International Economic Integration and National Governance as Synergistic Processes*

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Abstract

Few phenomena that are associated with globalization inspire as impassioned a debate as its impact on national governance. Some scholars fear that globalization inexorably results in the dissolution of state power, while others scarcely see evidence for such a posture. After detailing each of these positions, I examine several empirical studies on this subject, and challenge the notion of the receding welfare state. In particular, I conclude that while globalization indeed imposes some restraints on national governments, it also compels them to become more engaged and proactive, so as to protect their citizens against unpredictable oscillations of economic activity.

Keywords: Globalization; National Governance; Welfare Spending; Convergence

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Introduction

The analysis of economic globalization, as with that of any other phenomenon of comparable complexity, demands an appreciation of nuance and subtlety. In this paper, I examine its impact on the ability of national governments to implement policies that aim to improve the social welfare of their constituents. I am mindful of the impassioned debate that this subject has inspired and, accordingly, discuss it in conjunction with my own analysis. Some scholars fear that globalization inexorably results in the dissolution of state power, while others scarcely see evidence for such a posture.[i]

After surveying the arguments for each of these two positions, I examine a large swath of empirical studies on this subject, and challenge the notion of the receding welfare state. Thereafter, I offer my own conclusions, central among them a paradox: namely, while globalization indeed imposes some restraints on national governments, it is also compelling them to become more engaged and proactive, so as to protect their citizens against unpredictable oscillations of economic activity. Indeed, as both theoretical arguments and empirical evidence bear out, much of the concern over states' declining ability to implement policies of social welfare is exaggerated.[1]

The Two Central Arguments

<u>Globalization Is Undermining State Agency</u>

The belief that globalization will lead to the restriction of the state's agentive capacity, or even to its obsolescence, predominates in scholarly literature. Some, for example, believe that national governments are already relics of a slower, more static period in world history. Kenichi

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[i] I would be remiss to argue that these two arguments comprise the full spectrum of debate on this subject. However, they are sufficiently representative that I saw fit to ignore intermediate views in my analysis.

Ohmae, the noted “hyperglobalist,” for example, argues that “…the nation state is irrelevant…[now, it is] anti-progressive and introspective… the global economy acts to discipline governments and to streamline regions. Borders are nothing but a burden for old nation-states.”[2] Admittedly, his posture is extreme even within the school of thought that predicts the end of the nation-state. The only difference, however, between it and other similar views is its timeframe. That is to say, while most scholars do not believe that the state has already become irrelevant, they argue that it is heading in that direction. Martin Albrow, the prominent British sociologist, for example, renders this judgment: “[Globalization] demonstrate[s] the autogenic nature of [social organization] and reveal[s] the nation-state as just another timebound form.”[3] Dani Rodrik, a vocal participant in the debate that motivates this paper, contends that a system of “global federalism” will supplant the nation-state by the conclusion of the 21st century.[4]

The economic theory that underlies these beliefs is straightforward. As barriers to the flows of goods, services, and capital steadily decline, interfirm competition will intensify, as leading companies attempt to locate their production processes where they incur minimal costs. As technological innovation progresses, furthermore, and accelerates the process of modularization, the tenuous allegiance that firms maintain to their home countries will be further eroded. Therefore, if national governments wish to avert the exit of domestic enterprises, they must eliminate (or at least substantially reduce) any measures that inhibit competition: chief among them, taxes. If governments significantly reduce rates of taxation of firms, it follows, tax revenues will decline, thereby curtailing their ability to engage in welfare spending.

