Abstract. From an international political economy perspective, the international political system of states claiming exclusive authority and the monopoly of legitimate violence within their territorial limits—the so-called Westphalia system—is inseparable from the prevailing capitalist market economy which also first evolved in Europe. Each was a necessary condition for the evolution of the other. To prosper, production and trade required the security provided by the state. To survive, the state required the economic growth, and the credit-creating system of finance, provided by the economic system. But the latter has now created three major problems that the political system, by its very nature, is incapable of solving. First, there is the major failure to manage and control the financial system—witness the Asian turmoil of 1997. Second, there is the failure to act for the protection of the environment. Third, there is a failure to preserve a socio-economic balance between the rich and powerful and the poor and weak. The Westphalia system is thus failing Capitalism, the Planet and global (and national) civil society.

From a globalist, humanitarian and true political economy perspective, the system known as Westphalian has been an abject failure. Those of us engaged in international studies ought therefore to bend our future thinking and efforts to the consideration of ways in which it can be changed or superseded. That is the gist of my argument.

The system can be briefly defined as that in which prime political authority is conceded to those institutions, called states, claiming the monopoly of legitimate use of violence within their respective territorial borders. It is a system purporting to rest on mutual restraint (non-intervention); but it is also a system based on mutual recognition of each other’s ‘sovereignty’ if that should be challenged from whatever quarter.

But while we constantly refer to the ‘international political system’ or to the ‘security structure’ this Westphalian system cannot realistically be isolated from—indeed is inseparable from—the market economy which the states of Europe, from the mid-17th century onwards, both nurtured and promoted. To the extent that the powers of these states over society and over economy grew through the 18th, 19th and 20th centuries, they did so both in response to the political system in which states competed with other states (for territory at first but later for industrial and financial power) and in response to the growing demands made on political authority as a result of the capitalist system of production and its social consequences. The label ‘capitalist’ applied to the market-driven economy is justified because the accumulation of capital, as the Marxists put it, or the creation and

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1 As used by R. Cox, Production, Power and World Order; Social Forces in the Making of World History (New York, 1987), and by S. Strange, States and Markets (London, 1988).
trading in credit as I would describe it, was the necessary condition for continued investment of resources in the new technologies of agriculture, manufacture and services. As I put it in States and Markets, the security structure and the production, financial and knowledge structures constantly interact with each other and cannot therefore be analysed in isolation. The point is ‘kids-stuff’ to social and economic historians but is frequently overlooked by writers on international relations.

When I say that the system has failed, I do not mean to say that it is collapsing, only that it has failed to satisfy the long term conditions of sustainability. Like the empires of old—Persian, Roman, Spanish, British or Tsarist Russian—the signs of decline and ultimate disintegration appear some while before the edifice itself collapses. These signs are to be seen already in the three areas in which the system’s sustainability is in jeopardy. One area is ecological: the West failure system is unable by its nature to correct and reverse the processes of environmental damage that threaten the survival of not only our own but other species of animals and plants. Another is financial: the West failure system is unable—again, because of its very nature—to govern and control the institutions and markets that create and trade the credit instruments essential to the ‘real economy’. The last area is social: the West failure system is unable to hold a sustainable balance between the constantly growing power of what the neo-Gramscians call the transnational capitalist class (TCC) and that of the ‘have-nots’, the social underclasses, the discontents that the French call les exclus—immigrants, unemployed, refugees, peasants, and all those who already feel that globalisation does nothing for them and are inclined to look to warlords, Mafias or extreme-right fascist politicians for protection. The point here is that until quite recently the state through its control over the national economy, and with the fiscal resources it derived from it, was able to act as an agent of economic and social redistribution, operating welfare systems that gave shelter to the old, the sick, the jobless and the disabled. This made up for the decline in its role—in Europe particularly—as defender of the realm against foreign invasion. Now, however, its ability to act as such a shield and protector of the underprivileged is being rapidly eroded—and for reasons to which I shall return in a while.

