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Globalization and national governance: antinomy or interdependence?

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'Regardless of how you define or measure it, globalization is real and its impact on state power is significant', says the globalist. 'But how do you know?' replies the sceptic. In this opening interchange one sees the origin of a controversy that after almost a decade shows few signs of abating. Globalists continue to maintain that there are big, *fin-de-siècle* transformations under way in the world at large, which can be laid at the door of something called globalization. This new era—popularized as a 'world without borders' and symbolized by the dismantling of the Berlin Wall—ostensibly came into its own where the Cold War left off. Globalists of all shades see a new world order in the making, marked by the de-territorialization of economic and political affairs, the ascendance of highly mobile, transnational forms of capital, and the growth of global forms of governance. By the same token, globalization sceptics, scrutinizing very similar empirical terrain, continue to pose the same insistent question. The dispute between globalists and sceptics is *not* about the *reality* of change; it is about the nature and significance of the changes under way as well as the driving forces behind them. 'There is something out there', agree the sceptics, but it is not necessarily, or even primarily, responsible for what is going on 'in here'. The changes that fundamentally interest globalists are usually less economic than political. That is to say that their efforts to analyse or demonstrate economic change—the extent to which national economies have become more interconnected through trade, production, finance, and the growing web of international rules and institutions—are often a prelude to the political project.

Whether that project seeks to promote economic liberalism, political cosmopolitanism, or global peace, it entails showing that the political geography of nation-states, and with it the territorial principle, is being outflanked by the economic geography of capital flows, that national forms of governance are thus swiftly becoming outdated or redundant, and that the task of intellectual analysis is to prepare the ground for political and policy transformation to better adapt to the new geoeconomic reality.[1] While the ultimate objectives of that project vary according to the broader interests and political orientations of the analyst,[2] most accounts

[1] Wolfgang H. Reinicke, *Global Public Policy: Governing Without Government?* (Washington, DC, 1998) offers an unusually rigorous and coherent statement of this position.

[2] For liberal internationalists the project of advancing economic interdependence is a means to a political end: de-territorializing/de-nationalizing politics and advancing new forms of democracy and governance. See for example the Brookings Institution's project on 'Integrating National Economies', which has published a series of 20 or so studies analysing governance issues on a wide range of topics. For some former Marxists as well, global economic integration is to be welcomed rather than opposed because it is the vehicle whereby the contradictions of capitalism are being intensified (as Marx noted in *The Communist Manifesto*), a key difference being that this time around the nation state will not be in a position to effect a rescue of the economic system. I thank Mhegnad Desai for this clarification.

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nevertheless agree on one point: the state is no longer in command of its territory, governments have mostly lost control of the national economy, and their policies to promote wealth creation and social protection are destined to be ineffective. In various refinements of this idea, the nation-state is not necessarily displaced, but its powers are profoundly altered and in some fundamental respects superseded by new forms of governance above and below it.[3]

As far as globalists (and indeed many of their sceptic critics who devote much effort to measuring and refuting its importance) are concerned, then, global and national are *conflicting* principles of organization, and global networks are advancing *at the expense of* national ones. Most definitions presuppose this antinomy, and presumptions about globalization's policy impacts reinforce it.

This article argues that the juxtaposition of global and national is unfruitful. Its presumption of a zero-sum logic has led many commentators to mis-identify globalization as the major source of policy constraints, to overstate its 'transformative' (read 'weakening') impact, and to minimize its diverse outcomes. Globalization—as a real reflection of transborder flows rather than a jazzy metaphor for interconnectedness—is a highly circumscribed, partial process, and intrinsically limited by its dependence on (embeddedness in?) national and international rules and institutions. The world order has evolved in its present form not in opposition to the territorial principle, but rather on the basis of national *cum* institutional diversity (varieties of capitalism). To eliminate such diversity may also mean to destabilize rather than secure that order.

The article has four parts. The first outlines key points of agreement and disagreement between globalists and sceptics and notes considerable overlap in the way the meaning of globalization has often become confused with statements about its impact: i.e, as a process of state power erosion or transformation. The remaining sections show why this presumption of a zero-sum logic in the juxtaposition of global and national cannot be sustained. Part two contests the claim that increasing enmeshment in international regimes (political interdependence) marks the death of sovereignty and national policy autonomy, showing that international cooperation has been a pillar of so-called policy autonomy, and is increasingly the basis for capacity enhancement. Parts three and four appraise the proposition that transborder flows (economic integration) are eroding domestic capacities for economic governance and producing a new kind of (regulatory) state; these sections present a counterargument based on a range of comparative evidence—on social and industrial-techonology policies, as well as on approaches to financial liberalization—which point to the importance of domestic constraints, domestic orientations, and institutional capacities in understanding the global-national dynamic. A concluding section follows.

[3] For a clear statement of the globalization thesis and the way global flows are seen to impact on the state, see Jan Aart Scholte, 'Global Capitalism and the State', *International Affairs*, 73:3 (1997), pp. 427–52. See also, Susan Strange, *The Retreat of the State* (Cambridge, 1996); Philip G. Cerny, 'Globalization and Other Stories: The Search for a New Paradigm for International Relations', *International Journal*, 29: 1 (1996), pp. 617–37; Stephen J. Kobrin, 'The Architecture of Globalization: State Sovereignty in a Networked Global Economy', in J. H. Dunning (ed.), *Governments, Globalization, and International Business* (Oxford and New York, 1997); David Held, Anthony McGrew, Jonathon Perraton, and David Goldblatt, *Global Transformations* (Cambridge, 1999).

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Why the fuss about globalization?

Ever since comparative historians and macrosociologists drew attention to the messiness that makes up a 'society', the idea of a nation-state as a self-contained entity, of a pure 'inside' set against an equally pure 'outside', has seemed little more than a convenient fiction.[4] Nation-states, like societies, have always been composed of multiple, conflicting, overlapping networks of interaction—social, cultural, economic, technical, even political. Some of those networks reach across to nearby borders, others to more far flung places; some networks are widely dispersed in space, others more narrowly based. Similarly, some of those far-flung networks may reach deeply into the nation-state, involving a significant share of its population (e.g. the market for tradeables), while others intersect more broadly though superficially (e.g. sports, arts, and media communities).

Nation-states, then, have always been enmeshed in multiple crossborder networks of interaction. So why the fuss about 'globalization'? The dispute between globalists and sceptics is not about whether nation-states are penetrated by crossborder networks of trade, finance and production, or enmeshed with other nation-states by virtue of these linkages, for in varying degrees this has long been the case. Rather, there are two major points of contention. The first is whether this enmeshment has led to the 'transcendence' of territory, that is, to the stage where 'cross-border' and 'open-border' relations—synonyms for internationalization and liberalization respectively—have been superseded by 'trans-border' relations.

While definitional disputes can slide into tedious concept chopping, the globalization debate has suffered less from the phenomenon of competing definitions than from the tendency to avoid any precision or consistency of useage. The use of precise terminology is however important if one is to understand what is really going on and how social and political actors may deal with it. If territorial transcendence has not occurred, then the concept of globalization is redundant.[5] In order to avoid redundance, globalists must therefore provide clear criteria for distinguishing *cross-border* flows (between entities operating in different countries) from *trans-border* ones (between entities operating without regard to territory).

But as soon as we ask the meaning of the phrase 'without regard to country/territory/national boundary', it becomes clear that it cannot mean 'without regard to *any and every* territory'. In this sense, there can be no 'transcendence' of territorial space: for beyond the high seas and the high skies, every relationship and transaction (even those using electronic means, in so-called cyberspace) takes place within nationally defined borders—and is thereby subject, *in principle*, to the rules and laws of the nation-state in which it transpires (including intrafirm trade which is often misleadingly cited as evidence of 'trans-border'activity).[6] Thus the phrase 'without

[4] See, in particular, Michael Mann, *The Sources of Social Power*, vol. 1 (Cambridge, MA: 1986).
[5] Scholte, 'Gobal Capitalism and the State'.
[6] The important exception appears to be derivatives trading. See in particular, William D. Coleman , Private Governance and Democracy in International Finance', *Institute on Globalization and the Human Condition*, Working Paper Series, February (1999), pp. 14–15, who carefully dissects the domestic, international, and global aspects of financial systems and their governance. One could argue that the evolution of offshore debt or credit markets, designated as 'Euromarkets' to distinguish them from national financial systems, are a further important exception. These banking and securities markets, the basis for much of the global capital market development over the past 25 years, remove

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regard to territory' can only mean 'without regard to *any particular* territory'—in the sense that, let us say for illustrative purposes, I am a trans-territorial global citizen to the extent that I call no place 'home' and have no legal, financial, political, professional or other attachment to any particular country. Of course I must live somewhere and work from some base (however impermanently), and while doing so I must observe the regulations of the country in which I reside; while in principle I can 'easily' change my base by moving to another country, my choice of country is not likely to be completely open-ended or arbitrary, but shaped by considerations of language, culture, professional appeal and other 'national' differentials.

Thus, one may operate in a transborder or global capacity, but this does not create a transcendent reality. It is more appropriately a 'globalization with borders'.[7] Indeed, non-empirical terms like transcendence—which evoke that other 'G' word—are perhaps best left to metaphysics. Similarly, just as borders are not being transcended, so they are not, in a literal sense, 'dissolving' or 'breaking down'. In some ways the existence of borders is being strengthened and affirmed so that the passage of goods and people is made more costly or difficult, in other ways the reality of borders has become less important (i.e., less constraining). Thus the statement, 'MNCs are less constrained by *particular* borders' seems more accurate than 'MNCs are unconstrained' (capital mobility is relative, not absolute); just as the statement, 'the state is more constrained by certain forms of mobile capital' (namely, by the bond and foreign exchange markets) is more accurate than 'the state is eroded by capital mobility'.[8] I shall not deal with the normative question of whether borders are a 'good' thing.[9] But as to whether they are the source of the world's most divisive struggles, historians of nationalism find no evidence that the Enlightenment ideal of a borderless world would bring an end to ethnic tribalism.[10]

A key question then, for both rigorous globalists and their sceptic critics, is whether the weight of transborder/global networks is increasing relative to national and international ones. Sceptics, necessarily rigorous in their measurement of global flows, have arrived at the conclusion that globalization is fundamentally a financial phenomenon, limited to certain capital markets.[11]

From this literature we can extract a number of stylized facts which contradict the globalist claim that the national economy is increasingly irrelevant: (1) in most

borrowing and lending from the jurisdiction and regulatory influence of national authorities. Thus, for example, the markets for dollar-denominated loans, deposits, and bonds in Asia or Europe are not subject to US banking or securities regulations. The differences in interest rates and other conditions that exist beween domestic and external markets stem mainly from the extent to which national regulatory constraints can be avoided. Yet even in offshore debt markets, where the role of territorially-based domestic institutions is marginal, at least on a day-to-day basis, 'every international bank is ultimately accountable to a single national regulator' (Kapstein, 1994).