Reuven S. Avi-Yonah, Assistant Professor of Law at Harvard Law School, offers one of the clearer and more thorough defenses of this inferential chain, and argues that “if both globalization and social insurance are to be maintained, it is necessary to cut the intermediate link by limiting tax competition in a way that is congruent with maintaining the ability of democratic states to determine the desirable size of their government."[5] Rodrik, whose arresting conclusion I highlighted earlier, shares Avi-Yonah's concerns, and details them in his controversial work, *Has Globalization Gone Too Far?* Before proceeding any further, I note that his arguments and those of like-minded scholars are grounded in the "efficiency hypothesis": namely, that, government spending is inimical to competition, because it is generally linked to increased tax rates, or results in higher interest rates.[ii]

Furthermore, whether tacitly or explicitly, Rodrik and his counterparts affirm the principle of convergence: namely, that, as the integration of the global economy accentuates, states will largely relinquish their autonomy over macroeconomic policy. They will, instead, be compelled to adopt policies that nurture competition, such that, in the extreme, they will formulate and implement largely homogenous macroeconomic measures. William Baumol, Professor of Economics at New York University, believes in the existence of three "convergence clubs," wherein labor productivity of each of the member states approaches a common value.[6] In accordance with traditional thought on the subject, he believes that this phenomenon is attributable to, in considerable measure, the rapidity with which technological innovation proceeded after the conclusion of the Second World War. He reasons that, as in the case of taxation policy, once one state has pioneered a new technology, other states will adopt whatever policies are necessary to secure that technology, so as not to fall behind.[7] Other studies reach less dramatic conclusions. Charles I. Jones, Assistant Professor of Economics at Stanford University, uses a neoclassical model of growth to extrapolate the evolution of the global income

[ii] One need not look far to uncover a vast trove of scholarship on the debate between the "efficiency hypothesis" and the "compensation hypothesis," the latter of which maintains that high welfare spending correlates to robust governance. A good paper with which to start if one seeks a deeper understanding of each hypothesis' central tenets is Robert R. Kaufman and Alex Segura-Ubiergo, "Globalization, Domestic Politics, and Social Spending in Latin America," *World Politics* 53 (July 2001), 553-87.

distribution. He concludes that, since 1960, "there has been some convergence or 'catch-up' at the top of the income distribution and some divergence at the bottom."[8] This prediction of dichotomous movements is more prevalent than Baumol's assessment.[9]

<u>Globalization Minimally Impacts National Governance</u>

I offer only a brief statement of this argument, as it corresponds closely to the one upon which I expound in subsequent sections. While conventional wisdom views the state as increasingly enfeebled, this school of thought maintains that it is still highly relevant. States, after all, have nurtured the rise of multilateral agreements on flows of trade and capital that have helped to usher in the current phase of globalization. They determine the functionality, or lack thereof, of international economic institutions, and continue to serve as the principal organizational units around which global affairs center.[10] The main argument, however, in support of this position – the one that lays the foundation of my own assessment – is that the great heterogeneity of firms and political regimes serves to temper the theoretical impacts of economic globalization. The empirical survey that follows begins to highlight this point.

A Survey of Some Principal Quantitative Studies

Joseph S. Nye, Jr., Emeritus Dean of Harvard University's John F. Kennedy School of Government, argues that "Welfare states are alive and well in most developed countries…It is true that external influences add constraints on state policies, but economic integration is still at a relatively low level."[11] There are a host of measures that support this assertion. Consider, for example, that in 2004, developed economies' share in all flows of foreign direct investment was 73.8%.[12] Indeed, many have argued that the current phase of globalization is, in some ways, more limited in its scope than that which characterized the period from 1870 to 1914, because it is largely confined to the United States, the European Union, and Japan ("The Triad").

Furthermore, numerous studies have actually documented a robust relationship between international economic integration and government expenditures in developed economies, in contrast to Rodrik's premise. Giandomenico Majone, Emeritus Professor of Public Policy at the European University Institute, surveys the European Union, one of the world's most critical regions of economic interdependency. He finds that, even though it has been the site of increasing international capital mobility and declining barriers to trade,

> …the average tax rates have been climbing since the mid-1960s both in the original member states…and in the countries of the European 'periphery'… There are also few signs that a race to the bottom in the provision of public services is taking place in the European Union. Rather, as in the case of taxation, the race has been in the other direction, with the southern countries upgrading to northern levels of expenditure.[13]