In short, the system is failing Nature—the planet Earth—which is being increasingly pillaged, perverted and polluted by economic enterprises which the state-system is unable to control or restrain. It is failing Capitalism in that the national and international institutions that are supposed to manage financial markets are progressively unable—as recent developments in east Asia demonstrate—to keep up with the accelerating pace of technological change in the private sectors, with potentially dire consequences for the whole world market economy. And it is failing world society by allowing a dangerously wide gap to develop between the rich and powerful and the weak and powerless.

The fact that the system survives despite its failures only shows the difficulty of finding and building an alternative. No one is keen to go back to the old colonialist empires. And though Islam and Christian fundamentalism make good sticks with which to beat the western capitalist model, the myriad divisions within both make any kind of theocratic-religious alternative highly improbable. So the old advice,

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‘Keep hold of nurse, for fear of worse’ is still widely followed even while faith in her skill and competence is more than a little doubted.

The symbiosis of two systems

To understand how and why the political system based on territorial states and the economic system based on markets and profit came to grow together so closely that they are inseparable the one from the other, a little historical perspective is essential. As I said earlier, this is kids-stuff to historians and sociologists, but perhaps not so much so to many students of international politics.

Recall that the European state in the latter half of the 17th century was almost without exception dynastic, supported by and supporting a land-owning class deriving wealth from agriculture and passing its wealth down by rights of inheritance. The Treaty of 1648 removed one major source of conflict and instability—religion—but did nothing to stop conflicts over the major source of revenue and wealth for the state, which was control of territory and the surplus value created by farming. It would be hard to imagine a political economy further removed from the national economies of the 20th century.

The major difference between the system then and now, in my opinion, concerns the role of money in the state system. In the late 17th century, although states issued coins, they had little control over the choice of the medium of exchange preferred by traders—even within their own national territory, let alone beyond it. The benefits to be derived from seigniorage were therefore limited; adding lead to silver coins was common but yielded little extra to state revenues. Thus the opportunities for states to manipulate money for their own advantage were minimal.

Almost coincidentally, the big breakthrough for states came at the turn of the century with the introduction of a new kind of money—state promises-to-pay.3 Two Scots, John Law and William Patterson, both saw that by this means money could be created with which to replenish the resources of the state by issuing pieces of paper carrying the ‘guarantee’ of the monarch. In France, the venture ended in disaster from over-issue of shares and the disgrace of John Law. The Bank of England only just escaped the same fate by passing the management of the state debt to the South Sea Company.4 But by the end of the 18th century, the idea had caught on. Soldiers could be recruited and wars could be fought on credit; the American War of Independence was funded thus, and Napoleon paid his Grande Armée with the issue of assignats—promises to pay said to be guaranteed by the value of French land—but ultimately worthless.

In short, the creation of credit by governments and banks could (and did ) boost trade and production in the market economy—but it also allowed the abuse of the system by states. The list of sovereign defaulters on state debt in the 19th century

3 Michael Veseth has argued that this was first tried in 14th century Florence. He may be right but it was a political trick not widely copied. Veseth, Mountains of Debt; Crisis and Change in Renaissance Florence, Victorian Britain and postwar America (Oxford, 1990).
4 The full story is entertainingly told by J. K. Galbraith in Money—Whence it Came and Where it Went (London, 1975).
was a long one. Yet although some economic growth—in the American West especially—was generated by the discovery of new supplies of specie metals, most of it was owed to the creation of credit by banks and by governments. Led by Britain and the Bank of England, the developed countries all evolved their own regulatory systems and set up central banks as lenders of last resort to ensure that banks observed prudential rules in creating credit. Britain also passed laws to ensure that the state too behaved prudentially. The Bank Charter Act of 1844 put strict limits on the right of British governments to expand the money supply—limits only raised when war broke out in 1914. The result was that the value of the pound sterling in terms of gold remained unchanged for a century, thus creating the first stable international money. In the United States, the Federal Reserve System was established belatedly in 1913 only after the shock of the 1907 financial crisis.