[7] The phrase is from Michael Borrus and John Zysman, 'Globalization with Borders: the Rise of Wintelism as the Future of Global Competition', *Industry and Innovation*, 4: 2 (1997), pp. 141–66.

[8] On the overstatement and underevidencing of 'capital mobility', see the thought-provoking comments in M. Pollin (ed.), *Globalization and Progressive Economic Policy* (Cambridge, MA: 1998).

[9] On the post-Cold War sentiment that borders are inimical to peace, see Barry S. Strauss, A Truly Crucial Chapter In the History of Borders', *International Herald Tribune*, 30 April (1999), p. 9, Director of the Peace Studies programme at Cornell University.

[10] See, in particular, Anthony D. Smith, *Nations and Nationalism in a Global Age* (Cambridge, 1995).

[11] See Robert Wade, 'Globalization and Its Limits: Reports of the Death of the National Economy Are Greatly Exaggerated', in S. Berger and R. Dore (eds.), *National Diversity and Global Capitalism* (Ithaca, NY, 1996); Paul Hirst and Graham Thompson, *Globalization in Question* (Cambridge, 1999); Andrew Glyn, 'Internal and External Constraints on Egalitarian Policies', in D. Baker, G. Epstein, and R. Pollin (eds.), *Globalization and Progressive Economic Policy* (Cambridge, MA: 1999).

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developed economies, about 90 per cent of production is still carried out for the domestic market and about 90 per cent of consumption is locally produced; (2) domestic investment by domestic capital is financed mostly by domestic savings and far exceeds the size of FDI flows in all major markets; (3) FDI inflows into OECD countries are predominantly (i.e., more than 50 per cent) for mergers and acquisitions which typically resemble portfolio investments, hence 'involving a change in ownership but with relatively little [international] impact on industry behavior'[12]; (4) world equity markets remain poorly integrated; all the major stock exchanges are primarily local markets deriving the bulk of their turnover from intracountry trading, not simply because most firms have an insufficiently strong global reputation to be traded actively on foreign markets, or because traders prefer to trade without exchange risk, but also because international issues of stocks must carry the same rights as, and be fungible with, domestic stock; as such, they tend to find their way back to the home market. Moreover, unlike the Euro- (read 'global') bond markets, international trading in stocks goes on in the same manner as domestic trading: e.g., a German mutual fund buys and sells IBM stock on the New York Stock Exchange just as an American fund would do; (5) companies remain mostly multinational rather than transnational, concentrating most of their production, assets, and strategic decision-making in their home country (and trade in their 'home' region); while MNCs produced some 40 per cent of world output in 1990, the share of their overseas subsidiaries and affiliates was only seven per cent, confirming the dominance of the home base; thus most R&D is still undertaken at home rather than spread across the globe; (6) trade and investment patterns indicate strong regional concentration rather than world-wide or even north-south integration; finally, however (7) finance remains the one area where genuinely global markets have evolved, most notably in foreign exchange which accounts for the majority of financial transactions conducted globally on a daily basis, but also to some degree in bank lending (through syndicated 'offshore' loans), and certain securities (mainly bonds and derivatives).

So as far as sceptics are concerned, then, outside of finance a compelling case for a globalization tendency has not been established. Sceptics would agree that national economies are today closely interconnected (whether more or less than in some previous era is an interesting issue but irrelevant to an understanding of how that interconnectedness may presently constrain national economic management).[13] But the degree and nature of those changes are often highly exaggerated: economies are still primarily national in scope; their enmeshment through trade, investment, and finance has not displaced the preponderance of 'national' networks of interaction. If anything, it has produced a more complex system in which international and transnational have developed in parallel with and complementary to national systems of production and finance.[14] If this conclusion has made little impression on globalists,

[12] Glyn, 'Internal and External', p. 402.

[13] For a balanced account of trends in international production and finance before 1914, see Paul Bairoch and Richard Kozul-Wright, 'Globalization Myths: Some Historical Reflections on Integration, Industrialization and Growth in the World Economy', UNCTAD discussion papers, 113:March (1996).

[14] Coleman observes that in the most 'globalized' sector, that of finance, the emergence of global markets in most areas of financial services has run in parallel and complemented processes of internationalization based on distinct national financial systems; see 'Private Governance and Democracy in International Finance', p. 5; On the rejection of the global-national dualism in international production, see Borrus and Zysman, 'Globalization with Borders'.

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however, it is because most analysts assume that however limited globalization may presently seem in some respects, its further advancement is only a matter of time.[15]

From global flows to power shift?

But even if we were to assume further such advancement, in what way would it matter? Just how much is at stake in resolving the 'measurement' issue? Would it matter much whether countries and firms were trading more of their domestic output, or investing more of their capital abroad, or producing more of their goods offshore, or forming more alliances and entering agreements with other international actors? As far as most participants in the debate are concerned, it appears to matter a great deal, for one simple reason. *Both globalists and many of their sceptic critics have assumed that a globalized world involves a dramatic power shift*: one that restricts the scope for national institutions, actors, and policies while elevating the interests and preferences of non-national actors in a zero-sum form of logic. (Hence the widespread view that many political and policy changes among OECD governments, ranging from financial and welfare reforms to intergovernmental agreements, represent the response of besieged or hapless governments to transborder flows.)

In short, built into the very concept of globalization itself is a presumption about its win-lose impact on particular power actors. Definitions of globalization are often impossible to disentangle from causal statements about globalization's alleged effects (mainly on the state). Indeed, many definitions and recent accounts of globalization presuppose the very causal linkages which need to be demonstrated: if there is a globalization tendency, it is widely anticipated that this must entail less autonomy, capacity, or effectiveness for national decision-making *vis-à-vis* the domestic economy.[16] Thus, if global networks exist, it must be at the expense of national ones; and if national networks are under strain, it must be due to the impact of global ones. In short, globalization has by and large become synonymous with *state power erosion*. This zero-sum logic drives the reasoning process to the irresistible conclusion that global and national are antinomies rather than interdependent, competing rather than complementary.[17]

[15] A noteworthy exception is Reinicke, *Global Public Policy*, who draws attention to the sectoral, historical and geographical limits of globalization (while nevertheless being a strong advocate for a 'global' public policy).

[16] As Bairoch and Kozul-Wright observe, 'behind the basic disagreement as to whether globalization will lead to immizeration and economic crisis or to faster economic growth and convergence, there is a widely shared assumption that the role of the State in managing economic activity has already diminished under globalization pressures and will become irrelevant in the truly global economy', 'Globalization Myths', p. 4.

[17] There are several noteworthy exceptions to this negative-sum reasoning, among them those deriving from close analysis of international finance, production, and public policy, such as William D. Coleman, Financial Services, *Globalization and Domestic Policy Change: A Comparison of North America and the European Union* (Basingstoke, 1996); Reinicke, *Global Public Policy;* and Borrus and Zysman , 'Globalization with Borders'. For an argument that globalization has at times increased state sovereignty in the Southeast Asian growth economies, see Richard Stubbs, 'States, Sovereignty and the Response of Southeast Asia's "Miracle" Economies to Globalization', in D. Smith, D. J. Solinger and S. Topic (eds.), *State and Sovereignty in the World Economy* (London, forthcoming). Questioning of the global-national dualism is also a feature of recent conceptual analyses, in particular, Michael Mann, 'Has Globalization Ended the Rise and Rise of the Nation-State? *Review*

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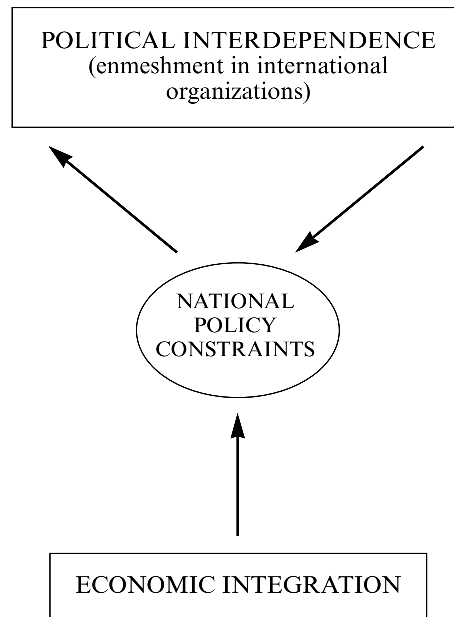

Figure 1. *The globalization hypothesis.*

Thus globalization has come to mean two quite different things: first, that trans-border networks are becoming more important than national and international ones; and second, that this process of economic enmeshment is eroding the basis of the state's authority and capacity to protect the social and economic well-being of its citizenry. In the language of globalism, state powers are being diminished, challenged, compromised, severely constrained, and ultimately transformed. And this is allegedly because of the advance of global and transnational networks, ostensibly exerting pressure both from below, in the form of mobile capital, and from above, in the form of a growing web of international rules and economic institutions.[18]

of International Political Economy, 4:3 (1997), pp. 472–96; and Ian Clark, 'Beyond the Great Divide: Globalization and the Theory of International Relations', *Review of International Studies*, 24 (1998), pp. 479ff. For many such writers a legitimate concern is that the regulatory bodies emerging out of intergovernmental cooperation to oversee global flows are not subject to democratic control—a sentiment neatly encapsulated in Scholte's statement that 'contemporary globalizing capital presents a challenge not to the survival of states, but to the realization of democracy', 'Global Capitalism and the State', p. 452. That may nonetheless downplay a more serious possibility. For if we turn our focus to 'threats' rather than 'challenges', we would have to conclude that some aspects of contemporary globalizing capital present a major threat not to the system of nation-states as such, but to the stability of the world economic order. Indeed, in the most globalized, risk-intense markets of all—derivatives—it is not even the absence of democracy, but the absence of any form of public governance that appears truly threatening. See Coleman, 'Private Governance and Democracy in International Finance'.