Similar patterns extend to the broader community of developed economies. Indeed, from 1965 to 2000, general government tax revenue as a percentage of Gross Domestic Product (GDP) rose by 11.6% in the countries that comprise the Organization for Economic Cooperation and Development (OECD).[14] Stephen Krasner, currently the Director of Policy Planning at the State Department, affirms this conclusion: "overall government activity, as reflected in taxation and government expenditures, has increased as a percentage of national income since the 1950s among the most economically advanced states. The extent of a country's social welfare programs tends to go hand in hand with its level of integration within the global economy."[15] Indeed, using a simple analytical model, Samuel Bowles, Professor of Economics at the University of Massachusetts, Amherst, argues that globalization and egalitarian redistribution, far from being mutually exclusive, can take place concurrently.[16]

I would be remiss to argue that developed countries comprise a monolithic bloc: there are, after all, critical variables that differentiate performances even among robust economies. Thus, for example, Duane Swank, Professor of Political Science at Marquette University, conducts an econometric analysis of 16 states (all of which possessed advanced industrial economies) that employs data for the years 1964 to 1993, and concludes “that international capital mobility has few direct effects on the scope of the public economy.”[17] Swank argues, however, that a state’s system of governance is a linchpin variable. Thus, he argues that in European welfare states, where inclusive electoral institutions prevail, and authority is concentrated, the degree of globalization correlates positively to levels of welfare spending. In countries such as Canada and the United States, however, where exclusive electoral institutions are the norm, and power is widely disaggregated, this relationship is inversed.[18] Swank recently conducted a similar econometric study, using data from the period 1981 to 2000, and once again concluded that fears of welfare state retrenchment are largely exaggerated.[19]

What does this empirical evidence suggest? At the very least, it warns us that any unequivocal declarations of state erosion should be viewed with reservation. It furthermore suggests that while globalization may impose some limitations on states’ ability to govern, these limitations are not nearly as exacting as some mainstream scholarship would have us believe. My own assessment centers on this last assertion.

My Own Assessment

I do not dispute that globalization has imposed some restrictions on the state’s ability to govern; even the most vocal criticisms of conventional doctrine will concede as much. Developed in the 1960s, the Mundell-Fleming model insightfully captured this fact. It illustrated that a small, open economy could only achieve two of the following three conditions: a fixed exchange rate, perfect capital mobility, and autonomy over monetary policy. Indeed, these three conditions collectively form the "impossible trinity."[20] At present, technological innovation and the twin revolutions in information and communication afford companies unprecedented opportunities to relocate one or more sequences of their production processes. It can reasonably be assumed, then, that a given company – particularly if it exerts a powerful influence in global markets – no longer maintains exclusive ties to its country of operation.

Why is it, then, that globalization has only had limited impacts on national governance? I would volunteer two reasons:

(i) There are myriad variables that determine a firm's decision to remain at home or relocate abroad, many of which receive insufficient attention.

(ii) States are increasingly pressured to become more proactive, so as to prepare for and neutralize the vagaries of the market.

It is quite often argued that international capital mobility has absolved the ties between firms and their base countries. Evidence for this assertion, however, is lacking. If it were indeed correct, we would expect to see the development of genuinely transnational companies. Available data challenges this proposition, suggesting that, insofar as it has progressed, the internationalization of business activity has largely been characterized by the proliferation of multinational corporations (MNCs). Furthermore, as of the late 1990s,

> between 65 and 70 percent of MNC value-added continues to be produced on the home territory…in many ways, [national systems] are being strengthened and reinforced by the internationalization of business. Firms are locking themselves into the advantages offered by particular locational production configurations, which are enhancing their ability to compete. In addition, the continuation of a clear home-centredness for most MNCs also

> needs to be recognized as providing them with advantages that they will not easily give up.[iii,21]

It is this last point that merits critical elaboration. Convergence theory rests on two assumptions: that firms are largely homogeneous within and across countries, and that they almost reflexively decide where to invest on the basis of cost. Again, although in theory, these propositions do not seem unreasonable, the documentary record reveals them to be tenuous.