These safeguards gave way before the onslaught of a global political system embroiled in the First World War. The Russians on one side and the Germans on the other paid for the war more than most by printing paper. As in Napoleonic times, states in the West failure system made desperate by the whip of war practised financial deception on their own and other people. The practice was the Achilles’ heel of the market economy. But the history of credit creation clearly showed the symbiosis of the political system of states and the economic system of markets. The entrepreneurs in the market economy needed the security, the law and order, and the state paraphernalia of courts, property rights, contractual rules and so forth to let market forces function with confidence in the other party, whether buyer or seller, creditor or debtor. Equally, the governments of states came to depend on the financial system that private entrepreneurs had developed to create credit. Before the 18th century, heads of state did occasionally borrow from bankers—the Medici were unusual in running their own bank. But it was only after 1700 that the practice took hold of borrowing from society by issuing paper money or government promises-to-pay. By the 20th century, government debt had grown to the point where the financial system had become indispensable for the conduct of state business.

The three failures

Let us start with the failure to manage this credit-creating system of finance. Up to summer 1997, the conventional wisdom was that states and their intergovernmental organisations between them were well able to supervise, regulate and control the banks and other institutions that created and traded in credit instruments—from government bonds to securitised corporate paper to derivatives. This was the message of a much-praised study by Ethan Kapstein. While national regulatory systems in each of the major developed economies functioned at the state level, the

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7 Derivatives are contracts to purchase or sell derived from some real and variable price. This can be anything from the yen-dollar exchange rate, the price of frozen orange juice or the debt of governments or business enterprises. Derivative trading has grown at a rate of 40 per cent a year since 1990 and by 1995 according to the IMF was valued at nearly $50 trillion a year, or twice world economic output.
International Monetary Fund (IMF) and the Bank for International Settlements in Basle (BIS) functioned at the transnational level. This two-level, belt-and-braces system of governance could take care of any problems arising in the markets. But in the course of 1997, events in east Asia cast serious doubt on this comforting conclusion. The turmoil that hit the Malaysian, Indonesian and Thai currencies and stock exchange prices came out of a clear blue sky. Neither of those international regulatory institutions had foreseen or warned against such a contingency. As the turmoil spread and grew, the first rescue packages proved insufficient to restore even minimal confidence and had to be substantially increased. The common factor in all the stricken economies was an influx of mobile short-term capital, too much of which went in ill-considered speculative loans or in unproductive real-estate investments. Prime Minister Mahomed Mahathir of Malaysia blamed George Soros and other foreign speculators who had moved their funds out of the country as quickly as they had taken them in. But it was soon apparent that national regulations over the banks and over short-term capital movements in each of the east Asian countries (Taiwan excepted) had been totally inadequate. The admonitions to embrace financial liberalisation that came from Washington and the IMF had been taken altogether too literally.

But it is not just that the national systems and the international financial organisations were equally unprepared for the shocks of summer and autumn 1997. The case against Epstein’s comfortable conclusions concern much more (a) the inadequacy of both the BIS and the IMF as global regulators; and (b) the inadequacy of all national systems of financial regulation. 9 To be fair to Epstein, it only became apparent after he had done his study that the Basle system of capital-adequacy rules devised by the Cooke Committee in the 1980s and subsequently elaborated was not after all really effective. In its 1997 report the BIS more or less admitted as much and, making a virtue out of necessity, announced that in future the supervisory responsibility would rest with the banks themselves. Now, as the Barings story had shown, trusting the poachers to act as gamekeepers was an unconvincing strategy. The bosses at Barings neither knew nor wanted to know what Nick Leeson was up to. Barings’ survival under acute international competition made them glad of the profits while discounting the risks he was taking. And even in the most prudent of banks these days, the complexities of derivative trading are often beyond the comprehension of elderly managers. 10

As for the IMF, its competence to coerce Asian governments into supervising and reforming their banking and financial systems is open to grave doubt. The IMF is used to negotiating with states (especially Latin American ones) over sovereign debts. Its officials—mostly economists—have no experience that helps them catch out wily and secretive bankers when they lie or cover up their business. Moreover, as the record in Kenya, for example, shows, IMF economists have no leverage when it comes to obdurate dictators protecting their corrupt and clientelist power structures. The problem with Suharto is above all political, not technical. The same is true of the African debt problem. Everyone, including the IMF, now agrees that rescheduling old debt in the Highly Indebted Poor Countries (HIPC) is only