[18] Treaties relating to trade, tax and investment policies, as well as banking regulation, currency convertibility and so forth, tie countries together through multilateral agencies like the WTO, the G-7, and so forth.

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But the question of whether or not there is a globalization tendency may ultimately prove less important than hitherto supposed. For the existence of globalization may be a poor predictor of its impact on state power. Figure 1 outlines the causal relationships implied in the globalist proposition that *economic integration creates national policy constraints, which together drive political interdependence (international cooperation), which in turn further reduces the scope for national governance.*

If we adopt this view, then state powers (specifically the capacity to pursue 'national policy preferences') are being forced to stand aside by two forces of globalization: on one hand the growth of economic integration, on the other, the increase in political interdependence. Regarding the first of these, the impact of economic integration on state power, it is important to emphasise that the policy constraints so often assumed to issue from global forces, in reality have quite complex sources—often of a predominantly domestic or structural character, as we shall see. In particular, I shall argue against globalism's central postulate that capital mobility has not only tied the hands of the social-protection state (social policy), but also proven the futility of its production-enhancing strategies (technology-industry policy). A related point is that some constraints are global only in an 'additional' sense—meaning that the constraints would exist *even in the absence of* international openness (as indicated below concerning the reaction of developed financial markets to deficit spending).

With regard to the second change in the environment of nation-states, the issue has to do with the alleged impact of international cooperation on national decision-making. To the extent that one can talk of a growing international political society—an expanding web of international norms, treaties, and institutions giving rise to sustained cooperation and higher levels of governance above the nation-state—this is indeed a major development. An unprecedented widening and deepening of international cooperation has led some to maintain that the nature of the state and of world politics are being fundamentally transformed. If this is simply taken to mean that states now cooperate over many more areas than in the past (hence by definition not monopolizing jurisdiction over 'internal' matters whenever these have 'external' consequences), then there is little to disagree with. Experts on jurisprudence may wish to cross swords on whether or not the state's sovereignty (a legal concept) is thereby affected, and whether it is properly 'internal' or 'external' sovereignty that is most implicated.[19] But for the purposes of appraising the capacity for national governance, we can safely leave such matters to one side.

If, however, political transformation is taken to mean that states have been compelled into cooperation by economic integration, or that international regimes displace fundamental national orientations and institutions, then there is much to disagree with concerning both the sources and consequences of cooperation, which are discussed in the following section.

[19] Among the many authors discussing this topic, see Robert O. Keohane, 'Sovereignty, Interdependence, and International Institutions', in L.B. Miller and M.J. Smith (eds.), *Ideas and Ideals* (Boulder, CO: 1993); Stephen D. Krasner, 'Westphalia and All That', in J. Goldstein and R.O. Keohane (eds.), *Ideas and Foreign Policy* (Ithaca, NY: 1993); Gianfranco Poggi, *The State: Its Nature, Development and Prospects* (Stanford, CA: 1990).

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Does political interdependence curtail national policy autonomy?

On the sources of international cooperation, the main point to emphasize is that the foundations for international collaboration were laid long ago in the postwar settlement. That settlement called for a liberal regime of economic openness and international cooperation to sustain it. From this perspective, international political cooperation (systematized through the institutions of Bretton Woods) paved the way for economic integration (mainly through trade) rather than *vice versa*. If this feature is given less attention than it deserves, it is thanks largely to the impact of the Cold War. For in magnifying the importance of the 'containment order', Cold War politics served to deflect attention from this evolving internationalist 'liberal democratic order'. Multilateralism thus advanced in the aftermath of World War II under the Bretton Woods system, deepening political reciprocity and economic ties above all through institutional support for an open trading system. In this light, the end of the Cold War appears less as a watershed than a marker in the rediscovery and retrieval of the liberal internationalist project that had all along been developing at its own pace. As John Ikenberry writes, in putting a destructive era of economic rivalry and political turmoil behind them,'The major industrial democracies took it upon themselves to 'domesticate' their dealings through a dense web of multilateral institutions, intergovernmental relations, and joint management of the Western and world political economies.'[20] Clearly, then, while the multilateral order has grown in recent years, globalization is not responsible for its emergence: the vision, the means, and the power sharing arrangements at international level all predate the boom in capital mobility and transborder flows that has so inspired the new globalism.

Integration and interdependence as pillars of, or threats to, policy autonomy?

In what way, if any, has state power declined, and to what extent can such decline be attributed to the rise of transborder power actors? According to current conviction, state power has declined in one fundamental respect, namely, in its 'policy autonomy'. It is claimed that national governments can no longer readily pursue their policy preferences, or if they do they will incur unacceptably high costs. A key stimulus for this assertion is the notion that governments have veered away from Keynesian solutions to the twin problems of the advanced democracies—slow growth and high unemployment. The economist Maynard Keynes proposed that governments could play a major role in increasing employment at times of economic downturn. He argued that unemployment was cyclical, arising from a shortfall in demand for goods and services, and advocated two policies, both monetary and fiscal, for demand stimulation. The orthodox monetary prescription of lower interest rates sought to induce employers to invest in capital goods; while the more radical fiscal strategem of deliberate budget deficits aimed to increase demand through

[20] G. John Ikenberry, 'The Myth of Post-Cold War Chaos', *Foreign Affairs*, 75: 3 (1996), pp. 79–91. On the role of the IMF in promoting the postwar vision of liberal internationalism, see Louis W. Pauly, 'Promoting a Global Economy: The Normative Role of the International Monetary Fund', in R. Stubbs and G. Underhill (eds.), *Political Economy and the Changing Global Order* (New York, 1994).

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public spending. Keynes insisted that the control of aggregate demand required governments to pursue both measures. It is often argued that Keynesian policies in this sense are 'severely constrained' by 'globalization' and economic openness. One response then is to try to turn back globalization in order to eliminate constraints.

However, the important issue is not the existence of constraints but their sources. Constraints on deficit spending tend to apply *even in the absence of financial globalization*. The transnationalization of financial markets can certainly speed up the response to deficit spending, but there is no evidence that it is the cause of that response in the sense of being either necessary or sufficient. A more insightful understanding of the causal process can be gained by asking what it is that triggers the adverse response of financial markets to deficit spending. As economists remind us, deficit spending increases the likelihood and anticipation of faster inflation in the future. It is the prospect of this inflationary outcome which induces capital flight, which in turn pushes up interest rates as investors attempt to circumvent future losses on their financial assets. In this way, the actions of financial markets end up bringing about the very outcomes that they anticipate. The key point, however, is that '*This [anticipatory action] would occur in any developed financial market and is not dependent on international financial integration*'.[21]

Whether the disciplinary action of finance comes in the form of a run on the currency due to balance of payments crises (for example, Britain in the 1960s), or the removal of capital offshore due to anticipated changes in government (for instance, the rise of Italy's Communist Party in the 1970s), the fact is that capital has long demonstrated willingness and ability to react to what it perceives as unfavourable policies. Indeed, there is ample evidence that capital mobility has long exerted a constraining impact on domestic policy, certainly well before one could speak meaningfully of global finance. Thus, while it may be argued that the creation of global financial markets has reinforced domestic policy constraints (and especially heightened awareness of them), the key point is that such constraints would exist independently of globalization. The main independent effect of financial globalization would therefore appear to be rather less than conventionally claimed.

The received wisdom nonetheless holds that after the Keynesian era, the state is 'less autonomous' and has 'less exclusive control' over economic and social processes within its territory. It is of course much easier to make assertions about 'more' and 'less' than it is to give substance to these notions. The effect of such statements is to construct a mythical Keynesian-era state: one wielding absolute autonomy and exclusive control.[22] Booming economies and high rates of world growth in the two decades after World War II helped to nurse the myth along by planting the idea that states were, once upon a time, wholly in command of their economies. In one sense, of course, there was the appearance of 'greater' autonomy than today: governments could more freely control the internal price of money (interest rates) and thus count on a more stable environment in which to advance their policy preferences (which, as Germany showed, were not necessarily 'Keynesian'). But the point that needs to be

[21] See Glyn, 'Internal and External Constraints on Egalitarian Policies', p. 397. Emphasis added.

[22] The idea that national governments were in control of their economies, independently pursuing their preferences took hold in the three decades after 1945, when trade openness was still a highly managed affair, and financial liberalization had barely begun. See Meghnad Desai, 'Global Governance', in M. Desai and P. Redfern (eds.), *Global Governance: Ethics and Economics of the World Order* (London and New York, 1995).

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emphasized is that the 'greater autonomy'of yesteryear was only possible because states adhered to an internationally agreed system of rules for controlling the external price of money (fixed exchange rates).

'National' autonomy was therefore highly dependent on 'international' cooperation—under the so-called Bretton Woods system of fixed exchange rates. That international regime itself was highly dependent on the actions of one particular nation-state. As soon as the US withdrew (following Nixon's closure of the gold window in 1971), the system of fixed exchange rates could no longer be sustained and the state of the so-called Keynesian era (which is what most English-speaking analysts seem to intend by 'national economic management'), entered a more constraining environment. When states stopped cooperating in this formal manner, they lost their policy autonomy. The main point however is that then, as now, *policy autonomy was only partial*, and its foundations lay beyond the territorial control of any single state. National (policy) networks of interaction were thus closely intertwined with international ones.