A good basis for continuing this discussion is the notion of "varieties of capitalism." Peter A. Hall, Krupp Foundation Professor of European Studies at Harvard University, and his colleague, David Soskice, former Director of the Research Unit for Economic Change and Employment at the Wissenschaftszentrum für Sozialforschung, Berlin, have largely pioneered this concept, distinguishing betwen "liberal-market economies" (LMEs) and "coordinated-market economies" (CMEs).[22] The essential difference between the two types is that firms that operate in LMEs are more likely to make key decisions on the basis of market structures, whereas firms that operate in CMEs tend to base their decisions on strategic interactions with other societal agents.[23] Hall and Soskice conclude that while theoretical models roughly predict the behavior of firms in the former category, they possess little explanatory power in regards to the actions of firms in the latter:

> …because international liberalization enhances the exit options of firms in LMEs, as noted above, the balance of power is likely to tilt toward business. The result should be some weakening of organized labor and a substantial amount of deregulation, much as conventional views as predict…Although there will be some calls for deregulation even in [CMEs], the business community is less likely to provide less support for it, because many firms draw competitive advantages from systems of relational contracting that depend on the presence of supportive regulatory regimes.[24]

[iii] For further discussion of this point, see Robert Wade, "Globalization and its Limits," in Suzanne Berger and Ronald Dore, *National Diversity and Global Capitalism* (Ithaca: Cornell UP, 1996) 78-82.

In particular, as the above discussion establishes, there are oftentimes key locational advantages that compel firms to remain in their home states. Knowledge spillovers offer a prime example. In its appraisal of the global knowledge economy, the Center for Strategic Economic Studies reaches a striking conclusion: "*Despite* improved capability for global communication, firms increasingly co-locate because it is the only effective way to share understanding (tacit knowledge)."[25] What arguments like Rodrik's miss, then, is that globalization and localization are not mutually exclusive processes, but, rather, can operate in conjunction.[26] One study even argues that international economic integration "accentuates" "the significance of the local context for innovative activities."[iv,27] Even beyond knowledge accumulation and diffusion, however, we confront significant challenges to the conventional wisdom. Alarmist analysis, for lack of a more suitable phrase, fears that in an effort to curtail their costs, firms will engage in a "race to the bottom struggle" that will result in lower labor and environmental (among other) standards prevailing in those locations where they decide to situate their production processes. Interestingly, it has been documented that firms oftentimes locate their operations where regulatory measures are more stringent and, accordingly, costly. Indeed, "Corporations that are used to operating in strict regulatory environments have fewer adjustments to make if other countries ratchet up their regulatory standards. This gives them a cost advantage over domestic firms in host countries that raise their standards, providing the opportunity to expand market share and profits."[28]

What the traditional criticisms of corporate behavior fail to recognize, or perhaps choose to ignore, is the multiplicity of factors that enter into a firm's decision to invest in a particular location. The seeming allure of developing states oftentimes proves to be illusory. After all, they

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[iv] Also, see Wolf, pp. 262-65, for a discussion of this point within the broader context of resource immobility.

are not only places of lower wages and laxer protocols; they are also, quite often, home to political instability, high unit labor costs (if workers are generally unproductive), poor infrastructure, and corruption. Where present, these, and other such, conditions, critically limit the value that firms stand to gain by investing in a developed country. The decision of where to locate one's plants, then, far from being binary, as the alarmist caricature would have one believe, entails a highly complex cost-benefit analysis.[v]

The other central explanation of the state's survival – and, indeed, general well-being – is that states have, by virtue of necessity, become more engaged. The disastrous experience of the Commonwealth of Independent States in the 1980s, the abrupt termination of East Asia's remarkable expansion in 1997-98, and similar macroeconomic crises of recent memory all affirm that unwavering faith in the market as a guarantor of stability and prosperity is misguided. They convincingly illustrate that "…globalization increases the role of government. Its role may be different than in the past, but it nonetheless remains crucial."[vi,29] Much scholarship has glossed over this distinction, arguing, in effect, that the changing nature of state power is tantamount to its diminution. Rather,

> International agreements on criminal investigation and deportation, mutual defense, customs and taxation harmonization, and statistical cooperation all mean that individual states can conduct their functions more, not less, effectively both at home and abroad. Other functions, meanwhile, might be rendered more problematic, such as macroeconomic management, immigration control or cultural policy. In addition, the

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[v] For a superb account of the (potential) drawbacks of investing in developing states, one that is informed by a rich array of recent case studies, see Suzanne Berger, *How We Compete: What Companies Around the World Are Doing to Make it in Today's Global Economy* (New York: Currency 2005).