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10 A 1997 survey of opinion in the City of London found that most people—bankers included—regarded ‘bad management at the banks’ as the no. 1 threat to the stability of the system. (Banana Skins survey by the Centre for the Study of Financial Innovation, 18 Curzon St., London W1).
making the problem worse, not better. But the IMF and World Bank are unable to force the creditor governments into the necessary agreement on whose debt should be wiped out and by how much.\textsuperscript{11}

As for the declining effectiveness of national systems of financial regulation and control, this may be less evident to Americans than it is to Europeans and Japanese. The German, French, British and Japanese systems function very differently. But all are currently being undermined by the technological innovations in financial dealing and the almost-instant mobility of capital across borders and currencies.\textsuperscript{12} A dangerous gap is therefore opening up between the international institutions that are unable and unwilling to discipline the banks, the hedge and pension fund managers and the markets, and the national systems of supervision and control whose reach is not long enough nor quick enough to prevent trouble. Eric Helleiner has argued that supervisors now have the technical know-how to trace funds as they move about the global financial system. True, but only far too slowly and with too much painstaking effort; not fast enough nor regularly enough to protect the system.\textsuperscript{13} So long as tax havens provide a refuge for wrongdoers, from drug dealers to corporate tax-evaders and heads of state who regard their country’s aid funds as personal property, the national regulators’ hands are tied.

The environmental failure

I have put the financial failures of the state-based system first because my recent research has convinced me that it is the most acute and urgent of the current threats-without-enemies. If we do not find ways to safeguard the world economy before a succession of stockmarket collapses and bank failures eventually lands us all in a 20-year economic recession—as the history of the 1930s suggests it might—then no one is going to be in a mood to worry overmuch about the longterm problems of the environment.

On the other hand the environmental danger is much the most serious. The planet—even the market economy—could survive 20 years of slow economic growth. But if nothing is done to stop the deterioration of the environment then the point might come with all these dangers when it was too late. The destructive trend might have become irreversible. Nothing anyone could do then would stop the vicious circle of environmental degradation and it would be the West failure system that brought it about and prevented remedial and preventive action. Why? Because the territorial principle which lies at the heart of it proclaims that the territorial state is responsible for its own land—but not for anyone else’s.

There are three distinct kinds of environmental danger. But for each, it is not the lack of technical knowledge, nor of appropriate policy measures that is lacking. It is the ability of the West failure system to generate the political will to use them. One is the destruction of the ozone layer. This is mainly attributed to the release of CFC gases from aerosols and other sources. As the ‘hole’ in the ozone layer grows larger,
the protection from the sun given by the earth’s atmosphere is weakened with serious atmospheric and climatic consequences. Another environmental problem is caused by carbon dioxide and sulphur pollution of the air. Some of this pollution comes from industry. But a lot comes from cars—cars that use petrol or diesel for fuel. Third, there is the depletion of the planet’s resources—primarily of water, shrinking the acreage available for cultivation. Secondarily, there is the depletion of forests—not only rainforests—bringing unforeseeable climatic consequences, and also the depletion of species of plants, fish and animals, upsetting ecological balances that have existed for millennia.

With each of these environmental dangers, it is not hard to see that it is the state, with its authority reinforced by the mutual support provided by the Westfailure system, that is the roadblock, stopping remedial action. One consequence of the principle can be seen in the indifference of British governments to the acid rain carried by prevailing westerly winds to Scandinavian forests; or the indifference of US governments to the same kind of damage to Canadian forests. Another can be seen in the impasse reached at the Rio and Kyoto intergovernmental conferences on the environment. European and Japanese concerns left the United States substantially unmoved when it came to stricter controls over CFC gases. Nothing much has changed since. The agreements at the Kyoto conference in 1997 were more cosmetic than substantial. And when it comes to the pollution danger, the biggest impasse is between the developed countries and China. Pressure on Beijing from the United States and others to slow down the consumption of fossil fuels for the sake of the environment is met with the question, ‘If we do, will you pay?’ After all, they argue, the environmental dangers you perceive today were the result of your past industrialisation, not ours. Why should you expect us to be more environmentally aware today than you were yesterday? With our growing population, we cannot afford—unless, of course, you are prepared to pay—to slow down our growth to keep the air pure and the water unpolluted. Only rarely, as when Sweden offered to contribute funds to Poland to pay for tougher environmental rules on Polish coal and chemical plants, is the Westphalian territorial principle set aside. But Sweden is rich, was directly damaged by Polish pollution and could justify the transfer on grounds of self-interest. China and the rest of the developing countries are a far bigger nut to crack. So long as the Westfailure system persists, Nature will be its victim.