International cooperation and infrastructural power

The preceding discussion made the point that globalists have overstated changes in state power (policy autonomy) and misidentified its sources. Since the end of World War II, macroeconomic policy autonomy has always been partial, highly dependent on the international context, and constrained by the existence of financial markets. The emergence of global financial markets, especially over the 1980s and 1990s, has not removed policy autonomy so much as heightened awareness of its partial nature. Nonetheless, globalists have gone on to make more ambitious claims about the impact of international institutions on state behaviour. They are certainly not overstating one of the novel features of our times in pointing to the expanding web of international treaties and institutions, which has emerged to regulate and adjudicate on matters of interstate behaviour. The number of conventional intergovernmental organizations alone rose from 123 in 1951 to 337 by 1986. (If one adds 'nonconventional' organizations, the numbers would more than double.)[23] The issue, however, is whether all of this cooperative activity is the harbinger of a new world political order. For that is fundamentally what many globalists appear to claim.[24] Does the multilateral revolution and its expression in institutions like the World Trade Organization (WTO) imply a corresponding obsolescence in the functions and capacities of national governance? Are the substantive policymaking powers of national governments being displaced in favour of supranational authorities? In short, is it the case—as implied in Figure 1—that these more or less

[23] Mark W. Zacher, 'The Decaying Pillars of the Westphalian Temple: Implications for International Order and Governance', in J. N. Rosenau and E.-O. Czempiel (eds.), *Governance Without Government: Order and Change in World Politics* (Cambridge, MA: 1992).

[24] See, for instance, David Held and Anthony McGrew, 'The End of the Older Order? Globalization and the Prospects for World Order', *Review of International Studies*, 24 (1998), pp. 219–43.

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permanent alliances of sovereign states extinguish sovereignty and foreclose key areas for policy discretion as so widely believed?[25]

Experts in international relations have long debated the impact of international regimes (norms, rules, and institutions) on state behaviour. However, they have been at loggerheads over a much more modest set of claims than those expressed by globalists. Specifically, analysts from the realist tradition contest the liberal institutionalist's claim that international regimes can mitigate the effects of anarchy (a state system in which there is no central authority to keep sovereign states in check), and thus modify state behaviour to forego short-term advantages in exchange for long-term gains. Prominent institutionalists like Robert Keohane claim that once established, multilateral institutions (e.g., the World Bank, the International Monetary Fund, the WTO, the Bank of International Settlements) take on a life of their own, even though a world power or hegemon—in this instance, the US—may have been necessary for their creation.[26] Moreover, because of the services provided by international institutions (in particular, reducing uncertainty and the costs of making and enforcing agreements), states have an interest in their preservation. Thus if, as realists claim, the world is dominated by sovereign states, the function of international institutions appears especially puzzling. Moreover, the puzzle must remain without solution, says Keohane, *as long as institutions are viewed as standing in opposition to, or above, the state*; the problem can be solved however if institutions are 'viewed as devices to help states accomplish their objectives'.[27]

Although the role and impact of international institutions are controversial, when viewed in this way, one is struck by the complementarity of realist and liberal institutionalist positions, not their antagonism. Political interdependence does not mean that states trade in their objectives, but that they advance them through power sharing. Whatever their points of disagreement, analysts from both traditions share the view that multilateral institutions cannot compel states to act in ways that are contrary to states' own selfish interests. It may be that as states have become more enmeshed in an expanding web of economic and political ties, the costs of disrupting those ties through unilateral actions have grown. But that is an empirical claim that needs to be tested against specific cases. One may well find that the cost deterrent applies more clearly to the use of military force than to the protection and/or promotion of national economic interests, and more readily to small states than to larger ones. Certainly the proliferation of trade disputes even under a strengthened WTO offers some support for the latter part of this proposition. (Even

[25] Many assess this development in normative terms: as 'a good thing', on the assumption that any process or institution which dilutes sovereignty must be good for world peace or world freedom. The Enlightenment thinkers thought along parallel lines, advocating commerce as an antidote to war. See Albert Hirschman, *The Passions and the Interests: Political Arguments for Capitalism Before Its Triumph* (Princeton, NJ: 1977). Such reasoning culminated in Adam Smith's celebrated study, *The Wealth of Nations,* in which he proposed that increasing international trade would eliminate war between nations.

[26] See Robert O. Keohane, *International Institutions and State Power* (Boulder, CO: 1989); for a recent contribution to, and defence of, the realist position, which examines the problem of relative gains, see Joseph Grieco, 'Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Iinstitutionalism', in D. Baldwin (ed.), *Neorealism and Neoliberalism: the Contemporary Debates* (New York, 1993).

[27] 'International institutions: can interdependence work?', *Foreign Policy*, 110 (1998), p. 84.

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as this article is being written, it is hard to ignore the preemptory unilateral measures taken by the United States in mid-1999 to protect both its lamb against imports and its genetically enhanced beef exports to the EU.) In sum, prominent institutionalists—like their realist counterparts—continue to stress the central role of the state and, while regarding the end of the Cold War as marking an important shift in the global balance of power, they do not see in the proliferation of international regimes a qualitative transformation in the nature of world politics.[28]

This conclusion is clearly at some remove from the globalist claim that national governments are no longer the locus of effective political power.[29] Our brief review of liberal institutionalism's stance on the matter indicates that it is both possible and necessary to go beyond this negative-sum way of understanding international cooperation. We can add to institutionalism's positive conclusion that states cooperate to achieve certain objectives by noting four limitations of the globalist view. First, it overestimates the 'encompassing' quality of international agreements, and underestimates the tenacity of national arrangements as well as the adaptivity of national actors. (Moreover, adaptivity is not one-way; like states, firms have also had to adjust to a more competitive environment as a result of changes in state policies.) To use a parallel from taxation rules, just as the existence of new tax rules does not thereby bring tax-minimising schemes to a standstill in the corporate sector, so there is no reason to assume that the emergence of international rules governing trade and investment will bring activist states and their production-enhancing schemes to a standstill. The WTO, for instance, may appear to be crowding out state activism in the domestic arena by seeking to exclude certain forms of government subsidy, but that is likely to have little impact on the new forms of industry promotion and more resonance in liberal market settings where states have traditionally applied themselves to regulatory rather than developmental policies (see the following section).

Second, the long-term survival of international regimes, especially in the economic sphere, appears contingent upon the continued welfare-increasing benefits of cooperation. This is not simply a theoretical postulate on which both neorealists and liberal institutionalists can agree. It is also the perception of leading decision-makers in the field. In discussing the key features of policies directed at promoting international integration, for example, Lawrence Summers, now Secretary of the United States Treasury, recently observed that one major feature 'has been the consistent desire to finesse sovereignty problems by highlighting the national benefits of internationally congenial behavior'. Thus, as Summers points out,

> . . . there is the greatest willingness to cede power to international institutions where there is the greatest technical agreement on what needs to be done and where issues of values are less paramount. Thus, for example, there is more international agreement on questions like air safety standards and bank capital requirements than on questions like tax rules and labor standards .[30]

[28] See Stephen M. Walt, 'International Relations: One World, Many Theories', *Foreign Policy*, 110 (1998), p. 46.

[29] See, for example, David Held and Anthony McGrew, 'The End of the Old Order? Globalization and the Prospects for World Order', *Review of International Studies*, 24 (1998), p. 235.

[30] 'Reflections on Managing Global Integration', paper presented at the Annual Meeting of the Association of Government Economists, New York City, 4 January (1999), p. 10.

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Third, it must be said that international rules and organizations do change the environment in which states must act and often redefine the instruments with which states can legitimately pursue their objectives. But international regimes do not *in themselves* change domestic goals and orientations, the commitment of state actors, or the institutional approach to achieving their goals. In the 1990s, scholars in comparative political economy still identify different configurations of national ideas, goals and institutions. Whether one distinguishes these domestic regimes as liberal, corporatist, and statist or some similar set of labels, it is clear that such regimes are not readily redefined by the advent of international organizations. This is not to deny that at critical moments state preferences, identity, and goals may be shaped and reshaped by the international context, as constructivists have argued.[31] Nor is it to deny that the spread of democratic norms, for example, has made it more difficult for modern states to act despotically by ignoring human rights issues. But these sorts of observations centre on changes in the legitimate purposes for which state power may be employed: in particular, by excluding the doing of physical harm to others. Yet this change appears to have less to do with the power of international regimes *per se* than with the 'liberal democratic' nature of internationalism. Moreover, the disciplinary power of democratic norms (preventing states from harming their citizens) is of a different order from the power implied by the globalist's view of multilateralism (effecting state transformation). State transformation involves reconfiguring power, purpose and institutions. But, as comparativists have shown, such configurations are path dependent; transforming domestic orientations and institutions will take much more than suprational rules and organizations. Moreover, in so far as diversity persists in domestic regimes, one can expect different outcomes in the way countries adapt to and implement internationally agreed rules (as well as in the way they undertake common liberalising reforms, as we shall see in the East Asian case discussed later).[32]

Finally, by aligning with other state actors, a state does not necessarily give up powers (infrastructural reach) exercised within its own domain; it may actually extend its penetrative capacities via international reciprocity, negotiation, and power sharing.Thus in a wide range of areas—from drug trafficking and money laundering to illegal immigration and environmental pollution—states are gaining infrastructural reach by cooperating with other state actors in order to prevent harm to themselves. A similar principle of *enhancing capacity* applies when governments enter into domestic cooperative alliances with business to attain their goals. Depending on the state's internal characteristics, the reciprocity or power sharing involved does not necessarily compromise or weaken the state's powers, but instead may enhance them by increasing the effectiveness of state involvement and thus the

[31] Both Japan and Germany, for example, traded in their militarism after 1945 for a more pacific identity, concentrating on economic strength; but that transformation required the foundation of shattering defeat on which national shame could help reshape national purpose while admission to the international community could keep it on course. See Peter Katzenstein (ed.), *The Culture of National Security* (New York, 1996).

[32] On the persistence of capitalist diversity, in spite of liberalizing reforms, see in particular Steven Vogel, *Freer Markets, More Rules* (Ithaca, NY: 1996), and Vivien Schmidt, 'Still Three Models of Capitalism? National Adjustment to Globalization and Europeanization', unpublished paper, Boston University, 16 May (1999).

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chances of achieving its goals.[33] States enter into international agreements with the anticipation of similar power-sharing outcomes. Such outcomes are of course much easier to discern where prevention of harm or risk is at stake (as in prosecuting international crime), and more open to question where prevention of economic advantage is at issue (as in implementing trade agreements).