[vi] Some scholars argue that it is domestic changes, rather than international ones, that are compelling the expansion of the welfare state. For an eloquent and powerfully stated argument in support of this view, see Torben Iversen and Thomas R. Cusack, "The Causes of Welfare State Expansion: Deindustrialization or Globalization?", *World Politics*, 52 (April 2000) 346. Iversen's and Cusack's paper is ambitious, in that it attempts to disentangle the impacts of internal and external economic forces, even as the two appear to be highly interwoven. I do not attempt to offer any convenient resolutions to the debate on this crucially important topic, and offer my arguments in this paper under the assumption that it is external economic forces (i.e., globalization) that are of principal importance.

> state as a generic form of institutional governance need not be diminished in power even if states, understood as national sovereign entities, are undermined.[30]

Over time, the state's functions have continually evolved. Furthermore, national governments have exhibited remarkable resilience, even though predictions of their erosion have endured.[31]

In the preceding discussion, I have spoken of states as if they are uniform. However, as I hastened to note earlier, it is crucial to recognize that the effects of globalization on states are highly variable, if only because the routes through which it exerts influence – particularly, political institutions – are arranged differently in almost every state. In an earlier section, I remarked that many critiques of globalization presume the homogeneity of firms. In an analogous manner, they oftentimes ignore the range of political systems with which globalization interacts. Thus, international economic integration will not have the same impact on a democracy as it does on a social corporatist state as it does on a dictatorship. Accordingly, "the filters provided by domestic politics and political institutions play a major role in determining what effects globalization really has and how well various countries adapt to it."[vii,32] Even among countries that have nominally identical political regimes, globalization's impact varies widely. Hence the conclusion of recent scholarship that external economic forces have had varying impacts on the welfare states that spawned in the wake of the Soviet Union's dissolution."[33] Furthermore, among developed economies, public expenses as a percentage of Gross National Product in OECD countries have increased by smaller amounts in liberal countries than in social democratic ones. Thus, from 1960 to 1995, this figure grew by approximately 12% in the former category, while it grew by nearly 28% in the latter category.[34]

[vii] For further discussion of this point, see Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca: Cornell UP, 1986) 234-38. See also David Cameron and Janice Gross Stein, "Globalization, Culture, and Society: The State as Place Amidst Shifting Spaces," *Canadian Public Policy*, 26:2 (2000), S25-6.

I will concede to analysts such as Rodrik that globalization's restrictive effects are more pronounced in economies that are more open and competitive. However, this admission is entirely compatible with my central argument. I have not argued, after all, that the correlation of economic globalization to welfare spending should be uniform across countries, only that it need not be (and usually is not) negative. I have also recommended caution, as the implicit presumption of political-institutional homogeneity that informs much analysis on this subject is flawed. Robert Boyer, founder of CEPREMAP, a French research center that examines the interface between economic research and public administration, offers a sophisticated and eloquent argument in favor of this assertion:

> Within [a paradigm that rejects convergence theory], there may exist a multiplicity of punctuated equilibria as opposed to a single one. The simple dynamics of convergence is only one out of many other evolutions: cumulative divergence, catch-up and collapse, catch-up and then forging ahead, partial convergence and then stabilization of the productivity gap. So, the simplicity, however largely erroneous, of convergence theory is usually preferred to the complexity of evolutionary models, which nevertheless are richer and fit better with empirical evidence about long-run capitalist growth and the coexistence of contrasted national trajectories.[35]