As Andrew Hurrell commented in a recent review, ‘the pitfalls outweigh the promise by a very considerable margin’ when it comes to transmuting short-term transfers into well-institutionalised long-term commitments on environmental matters. Hurrell also quotes one of the concluding chapters in the book, ‘The studies of environmental aid in this volume paint a rather dark picture. Constraints on the effectiveness of environmental aid seem more pronounced than windows of opportunity’.

The third Westphalian failure is social, or social and economic. The discrepant and divergent figures on infant mortality, on children without enough to eat, on the spread of AIDS in Africa and Asia, and on every other socio-economic indicator tell the story. The gap between rich countries and very poor ones is widening, and so

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is the gap between the rich and poor in the poor countries and the rich and poor in the rich countries. It is not that we do not know the answer to socio-economic inequalities; it is redistributive tax and welfare measures and what Galbraith called countervailing power to make good the tendency of capitalism to private affluence and public penury, and to booms followed by slumps. But applying that answer to world society is frustrated by the West failure system, so closely tied in as it is with the ‘liberalised’ market economy. If national Keynesian remedial policies are made difficult by the integrated financial system—as Mitter found out so painfully in 1983—transnational Keynesian policies are practically inconceivable. We have had one demonstration of this in central Europe in the early 1990s. Here was a case, if ever there was one, for a second Marshall Plan to prime the pump for a rapid transition from state-planning to an open, competitive and therefore productive market economy. But the Reagan and Bush administrations were ideologically unsympathetic and the Germans too self-absorbed in their own unification to bother about the fate of their nearest neighbours. Indifference, whether to central Europe or to Africa, is not just a matter of the selfish, conservative mindsets that Gerald Helleiner recently parodied in verse:

The poor complain. They always do. But that's just idle chatter. Our system brings rewards to all, at least to all that matter.

It is actually an inevitable result of the symbiosis between a world market economy and a state-based political system in which those with political authority are inherently unable to see that socio-economic polarisation is not in anyone's long-term interest. It is not just that the underprivileged may riot and loot as in Los Angeles in the 1980s or Jakarta today, or that they may pass their new epidemic diseases to the rich, or wage terrorist campaigns under the guise of religious jehad.

It is that socio-economic inequality becomes intolerable if people believe it will get worse, not better. They can bear deprivation and hardship if they believe that their children's lot will be better than theirs. Moreover, a flourishing market economy needs new customers, with money to spend, not homeless beggars and starving African farmers. America would not be what it is today without the millions of penniless immigrants that constantly expanded the mass market for its manufactures.

What is to be done?

The two commonest reactions to the three failures of the system I have briefly described are either to deny the failures and to defend the dual capitalism-state system in panglossian fashion as the best of all possible post-Cold War worlds, or else fatalistically to conclude that, despite its shortcomings there is nothing that can be done to change things. Only quite recently has it been possible to detect the first tentative indications of a third response. It is to be heard more from sociologists than from international relations writers, perhaps because sociologists tend to think in terms of social classes and social movements rather than in terms of nation-states.

16 Helleiner in Kenen (1994).
As a recent collection of essays around the theme, ‘The Direction of Contemporary Capitalism’ shows, there is little consensus among them either about current trends or about possible outcomes. A good deal of this thinking has been inspired by the rediscovery of Antonio Gramsci and his concepts of hegemony, the historic bloc and social myths that permit effective political action. A common assumption is that the present system is sustained by the power of a transnational capitalist class (TCC).