Nonetheless, even with the more restrictive functions of a body like the WTO, it is possible to see cooperation as part of a new power infrastructure of states whereby they not only maintain control of territory (setting and monitoring rules 'within'), but also extend their infrastructural reach 'without' by aligning with other state actors. Such forms of cooperation mean that in principle there is no territorial space that is beyond the reach of any particular nation-state (that is, for the purposes of controlling activities outside its borders, which would impact on activities inside its borders). The historical dynamic suggests that the techniques and tools of state power are constantly spinning out of control and away from the state as society invents new means of organising its activities—means which cannot be monopolized by states[34] (e.g., formerly writing, now the Internet); but then states acquire new means of regaining control (e.g., by reorganizing, as they are now doing via cooperative arrangements).

Such adaptation to new challenges may not always be successful and can never be guaranteed in advance. The point however is that by taking the long view, it is easier to appreciate the significance of the contemporary dynamic: the process of states and societies gaining new organizational means has been going on over many centuries and viewing this in win-lose terms seems unfruitful. One can, for example, without too much effort envisage an environmental equivalent of the WTO which will impose new standards on the countries of the world; but rather than seeing an end to institutional and power diversity, such standards are just as likely to nurture it as industries in different countries invent new ways of being green and clean and as public purpose is marshalled to support them. Current Japanese and German initiatives in environmental technology at public and private levels offer interesting glimpses of such a future.[35] Moreover public-private innovation clusters, stretching from Taiwan to Saxony and Silicon Valley, are increasingly the preferred means of doing 'industrial policy' in the 1990s, not because the WTO has foreclosed other forms of economic promotion, but because supporting innovation and thus upgrading industry and skills is central to sustained national wealth creation.

Does economic globalization constrain national governance?

Having appraised the tranformative impact of political interdependence on national

[33] See Linda Weiss, *The Myth of The Powerless State* (Ithaca, NY and Cambridge, 1998), ch. 7. The important qualification is that if states enter such alliances from a position of structural and organizational weakness or ideational uncertainty, they are more prone to 'capture' by business and to exploitation by other states Hence the greater likelihood of a lopsided or hierarchical relationship emerging out of such power imbalances. See Peter Evans, *Embedded Autonomy* (Princeton, 1995) and Weiss, *The Myth of the Powerless State*, ch. 3.

[34] Mann develops this argument at length in Volume I of *The Sources of Social Power* (1996).

[35] Germany and Japan have made great strides in developing environmental technology as an industry of the future; these developments have gone hand-in-hand with some of the tightest environmental regulations in force in the world today.

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governance, we turn now to a similar set of claims regarding the constraining consequences of economic integration. As we have seen, many commentators believe that states are no longer the primary decision-making authorities in matters governing their territory and many have chorused the 'erosion of national political autonomy'. But the criteria for assessing this erosion have been 'at best vague and tailored to meet the particular demands of the moment'.[36] Moreover, this way of looking at the matter may be somewhat arcane and abstract. The more fruitful question to pose is whether states can act to enhance wealth creation and social protection within their territorial domain. And if so, why policy preferences may or may not lean in that direction. Does globalization (transborder flows, capital mobility) either prevent or—to use the language of state power erosion—'seriously challenge and constrain' the national pursuit of these objectives? In short, what has economic globalization to do with the capacity of national governments to enhance or assist the processes of social protection and wealth creation? Let us examine each policy area in turn.

Globalization and welfare state erosion

Why do analysts link globalization with welfare state reforms and cutbacks? The answer, in a nutshell, has to do with fiscal policy—the purported decline of revenues essential to sustain social policy; a decline due to pressures placed on governments by mobile capital in order to reduce costs. An influential claim maintains that governments in the developed world are confronted with an eroding tax base; that this erosion has come about because of increased transborder capital mobility; and that this enhanced mobility impacts on fiscal policy in a number of ways, but most of all by inducing governments to lower corporate taxes in order to attract and retain capital. If we examine the evidence for this proposition, however, globalization has little if anything to do with the current challenges or changes to the welfare state.

Have the pressures of capital mobility (arising from financial deregulation and revolutionary changes in technology) induced governments unilaterally to reduce corporate tax rates in order to attract or retain capital, and thereby whittled away the revenue base for social protection programmes? The question needs to be posed because the claim is widely repeated as if it were an established fact. Yet recent research for the most part demolishes this conclusion. In the most rigorous comparison of corporate taxation to date, covering 17 OECD countries over the 1966–93 period, Swank evaluates the extent to which the globalization of capital markets has led to decreases in business social security, payroll and profit taxes. Since the findings overturn the common wisdom, they are worth reporting in some detail.

The most important finding is that, in contrast to expectations, the 'direct effects of globalization of capital markets are [if anything] associated with slightly higher business taxes and, to a degree, the diminution of tax policy responsiveness to the conditions that underpin investment'.[37] The explanation given for this is straight-

[36] Guy B. Peters, '"Shouldn't Row, Can't Steer": What's a Government to Do?', *Journal of Public Policy and Administration*, 12:2 (1997), p. 54.

[37] Duane Swank, 'Funding the Welfare State: Globalization and the Taxation of Business in Advanced Market Economies', *Political Studies*, 46:4 (1998), p. 691.

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forward: as capital flows were liberalized, so business tax policies 'were stripped of their explicit market-regulating roles'. This meant that although policymakers viewed tax rate cuts as economically advantageous, they nevertheless insisted on the need to make overall changes revenue-neutral. Accordingly, to protect the state's revenue requirements, rate cuts came to be offset, in particular, by elimination of corporate tax and other benefits such as investment credits, allowances, and exemptions. Where tax rates were altered, these were not made to privilege business but to allow for greater market discipline. As Swank reasons, 'the emphasis in business income tax policy became the creation of a level playing field, where the market allocates investment and the revenue needs of the state are satisfied'.[38] Thus there have been no general reductions in corporate taxation; where specific rate cuts have been made, these have generally been offset by cuts to business benefits and investment incentives.

The conventional wisdom nonetheless receives confirmation in one respect: that is, with regard to the influence of trade liberalization (as distinct from the deregulation of financial markets or the rise in so-called 'capital mobility'). Rises in international trade openness have exerted some pressure on policymakers to lower business costs through tax reductions. Yet, even here, the pressures are found to be 'modest' rather than substantial and the driving forces behind them turn out to be more clearly connected with plain old 'international competition', than with the 'transborder' flows of globalization. Moreover, policymakers have introduced tax rate changes that might improve the international price competitiveness of firms regardless of their level of 'mobility'. Thus the targets of the lowered tax rates include both export firms competing in international markets and non-export firms exposed to import competition in the domestic market. Ultimately, however, even with regard to international trade pressure, it appears that its overall tax-reducing effects have been 'weak'. Rodrik, whose study is sometimes cited in support of the opposite conclusion, concurs.[39] He finds that trade openness is associated with higher taxation of labour and lower taxation of profits. Yet, his data, drawn from a group of OECD countries for the period 1965–92, show only a weak tendency for taxes on labour to rise faster than those on capital.

Finally, with regard to the impact of the globalization of capital markets on business tax and on the capacity of states to pursue social protection policies of their choosing, Swank's study concludes that

> While tax policy has been market-conforming, there is little evidence that aggregate tax burdens themselves have been reduced. Indeed, there is an emphasis on 'defending the treasury' in the contemporary period. Thus, from the perspective of the taxation of business in the advanced democracies, there appears to be no dramatic, irresistible pressure to radically retrench social spending and eliminate public goods provision. Within relatively tight parameters, governments of all ideological and programmatic orientations appear to have room to pursue their preferred policy goals.[40]

This conclusion dovetails with that of recent studies of welfare state developments. Specialists in the field of social policy show three things: (1) The rhetoric of cuts is not matched by the reality which overall shows persistence of expenditure

[38] Ibid.
[39] Dani Rodrik, *Has Globalization Gone Too Far?* (Washington, DC: 1997), Table 4.5.
[40] Swank, 'Funding the Welfare State', p. 691.

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levels rather than decline;[41] (2) changes have occurred at the margin rather than to the core programmes;[42] (3) the welfare state is certainly under pressure, but not from transborder flows; rather, the postwar welfare state is strained by more than two decades of low rates of world growth as well as shifting demographic and household patterns that are poorly accommodated by a welfare structure designed for an earlier era. Consequently, welfare states are in need of considerable revamping, not in response to pressures of internationalization, but in order to meet the new needs thrown up by structural and life-style changes.[43]

In sum, welfare provision *is* strained for revenue; but this would be the case in any low-growth environment. Pressures for change reside chiefly in demographic shifts (an ageing population requiring pension support in retirement); in household shifts (e.g., the rise of one-parent families and two-bread-winner families, the latter which tend to be relatively income rich, yet like the first type, time poor); and in low job creation necessary to absorb persistently high unemployment, largely of low-skilled labour. While the causes of high unemployment, especially in Europe, are in dispute, the low rate of job creation has largely domestic sources.[44] To a considerable degree therefore governments can, in principle, make a difference to the outcome.

Recent analyses indicate two different areas of the labour market are involved. The first concerns raising the supply of knowledge-intensive skills for growth sectors such as the ever-expanding information-technology market. The second concerns increasing the demand for time-intensive labour—specifically in those service areas largely sheltered from international competition. It is noteworthy that none of these job-creation strategies involve Keynesian demand management techniques. The first entails a continuous provisioning for (re-)training and education that equips people to work with the new information technology. As such it requires an *enhanced*, not reduced, role for government policy.[45] The second sphere of action involves changing the regulatory regime which, in several continental European countries, protects skilled labour at the expense of the jobless (since it appears that no amount of retraining provision will completely eliminate the demand for some low-skilled labour). As such, it would most fruitfully entail *sectoral* (rather than generalized) deregulation to enable the formation of a service sector capable of supplying moderately-priced personal services and thus job creation for the low-skilled; the

[41] For a state-of-the-art analysis on this whole topic, See Martin Rhodes, ‘The Implications of Globalization and Liberalization for Income Security and Social Protection’, Robert Schuman Centre, European University Institute, Florence (1999); See also OECD, *National Account Statistics*, vol. II, Country Tables (Paris, various years), which show almost universally that the trend is towards increasing welfare expenditure levels in the 1990s, compared with the 1980s.

[42] Paul Pierson, ‘The New Politics of the Welfare State’, *World Politics*, 48: 2 (1996), pp. 143–80.