A final point that bears mention is that globalization and national governance should not be viewed as systems operating independently of one another. Indeed, the former critically depends on the latter. One scholar elegantly argues that "Globalization…[is] intrinsically limited by its dependence on and embeddedness in national and international rules and institutions."[36] The interwar period (roughly, 1914 to 1939) is the clearest affirmation of this principle. The First World War served to legitimate the collectivist ideologies against which liberalism had continually struggled, and prompted the vast majority of developed states to erect barriers to trade. The oft-noted result of such policies was the abrupt termination (or, at the very least, critical deceleration) of the wave of globalization that had been gaining momentum since roughly 1870. After the conclusion of the Second World War, by contrast, states constructed the trade networks whose solidification would serve to resuscitate the global economy. Today, their role in shaping globalization remains as vital as ever. After all, they are responsible for "establishing the legal and institutional environment for non-state actors," "cushioning domestic constituencies from the negative impact of international transactions," and "setting the rules that govern the movement of goods, capital, and people across national borders."[37]

At present, perhaps the most illuminating affirmation of the state's viability is the recent failure of the European Union (EU) to ratify a constitutional referendum. Even though it has become fashionable to speak of its citizens developing supranational identities, which will supplant their allegiances to national governments, this crucial setback implies otherwise. One study of European public opinion polls arrives at the following conclusion:

> In short, the European Union is a polity – a self-governing community with authority over those who live in its territory. As such it engages the territorial identities of citizens. It is no longer possible to conceive of identity as an inert outcome of integration. As European integration has moved along a broad policy front, and as one national competence after the other has come to be shared with EU institutions, so territorial identity has become an obvious constraint on support for the European Union.[38]

Concluding Remarks

The theory upon which much of mainstream scholarship has prophesied the erosion of national governments or, at the very least, their agentive capabilities, is not without some merit, as I earlier conceded. Even so, it is largely incorrect. While some exogenous phenomena (chief among them, technological advances) have accelerated globalization, it is endogenous ones that have served as its principal drivers. International economic coordination and cooperation have been of particular importance. The argument that states, having, in considerable measure, given rise to and nurtured globalization, are now powerless to shape or alter its continuation, seems tenuous. Indeed, amidst the whirlwind of international economic integration that is currently blowing, the state remains the pillar of global affairs, as it properly should.

Therefore, even as globalization presents novel challenges to governments, "it also strengthens the world-cultural principle that nation-states are the primary actors charged with identifying and managing those problems on behalf of their societies."[39] Intense debates about immigration, agricultural subsidies, outsourcing, and trade agreements, among other contentious issues, affirm this assessment. One of the ironies of globalization, then, is that, far from resulting in an attenuation of the state, it appears to highlight the state's critical importance.[40]

The belief that a system of global governance will transcend current organizational structures, while an interesting theoretical consideration, appears far removed from current realities. Rather than focusing their attention on a scenario that is unlikely to emerge (any time soon, that is) – namely, the state's dissolution – scholars and policymakers should attempt to better understand how globalization and national governance can maintain and strengthen their synergy.

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Notes

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[12] United Nations Conference on Trade and Development, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D* (New York: United Nations Publishing, 2005) 303.
[13] Giandomenico Majone, “International Economic Integration, National Autonomy, Transnational Democracy: An Impossible Trinity?”, Robert Schuman Centre for Advanced Studies Working Paper No. 48 (2002) 6.
[14] Wolf 255. This figure is unweighted.
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[16] Samuel Bowles, “Globalization and Redistribution: Feasible Egalitarianism in a Competitive World” in Richard Freeman (Ed.), *Inequality Around the World* (London: Palgrave, 2002) 230-63.
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[18] Ibid.
[19] Duane Swank, “Globalization, Domestic Politics, and Welfare State Retrenchment in Capitalist Democracies,” *Social Policy and Society*, 4:2 (2005) 183-95.
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[23] Hall and Soskice, 8.
[24] Ibid, 57-8.
[25] John W. Houghton, “The Global Knowledge Economy,” Center for Strategic Economic Studies (February 2002) 12. Emphasis my own.
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