I have no doubt that such a class exists and does exert its power over the market economy and the rules—such as they are—that govern it. Nearly a decade ago, I referred to it as the dominant ‘business civilization’. I think Gill was mistaken in seeing evidence of its power in the Tripartite Commission, which was more a club of well-meaning has-beens than an effective political actor, a mirror rather than a driver. But he was right in spotlighting the emergence of a transnational interest group with powerful levers over national governments including that of the United States and members of the European Union. Recent research in telecommunications, trade negotiations concerning intellectual property rights and a number of other spheres where international organisations have been penetrated and influenced by big-business lobbies all point to the existence of such a TCC. Yet to call it a class suggests far more solidarity and uniformity than in fact exists. The more I look into the politics of international business, the more I am struck by the growing divide between big business—the so-called multinationals—and the people running and employed by small and medium business enterprises. These enjoy few of the perks and privileges of the big corporations yet have to conform to the rules and agencies created by them. For them, globalization is something to be resisted, if only because it so blatantly tramples on the democratic principles of accountability and transparency.

The environmental issue area is a good example of the fissures in the TCC. On the one side are the big oil companies, the giant chemical combines, the vested interests of the car manufacturers and associated businesses. On the other are firms in the vanguard of waste disposal and clean-up technologies and interestingly—the transnational insurance business (Haufler, 1997). Fear of the vast claims that might be made against their clients on environmental grounds is putting insurers increasingly in opposition to the polluters. Their opposition, of course, is predicated on legal systems that are sensitive to public opinion. The power of the latter meanwhile is also evident in the growing sensitivity of some elements in business to shareholders and consumers.

Thus, the notion tentatively posited by some of the neo-Gramscians that while there is some sort of TCC there is also an emerging global civil society is not lightly to be dismissed. To quote Leslie Sklair:

No social movement appears even remotely likely to overthrow the three fundamental institutional supports of global capitalism . . . namely, the TNCs, the transnational capitalist class and the culture-ideology of consumerism. Nevertheless in each of these spheres there are resistances expressed by social movements.

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Similarly, Rodolfo Stavenhagen, writing on ‘People’s movements, the antisystemic challenge’ in the collection of essays edited by Bob Cox, finds the growth points of a nascent transnational opposition, or counterforce to Sklair’s three institutional supports sustaining the Westfailure system. Not only, he says, are such social movements non-governmental, they are popular in the widest sense of that word; they are alternative to established political systems, and therefore often at odds with national governments and political parties and they seek ‘to attain objectives that would entail alternative forms of economic development, political control and social organisation’.

In his introduction to this collection of essays, Cox does not predict the imminent demise of the ‘fading Westphalian system’. The future world, he observes, ‘will be determined by the relative strength of the bottom-up and top-down pressures’. The contest may be a long one and no one should underestimate the power of big business and big government interests behind these top-down pressures. Yet at the same time there is no denying that as Cox says, ‘people have become alienated from existing regimes, states and political processes’. Witness the recent amazing, unforeseen turn-out—a quarter of a million in Paris and the same in London—in anti-government marches by country dwellers of every class and occupation. Everywhere, in fact, politicians are discredited and despised as never before. The state is indeed in retreat from its core competences in security, finance and control over the economy; and this retreat is not inconsistent with its proliferating regulation of many trivial aspects of daily life. The new multilateralism Cox predicates ‘will not be born from constitutional amendments to existing multilateral institutions but rather from a reconstitution of civil societies and political authorities on a global scale building a system of global governance from the bottom up’.

For international studies, and for those of us engaged in them, the implications are far-reaching. We have to escape and resist the state-centrism inherent in the analysis of conventional international relations. The study of globalisation has to embrace the study of the behaviour of firms no less than of other forms of political authority. International political economy has to be recombined with comparative political economy at the sub-state as well as the state level. It is not our job, in short, to defend or excuse the Westphalian system. We should be concerned as much with its significant failures as with its alleged successes.

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20 Rodolfo Stavenhagen, in R. Cox (ed.), The New Realism: Perspectives on Multilateralism and World Order, p. 34.
21 Strange, 1996.
22 Cox, op. cit., p. xxvii.