[43] See Gosta Esping-Andersen (ed.), *Welfare States in Transition: National Adaptations in Global Economies* (London, 1996); and Martin Rhodes, ‘The Implications of Globalization and Liberalization for Income Security and Social Protection’.

[44] Colin Crouch argues that decline in the demand for low-skilled labour is not due to increased international competition *per se*. It is because the welfare state had grown to its limits, especially with respect to its financing; increased pressures on the public purse have curtailed job creation schemes in the public sector, an important, widespread means of creating employment for relatively low-skilled workers in the 1970s and early 1980s. See Colin Crouch, E. Hernerijck, and David Finegold, ‘The Skill Predicament in the Open Economy’, Conference paper for ‘Relations between Social Protection and Economic Performance’, Florence, EUI, European Forum, Centre for Advanced Studies, May 6–7, (1999), p. 32.

[45] See Colin Crouch, David Finegold and Marie Sako (eds.), *Are Skills the Answer?: The Political Economy of Skill Creation in Advanced Industrial Economies* (Oxford, 1999).

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effect of selective deregulation would be to shift services from the unpaid household sector into personal services provision, which is more sheltered from international competition.[46]

To conclude, there are pressures on contemporary welfare states, but one does not need to invoke 'transborder capital' to explain them. The generalized revenue constraints can be linked directly to the slowdown in world growth that has persisted since the end of the long boom (an unhappy coincidence with the growth of globalization over the same period?). Further pressures have come in part from demographic shifts (the ballooning claim on pension entitlements as the population ages) and partly from high rates of hard-to-shift unemployment of low-productivity, low-skill labour. Globalization may have contributed to the world-wide slowdown—though this is not what some globalists would wish to argue. On the other hand, globalization has nothing to do with the added claims on the public purse brought about by demographic change; and it may be only weakly related to unemployment in so far as trade can be shown to have some employment-displacing effects (the recent growth of unemployment in some countries, like Germany, having little to do with deindustrialization). The unemployment issue, however, can more fruitfully be understood as fundamentally a problem of job creation—and as European experts on labour markets point out, this is essentially a problem of public policy, hence involving national economic management and government-industry collaboration.

The futility of wealth creation strategies?

The claim that international flows render national governance ineffective takes many forms. The most recent in the globalist's armoury focuses on the importance of 'strategic alliances' between MNCs. The strategic alliance is widely perceived as the latest and most powerful threat to an active wealth creation strategy, driving the last nail in the coffin of the activist state: an end to technology policy.

Thus one of globalism's more recent assertions that has yet to attract close scrutiny is the claim that policies to improve domestic innovation capacity are futile because of the leakage that comes with crossborder (note, not 'transborder') alliances. By trying to improve the technological capabilities of 'its' firms, a government merely ends up helping others. While more systematic research is required here, at least three observations indicate that the leakage hypothesis—like many other aspects of the globalization argument—has inflated a small and partial (and not quite novel) truth into the status of a new and substantial constraint on national governance. Let me explain further.

First, if there is substance to the policy futility claim in the face of leakage, it should apply to any kind of crossborder (i.e. international) activity where resources can migrate or leak abroad. Thus, it should apply equally to education and training policies aimed at inculcating specialist knowledge and upgrading technological skills. Whether trained in the arts or sciences, in information technology or advanced engineering, the knowledge worker of today is no less (and indeed may be considerably more) mobile than the MNC. Indeed, in an expanding world market for

[46] Gosta Esping-Andersen, *Social Foundations of Postindustrial Economies* (Oxford, 1999).

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specialist skills, the problem of how to prevent highly skilled labour from migrating to the highest bidder—the so-called 'brain drain'—has been documented at least since the nineteenth century. (The Taiwanese government successfully introduced 'reverse brain drain' policies in the 1980s and 1990s to lure Taiwanese nationals from Silicon Valley back to Taiwan in order to help implement the state's own high-technology strategy for industry.) Remarkably, however, such mobility has not led globalists to conclude that education and training policies are futile! Indeed, it usually leads to the opposite conclusion.[47] Why then should it be any different for innovation and technology (which are essentially the up-to-date version of industry) policies?

Second, open economies deal with the problem of leakage by inventing new ways of promoting 'their' industry. Nowadays, for example, such promotion relies much less on the use of the export 'subsidy' and the import tariff. This is only partly because subsidies are increasingly condemned by international trade agreements; it is also because they have diminishing relevance to the new technological conditions of competition. Increasingly, where governments can effectively enhance wealth creation through industry promotion, they act as catalysts for innovation—the development of high skill, high technology clusters—drawing on a range of resources and strategies according to the distinctive institutional features of their national context. The well-documented catalytic role of Taiwan's Industrial Technology Research Institute (ITRI) can also work in unexpected ways. For example, by merely initiating a consortium of Taiwanese firms to develop LCD technology (Japanese firms having continually rejected ITRI's overtures for technology partnerships), this pushed the Japanese leader in LCD technology to offer the Taiwanese a joint venture.[48]

More generally, as technologies become more complex and the scope for innovation expands, governments play a catalytic role in sponsoring applied research and technology transfer institutes. This remains true for the countries of 'managed capitalism', whether one includes the newly developed economies of Taiwan and Singapore—where specialized institutes are the nodal points for high technology clusters, scanning, absorbing, sharing and diffusing technical know-how—or the more highly developed countries of Japan and Germany. But even in the more 'market capitalist' US, industry promotion through support for national technology networks has become a more prominent feature of policy. As competition intensified between Japanese and American high-technology industry in the late 1980s, cooperative mechanisms enabled government and firms to combine resources to relaunch the US semiconductor industry. The success of the socalled Sematech initiative has stimulated further public-private cooperative research programmes, for example, the recent launch of a ten-year, $600m programme between the US Department of Defence, leading chipmakers and 14 leading research universities to develop the next generation of semiconductor technology. As recent studies have documented, American technology policy has shifted since 1993 towards an expansion of public investments in partnerships with private industry.[49]

The leakage hypothesis clearly contains a kernel of truth, but its veracity does not depend on the existence of *strategic alliances*. Mergers and acquisitions (M&As) are

[47] See, for example, Robert Reich, *The Work of Nations* (New York, 1992).
[48] I owe this point to Tain-Jy Chen at the Chung-Hua Institution for Economic Research, Taipei..
[49] See, for example, L. Branscomb and J. Keller (eds.), *Investing in Innovation* (Cambridge, NY: 1998).

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a much older version of the way in which 'national' and 'international have long intermeshed. M&As have frequently been carried out by foreign firms with a view to gaining entry to the insider government-business relationships reserved for national firms.[50] Just as these entry points have often been blocked to outsiders, so one must reserve judgment for the 'new' strategic alliances. When the US government was confronted with what to do about such alliances as Sematech, which was formed in 1987—the semiconductor technology consortium established with a 50–50 partnership between government and business, which lasted ten years—it resolved the matter straightforwardly. Foreign firms were simply excluded from the consortium, a situation which endured for the ten-year period of that partnership. Some might maintain that the remarkable turnaround of the US semiconductor industry owes little to this public-private partnership; but few commentators would seriously seek to argue that the policy was futile because it directly benefited the foreign partners of the US firms in the consortium.

Finally, though, there may be a more serious flaw in the leakage reasoning: it presumes that strategic alliances are between *similarly endowed entities* and that therefore as one gains from the insider relationship with government, so this gain will spill over to the foreign firm. But this may be true only in the most indirect sense, for the reasons why firms enter into strategic alliances have mostly to do with the quite *different specialisms* that each firm brings to bear on a common project. By combining their different knowledge resources, they can more quickly and economically acquire what is needed to be effective in different markets and technologies. Because the rationale for coming together turns on the possession of different not similar strengths, strategic alliances may in fact have quite marginal implications for national policy leakage.

We return then to our opening question. Can national governments act to enhance the wealth creation process? Comparative analysis indicates that in principle, there is considerable scope for such involvement, but that in practice there is significant diversity in the extent of such involvement. Such comparisons have been pursued in detail elsewhere.[51] They indicate that to the extent that policy is 'constrained', the sources of constraint are less external or global in origin that domestic-institutional. In short, the most important limitations on national governance are self-imposed rather than externally induced and stem from fundamental ideas and orientations about the scope of state involvement in the economy, and from institutional capabilities that have evolved around those orienting ideas. International flows and organizations can modify the options available to national governments—or more precisely, alter the means that states can deploy to further their preferences—*viz.* the restrictions imposed on the use of the subsidy by highly developed nations. But in contrast to 'market-led' capitalism, in settings where managed capitalism has prevailed, we should expect to find that this modification gives rise to a search for new means of achieving desired outcomes and preserving valued institutional arrangements.

[50] Yves Doz and Gary Hamel, *Alliance Advantage: The Art of Creating Value Through Partnering* (Harvard, MA: 1998).

[51] See, for example, Weiss, *The Myth of the Powerless State*.

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A new kind of state?

As centralized governing bodies, states have traditionally exercized two sorts of powers: substantive and outcome-oriented decision-making powers, and formal-procedural powers involving the state as a regulatory authority. For a number of commentators, these two aspects are now pulling apart as economic management becomes increasingly futile, giving rise to a 'regulatory' state denuded of its substantive policymaking role. Even sceptics can be found to argue that the power of states as policymaking bodies has 'declined' and that the scope of national economic management has been restricted by economic integration.[52] From this perspective, the outcome-oriented (i.e., economic management) functions of national governance are declining while the procedural-regulatory functions are becoming more important.

Such a conclusion would sit just as easily with the more moderate globalists. For them too, the state is becoming more monofunctional—approximating more and more to a regulatory body, ceding substantive power to supra-state agencies. But moderate globalists would be quick to agree with their sceptic critics that 'nation states are still of central significance'. They are no longer central to substantive decision-making, for they apparently cede this to supra-state agencies. Rather they are central because they acquire new roles, in particular, legitimating and supporting the supranational authorities they have created by virtue of pooling sovereignty.[53] Thus *if states are still significant it is no longer as sources of substantive and outcome-oriented decisions or national economic management.* It is rather because they are the key sources of constitutional order and legal power distribution, giving shape and legitimacy to other authorities above and below.[54]

I do not wish to dispute this conclusion in its entirety. It may well be an accurate statement of tendency for some states in some settings (a specifically liberal pattern?). However, in this section I shall indicate two major limitations of a conceptual and empirical nature. Taken together, they considerably weaken the regulatory hypothesis as a general statement of tendency. Finally I shall draw on recent research on the Asian crisis by way of illustration.

