments about the impact of foreign pressure on a national government often ignore the complexity of the relationship between international factors and domestic politics. The full picture requires careful attention to both the inter-state and the domestic dimensions. For example, the starting point for analysis should be to assume that both sending and target countries begin the interaction in political-economic

equilibrium, with existing government policy in both countries reflecting the governments' best (or at least sustainable) responses to pressures from constituents. To start by considering the target country, it cannot be taken for granted that geopolitical carrots or sticks will change the domestic political-economic equilibrium. Providing aid to the target government may simply allow it to provide more resources to its constituents. For the aid to achieve a geopolitical goal it has to change the domestic equilibrium in ways that make it possible for the government to alter its geopolitical policy. This can be done, but it requires a *domestic* linkage, not just an international one. If the hegemon wants a geopolitical concession that is blocked by the target country's military, the hegemon's offer of aid or threat of sanctions may not move the needle unless it directly affects the preferences and/or domestic political influence of the military. On the other hand, if the hegemon makes the provision of military aid contingent on the target military ceding the point in contention – linking aid given directly to the domestic veto player to a concession by the veto player – it can change the constraints on the target government.⁷

Both sending and target countries clearly understand and act upon the domestic political economy of geopolitical policies. Sanctions aimed at powerful individuals or groups have the implicit or explicit purpose of encouraging them to get the target government to change its policies in the desired direction. The target governments of the Trump Administrations' trade policies routinely choose to retaliate against goods

and regions of particular importance to the Republican Party. This is an implicit recognition of the centrality of domestic politics to geoeconomics.

The domestic political economy of geopolitics. As noted, CMS provide (section 3.5) a valuable framework for thinking about the impact of domestic political economy factors in the formulation of geopolitical policies. I suggest that theoretical and empirical progress in analyzing geoeconomics *requires* the incorporation of such domestic political-economic factors.

Domestic political pressures affect a government's geoeconomics – its geopolitical utility and the weights it gives to geopolitics and other values. Perhaps most obviously, it must be the case that a government's preferences over geopolitical outcomes are a function of its domestic politics. "National security" is defined very differently in different countries, and by different groups within countries; the pursuit of national security goals depends on who defines those goals, and how. A world or regional equilibrium structured by a mercantilist power looks very different than an equilibrium structured by a Communist power, which in turn looks very different from the post-war American-led international order.⁸

The importance of domestic political economy factors runs throughout the analysis of geoeconomics. Domestic politics in a sending country (hegemon) condition the range of feasible policies, those acceptable to constituents. Domestic politics in a target country determines the most efficient instruments to encourage its government to

change policies, by affecting domestic political constraints as desired by the sending government. Sanctions, to take an example, rely heavily on domestic politics, especially as they typically impose costs on groups and people in both the sending country and the target country. They are only useful to the sending government if these costs change the nature of political pressures on the target government. They are only credible to the target government if the sending government can withstand pressures from those who bear the costs in the sending country.

The domestic political economy is also important to the network effects that play a major role in CMS. For them, a hegemon's geopolitical power is enhanced by the growth of its network, as this both increases the value of the inside option and lowers the value of the outside option. There is something of a virtuous circle here (if the hegemon is pursuing virtue; vicious, perhaps, otherwise). The circle typically runs through domestic politics. As the network grows, its attraction to domestic groups increases, encouraging the government to join the network. Once joined, network effects increase these groups' domestic economic and political power, cementing the government's commitment to the network. It is worth pointing out, especially with current events in mind, that this process can work in reverse: as the network unravels, its unravelling builds on itself in an ever-faster downward spiral.⁹ More generally, inasmuch as the use of geoeconomic tools can change the international economic environment, they can alter the domestic political economy of both sending and target

nations in ways that go on to change the “national preferences” of the countries in question.

We cannot ignore the domestic political economy of geopolitics. Indeed, I think that attention to domestic political economy can help resolve the complex problems of clarifying what we mean by geopolitical utility, and the weights placed upon it. I do not say this (only) as the professional deformation of a political economist; I think that logic and evidence suggest that this is a crucial research frontier for those interested in geoeconomics.

Where we are and where we are going. Geoeconomics is here to stay.

Governments have always used economic policies for non-economic, including geopolitical, purposes; the current troubled international scene will undoubtedly lead to a continual increase in this trend. Clayton, Maggiori, and Schreger have provided us with impressive and compelling tools with which to analyze many aspects of modern geoeconomics.

Further analysis of geoeconomics requires both theoretical and empirical development. Within this, I believe that an emphasis on the domestic political economy of both hegemonic and non-hegemonic – sending and target – nations will be crucial. Geoeconomic policy can allow governments to achieve their goals more effectively, but it can also impose important costs on powerful groups in society. The success of a government’s use of geoeconomic tools depends on domestic politics and economics in

the target country. Governments must therefore navigate domestic political and economic constraints as they consider using economic tools for non-economic purposes. This puts us squarely in the realm of political economy, and suggests that our ultimate goal is an understanding of the political economy of geoeconomics.

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Endnotes

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¹ The “bargaining theory of war” is now the standard model in International Relations; see Fearon 1995 and Reiter 2003 for a classic statement and a survey.

² Note that while linkage increases the benefits of cooperation, it can also increase the benefits of defection, so the outcome can be indeterminate. See, for example, Alt and Eichengreen 1989.

³ This problem bedeviled much of International Relations (IR) scholarship in Political Science, especially in the 1970s and 1980s. In that era, many IR scholars engaged in unproductive debates over the matter, for example when “Realists” argued that states maximized “survival,” whatever that means. Robert Powell (for example Powell 1991) effectively demolished the theoretical logic of many of these debating points, but the residue remains to haunt a corner of IR that continues to spin wheels and wave hands over basic theoretical issues, addressed with a distressing lack of rigor.

⁴ Note that the topic, and CMS’s approach to it, is not restricted to the behavior of hegemon or superpowers; many middle and even lesser countries can use geoeconomic instruments to try to achieve their goals.

⁵ Lake 1993 is a valuable summary of the way scholars thought about the issue, especially addressing the distinction between “benevolent” and “coercive” uses of hegemony. Keohane 1982 and 1984 incorporated these considerations into the possibility of the persistence of the equilibrium even “after hegemony.”

⁶ This is a somewhat labored point, made simply for effect. First, trade policy is almost certainly more heavily influenced by special interest pressures than by concerns about optimal taxation. Second, substitutability in a geopolitical context may be endogenous: the Nazis invented polyurethane to replace rubber and methadone to replace opium.

⁷ Allen Drazen 2002 makes this point cogently in an application to IMF programs.

⁸ Ruggie 1982 was a powerful statement about the importance of the “social purpose” of both the hegemon and the order it constructs; I regard this point as more central, in fact, to the essay than his coining of the since-influential phrase “embedded liberalism.”

⁹ I made an analogous point about the gold standard in Frieden 1993.