State diversity and path dependence

One limitation of interpretive judgments of this kind, which are clearly unavoidable for some purposes, is that they offer no way of recognising, weighing or evaluating differences between states to begin with. The implication is that whatever differences there may have been to start with—between, say, Germany, France, and Japan on one hand and Britain, Canada, and the US on the other—they are of little con-

[52] See, for instance, Hirst and Thompson, *Globalization in Question*, ch. 9.
[53] Ibid.
[54] Globalists who reject the global-national dualism, however, do not necessarily accept this emasculated capacity interpretation (see, e.g., Scholte, 'Global Civil Society: Changing the World?', *CSGR Working Paper* no. 31 (1999), p. 23; see also Richard Higgott, 'Economics, Politics and (International) Political Economy: The Need for a Balanced Diet in an Era of Globalization', *New Political Economy*, 4:1 (1999).

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sequence now since most if not all states are held to be moving more decisively towards a regulatory model, away from substantive outcome-oriented decision-making. But what if many states have not really moved very far at all—simply because *they were already there*? This at least is the conclusion one might reach on the basis of comparative political economy analyses. Conversely, what if those states which have most consistently deviated from the regulatory path are those most likely to continue along a different trajectory? Let me elaborate.

In 1982, Chalmers Johnson pioneered the fruitful distinction between two types of states associated with two different kinds of political economy: the 'regulatory' (procedurally oriented) state and the 'developmental' (outcome-oriented) state.[55] The first is typified by the liberal states of market capitalism, the US and the UK, primarily active in establishing the rules of competition and fair play rather than pursuing substantive outcomes. The second is more commonly associated with the state guidance of managed capitalism in Japan, Taiwan, Korea and Singapore (and one might include certain European states, such as Germany, Austria, and France).[56] In economic matters, it is no exaggeration to say that developmental states have been much more concerned with achieving substantive goals: for example, raising the level of savings and investment, acquiring particular technologies, upgrading the industrial portfolio, and so on. In elaborating the idea of the developmental state, Johnson was also drawing attention to the misleading nature of the Cold War polarity which described a world divided between command-led economies and market-led economies. Capitalism, in short, was not monolithic. It came in different varieties. Nowadays, however, the future of that variety is in doubt: pressured from below by capital mobility and from above by supranational forms of governance, it is most unlikely to endure, say the globalists.

But the most important implication of the Johnsonian conclusion for the present discussion is that whatever pressures are 'out there' (whether coming from above or below and whether we agree to label them internationalization or globalization), *states are responding from very different institutional and ideational bases* and are therefore most unlikely to be moving in a single (regulatory) direction. This is because, in an internationalized economy, path-dependency (historical linkages between institutions which create interlocked systems) still carries weight: the weight of both historically formed regime orientations (e.g., fundamental norms about the state's role in economic and social relations) and institutional configurations (e.g., the availability of cooperative mechanisms for public-private governance).[57]

Regulation as capacity enhancement

There is a further limitation to the regulatory state hypothesis. While there is some substance to the notion that states are becoming more active as regulators—how

[55] Chalmers Johnson, *MITI and the Japanese Miracle* (Berkeley, CA: 1982). We are of course talking in terms of broad 'ideal types'. All states in reality combine both features; the purpose of the ideal type is to highlight and magnify those features which tend to predominate.

[56] See Meredith Woo-Cumings (ed.), *The Developmental State* (Ithaca, NY: 1999).

[57] For the argument that there are still three models of capitalism in spite of international integration, see Vivien Schmidt, 'Still Three Models of Capitalism?'.

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could it be otherwise when so much 'deregulation' calls for 'reregulation'?[58]—it does not follow that states generally are abandoning or sidelining substantive, outcome-oriented action.[59] As a small open economy, the experience of Taiwan in confronting financial liberalization is particularly noteworthy.

The case of Taiwan's monetary authority offers an instructive illustration of how, even when a state agency appears to be acting in a strictly 'regulatory' capacity, it can use the rules to achieve *substantive* outcomes—rather than simply focusing on procedural issues. Thus as Taiwan embarked on a further phase of financial deregulation in 1993, the Central Bank of China deployed new rules that would favour developmentalism while guarding against foreign exchange speculation.[60] The issue concerned liberalization of the market for corporate bonds. While the process was one of deregulation—allowing Taiwanese firms to remit the proceeds in NT dollars of their offshore bond issuances—there was accompanying reregulation: the stipulation that such domestic remittances could be invested *only* in plant expansion.[61] Thus central bankers have simultaneously guarded against sudden inflows disrupting money markets (in particular, the risk that inflows would be used to speculate against the currency) and enhanced developmental capacity. As this example shows, regulatory activity may also entail substantive outcomes, while at the same time enhancing rather than diminishing the state's powers of coordination. Whether states will seek to use regulatory controls in this way is likely to depend on the pre-existing constellation of institutions and orientations that give state capacities their shape and *raison d'être*. In view of their different legacies, it would therefore be most unwise to anticipate the end of national economic management in the developmental states of Europe and Asia.

We have, then, two major limitations of the regulatory state hypothesis. First, it understates institutional diversity and overlooks the impact of path dependence, the significance of institutional and ideational differences in filtering and shaping national responses and policy outcomes. Second, it ignores the way in which 'regulatory' activity may itself offer states new ways to achieve substantive outcomes, rather than simply to perfect new control procedures. If there is one major constraint preventing such an outcome, it is to be found in the underlying regime goals and orienting ideas of state actors themselves. When state actors, for whatever reason, begin to question their purpose, goals, or commitment, the unravelling of state capacity is not far away, as the case of Korea illustrates in the decade preceding its embroilment in the Asian financial crisis (see below). In this sense, state

[58] Steven Vogel, *Freer Markets, More Rules*.

[59] See, for example, Woo-Cumings, *The Developmental State*; Schmidt, 'Still Three Models of Capitalism?'; Lonny E. Carlile and Mark Tilton, *Is Japan Really Changing Its Ways?* (Washington, DC, 1998); Weiss, *The Myth of the Powerless State*; Linda Weiss, 'Developmental States in Transition: Adapting, Dismantling, Innovating, not "Normalizing"', *Pacific Review*, 13:1 (2000).

[60] Indeed, during our most recent round of interviews with the Central Bank of China, conducted in Taipei in June 1999, it became clear that developmentalism is not just the central defining feature of the Ministry of Economic Affairs or the Committee for Economic Planning and Development; it is a fundamental orienting quality of the central bank. The regional financial crisis has provided a critical if unexpected test of Taiwan's developmental commitment and the result has been a reaffirmation of the latter, accompanied by a sharpening of the state's monitoring and coordinating powers, especially where short-term capital flows are perceived to threaten Taiwan's industrial competitiveness. These ideas are developed in Wan-wen Chu and Linda Weiss, 'Has state capacity survived liberalization and democratization in Taiwan?' (forthcoming).

[61] For the detailed argument, see Linda Weiss, 'State Power and the Asian Crisis', *New Political Economy*, 4:3 (1999).

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orientations matter and have consequences and in this light the argument that 'governments are most constrained when they believe themselves to be powerless, and least constrained when they do not', deserves to be taken seriously.[62]

To illustrate how changing orientations mattered to the use of state power and the differential capacity to withstand the regional financial crisis of 1997, consider the cases of Korea and Taiwan.

The critical role of state capacity in the Asian crisis: Korea and Taiwan

The Asian crisis is a powerful illustration of the new global orthodoxy that markets rule supreme. When the economies of East Asia went into a deflationary tailspin in late 1997, many commentators, including the IMF, argued that the 'Asian model' was unsustainable because it ignored the realities of globalization—i.e., the power of international markets to punish policies and arrangements that deviated too far from the neoliberal (Anglo-American) norm. But this tends to distort by over-generalizing (and under-conceptualizing) the so-called Asian model. Indeed the uneven impact of the Asian crisis offers support for two propositions at the centre of this article: (1) that the impact of 'global' flows is highly dependent upon the character of national purpose and institutions; and (2) that global networks depend on national networks of interaction in order to function. In this way, they emphasize the limits to liberalization. Let us take each point in turn.

National mediation of global impacts

The significance of the Asian crisis, for the purpose of this argument, is that it seems to many to signal the end of the developmental state's viability and its transformation into a different kind of beast. In that respect, the crisis is pivotal to the Western confidence that globalization curtails capitalist diversity (read divergence from the free market norm), and that state-guided capitalism has failed the survival test. There are, however, at least three problems with the view that the crisis was a byproduct of the developmental model of capitalism. First, none of the most troubled Southeast Asian economies—Thailand, Indonesia and Malaysia—could be seen as developmental states, let alone transformative states. If they fell victim to international financial markets, they did not do so from a position of robust institutional capacity. Second, Japan itself was not a victim of the financial meltdown. It certainly had a banking crisis of its own, but this was mainly self-induced and long predated the events of 1997. Thus the Japanese model is not directly implicated. Third, the one developmental state which did become a victim of the financial debacle—Korea—had undergone such a substantial institutional makeover by the time the crisis struck, that one might plausibly argue that it was Korea's emerging neoliberalism rather than the legacy of statism that made it more vulnerable to a financial shakedown. In fact, one can turn the IMF argument on its

[62] See Vogel, *Freer Markets, More Rules*.

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head: Korea was pulled into the financial maelstrom not because it deviated too far from the free market but, as I have argued at length elsewhere, because it had abandoned too much of its transformative capacity.[63]

Dismantling of Korea's developmental arrangements began very gradually in the early 1980s. State actors began slowly to unravel the financial ties which bound the chaebol closely to the state. Multiple overlapping crises—political, financial, and social—forced a questioning of statist arrangements and propelled the authorities towards domestic reform. In particular, state actors perceived financial liberalization as a means of distancing the state from the chaebol's financial affairs by expanding their financing options. Liberalization was thus initially aimed at the domestic arena as the state gradually privatised state-owned banks, increased reliance on equity financing through the creation of a stock market, and reduced policy loans. Financial market opening gathered pace very quickly in the first half of the 1990s as firms and financial institutions were allowed to raise more and more funds on overseas markets, with little or no supervision of the level or composition of those funds. The result was a surge in the inflow of portfolio investment in the 1990s. During 1990–94 alone, the net inflow of foreign capital, reaching some $32 bn, was more than ten times the total for the 1980s. Most of this was short-term portfolio investment, exceeding $27 bn in the 1991–94 period alone. This massive influx of capital took place as the developmental state's key agency was being marginalized, culminating in the definitive dismantling of the EPB, the pilot agency which coordinated Korea's rapid industrial transformation. Without coordinating discipline, there was no corrective to the high-risk, expansionist, surplus capacity tendencies of the chaebol, a weakness which soon became manifest in the economic vulnerabilities that exposed Korea to financial crisis: declining export growth, soaring current account deficits and debt repayment difficulties.

The argument that Korea's malaise is due more to an abandonment of transformative capacity than deviation from free-market rules gains strength when we reflect on the differential involvement of Taiwan and Korea in the events of 1997. In Taiwan, state actors approached financial reform very differently from their Korean counterparts. The state centred on Taipei has held fast to a transformative orientation, reflected *inter alia* in one of the world's strongest national innovation and upgrading programmes. Developmentalism was further reinforced through the stance and policies of the Central Bank of China (CBC) whose unusual vigilance and conditionalities ensured that financial liberalization would mean keeping a tight rein on foreign exchange activity.

In short, Taiwan's regime goals and institutional arrangements were largely intact when it set about regulatory reform in the late 1980s and 1990s. While Korea set about liberalizing finance in a way that would complement the larger goal of dismantling the structures of credit activism and industrial policy, in Taiwan the process of liberalizing capital inflows involved re-regulation to enhance existing capabilities. Thus, in the political bargaining that preceded capital account opening in the early 1990s, the CBC held out for a safety blanket, insisting on guaranteed emergency powers should things go wrong. Under these powers, the central bank has kept strict control of the foreign currency market, intervening to discipline

[63] The points in this paragraph and the following are based on material drawn from Weiss 'State Power and the Asian Crisis', and 'Developmental States in Transition'.

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international speculators in the wake of the Asian crisis. Thus, as indicated earlier, the very process of opening up Taiwan's capital markets in the 1990s has brought with it new regulatory controls which have preserved and at times strengthened coordination powers. Financial liberalization in the hands of the Taiwanese has thereby become much more an instrument for complementing and enhancing state capacities than for relinquishing them.

The key points then are twofold. First, in the Asian setting, developmental state weakness or dismantling paved the way for a particular approach to liberalization, one in which financial reform was perceived as a means of distancing the state from industrial governance (the Korean experience), rather than complementing its transformative capabilities. Thus, where coordinating powers were relatively weak to begin with (as in Southeast Asia), or had been partially dismantled in response to domestic crises (as in Korea), liberalization was undertaken in a way that would emphasize and reinforce institutional weakness rather than enhance capability. Second, where developmental state dismantling did not occur, liberalization was a more highly managed process (the Taiwan experience). In the Taiwanese setting, managed liberalization was undertaken in a manner that sought to complement and enhance developmental capacities, not to retreat from industrial governance.

(National) limits to liberalization

The idea that global finance needs strong national institutions would seem to be—paradoxically—one important lesson of the Asian financial crisis. For if the crisis has taught us anything about the power of globalization, surely it is that when left to their own devices, unregulated capital markets in the form of massive movements of short-term capital flows end up cannibalizing not just the national economy, but ultimately the very basis for the financial market's global operation. Global finance can act like a 'wrecking ball', to use the vivid imagery of George Soros, but the wreckage can undermine its own conditions for existence. Thus the more national economies are damaged, the less institutional and ideological support exists for strengthening interdependence in the form of open capital markets. Witness, for example, the renewed support for controls on short-term capital flows in the region and the mounting challenge to free-floating finance that has occurred more generally in the wake of the ruin created by global finance. While it is important not to overstate the significance of this movement, one of the main consequences of the crisis has been a worldwide questioning of the benefits of removing capital controls, and in the Asian region at least, a partial closure against global financial markets. Even policymakers in the United States now intellectually accept the case for limits on short-term capital flows, although the interests they serve may prevent explicit support for this agenda.[64] These wider consequences of the crisis do give some basis for the proposition that there are important national (institutional) limits to globalization.

More generally, the Asian crisis has left little doubt that exposure to volatile (short-term) capital flows is bad for growth, damaging even the most sound econo-

[64] I owe this point to Jeremy Heimans, reporting comments from an interview with Joseph Stiglitz.

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mies. The conclusion to draw from this, however, is not that global financial markets have somehow disempowered the state or that national systems are converging on liberal economics. Any such triumph would be a phyrric victory for globalism for it would mean undercutting its very foundations of existence. If this reading is correct, then rather than a retreat or transformation of the state (developmental or otherwise), we are much more likely to see a retreat of untrammelled markets in favour of the prudential use of capital controls.

Conclusion

The general argument here has been that whether or not a globalization tendency exists may in the final analysis not be deeply important, at least not for the institutions of national governance and their capacity to improve wealth creation and social protection. The key proposition is that global and national are interdependent principles of organization rather than antinomies. Global networks have evolved and strengthened on the basis of national and international institutions; they are more likely to be sustained where they complement and coexist with such institutions, rather than by weakening or displacing them. In this sense, 'global' is no more a pure concept than 'national' or 'international'. I draw three main conclusions from the argument offered in this article.

First, globalization, itself a partial and limited process, has not so much undermined national capacity for wealth creation as increased the need for it, an argument which has been advanced in much greater detail elsewhere.[65] Just as some have argued that there can be no globalization without (national) social protection, so there can be no social protection without wealth creation, and ultimately no sustained wealth creation without national governance. National governments can act to improve social welfare (read 'social protection' and 'wealth creation'). But this must be taken as an 'in principle' statement. If in practice many governments do not act in this way, it is less because of pressures stemming from the global economy than because of constraints imposed by underlying regime orientations and institutional capacities.

Proposing that states act as mediators and midwives, rather than being mere victims of economic integration, does not mean that political choices are utterly open-ended. The big choices that state actors make—*vis-à-vis* regulatory reform, social protection, and wealth creation—are strongly informed by external-competitive pressures; but the way in which states tackle such issues as well as their outcomes are path dependent. This means that the choices actors make and their outcomes are to a large degree shaped by (domestic) regime characteristics rather than being imposed on them. There are still constraints, but the way states respond to them is much more regime dependent than externally determined. So in assessing the impacts of international integration, we need to distinguish between two different issues. The first is why states make certain choices, e.g., to alter social policy programmes, to deregulate a particular industry, and so forth (which may or may not have to do with 'external' structural changes and pressures and the costs and

[65] See Weiss, *The Myth of the Powerless State*.

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benefits thereof). Second, even when those choices appear to stem from common sources, the issue is why apparently similar choices may produce distinctively different outcomes. One important implication of the preceding argument is that we can expect continuing diversity in national systems of political economy—in short, varieties of capitalism.

Second, growing political interdependence has not eliminated the territorial principle but rather organizationally 'tamed' it. In subdued form today, this 'neo-territoriality' continues to provide the foundation for enhanced cooperation.[66] Indeed without a territorial basis, it is hard to imagine why states would be disposed to engage in interstate cooperation. It is not hard to appreciate that economic integration has increased hand-in-hand with the strengthening of nationally distinct forms of economic management. Under the Cold War regime, countries and regions have become more diverse, not more homogeneous. And it has been on the basis of accepting and strengthening diversity—not imposing uniformity—that international cooperation has flourished. The combination of increasing interdependence (particularly in trade) and the consolidation of different national models of economic and political management defines a major and distinctive feature of the developed world's postwar 'golden age' period.[67] Variations on the free-market norm were once tolerated as part of the United States' strict-geopolitical—relaxed-economic stance, which encouraged and supported capitalist diversity as a means of strengthening capitalism against communism. Once the Cold War ended, however, tolerance for capitalist diversity rapidly declined (a trend especially evident in the United States' recent dealings with East Asia). But if that old adage of 'strength in diversity' remains valid in the world of international affairs, then current attempts to submerge the national with the global rather than to support and encourage their coexistence may prove the greater threat to world order in the long run. In sum, if the postwar pattern offers any guide to future stability, the persistence of national institutional diversity rather than its suppression would appear a more robust basis for the consolidation of international cooperation.

Finally, the big choices in international relations theory between anarchy and cooperation, realism and liberal institutionalism appear less clear cut. Realists will no doubt continue to insist on the enduring reality of the sovereignty principle, on the impossibility of changing the nature of states as a result of their cooperation. Institutionalists, on the other hand, will be more inclined to see in international forms of cooperation a newly emergent institutional reality, whereby the whole becomes more than the sum of its sovereign parts. But unlike individuals who eventually lose control over the institutions they have historically set in motion (control over the state itself being a primary example), states may not succumb to a similar institutional dialectic. For—however much they orient themselves to internationalism—they remain anchored in a domestic constituency. Similarly, one may argue that, like cats, states can be 'domesticated' via international society; but for all their domestication, cats are still prone to hunt down their feathered friends when circumstances favour. Binding states into international organizations may be a bit

[66] John Hertz's term refers to 'a world in which sovereign states recognize their interests in mutual respect for each other's independence and in extensive cooperation', cited in Zacher, 'The Decaying Pillars of the Westphalian Temple' , p. 100.

[67] Lars Mjoset, 'Atlantic, West-European and Nordic integration', Department of Sociology and Human Geography, University of Oslo (1999), p. 12.

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like making the cat wear the proverbial bell: it's good for the society of wildlife and it does no harm to the cat. The lesson may be that states can be increasingly dual creatures: exercising their cooperative (international) aspect, as well as their more traditional self-interested side as circumstances require. That of course is the critical point. Over the long haul, much depends on the fruits of cooperation. States will cooperate as long as the welfare benefits of doing so outweigh the sovereignty costs. It would be unwise to expect states willy nilly to abandon self-interest or sacrifice national welfare on behalf of interdependence.

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