1 Introduction: bringing domestic institutions back in

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An issue of central importance in the globalisation debate today concerns the impact of increasing economic openness upon the state's capacity to govern the national economy. As participants in that debate, we seek answers to the big questions, such as whether, in a world of highly mobile capital, states – as territorially centred authorities – are still vital to the social and economic well-being of their citizens. We want to know what, if anything, states can do to promote wealth creation and social protection in an era of economic interdependence. And we want to know whether countries which travel the path of international economic openness must necessarily abandon their distinctive institutions (and embrace the norms, arrangements, and policies of competitive liberalism).

These are not idle questions. The reason we are asking such questions so insistently at the turn of the century has much to do with the widespread changes going on both inside and outside the nation-state – ranging from welfare reforms, through financial liberalisation, to the proliferation of intergovernmental agreements.

These organisational and regulatory reforms appear to be coinciding with other changes taking place in the structure of the international political economy – in particular, the multinationalisation of production and the growth of so-called 'footloose' business corporations, as well as the astonishing increase and speed of cross-border capital flows. So the assumption frequently made is that these two sets of changes must be intimately related, that the state's actions (or inactions) – from fiscal conservatism and deregulation to welfare restructuring – can be explained readily as a response of besieged or hapless governments to global flows and similar pressures of openness and interdependence.

This is why much of the discussion being conducted today about globalisation's alleged impact on the state evokes that well-told tale about a drunken fellow who loses his keys in a dark place and then goes over by the light in order to search for them. 'What are you doing?' asks a passing stranger. 'Well', replies the inebriate, 'I won't get very far searching for my keys in the dark place, so I'm looking over here where the light is brighter.'

Domestic institutions are a bit like the 'dark place' in the globalisation debate. Challenges coming from the global arena are well illuminated. But there is correspondingly little sense of how national authorities are managing the challenges of openness. Indeed, a good many of the participants in the globalisation–national governance debate, somewhat like the drunken figure, have been reeling from the many changes to the domestic and international environments and, like that figure, they have been searching over by the light of globalisation for clues as to what it all means.

The result is a story that is being told largely in terms of one-way traffic. That is to say that most thinking about the changes going on at the domestic level has been oriented towards the global arena because that is where most light is directed, with global actors and markets always seen to be 'constraining' national governance, and states either responding ineffectually, or else retreating more and more from economic management.

In the standard tale, then, globalisation is very much a 'top-down' affair, understood as a series of constraints that economic openness places on the viability and effectiveness of particular national policies – macroeconomic, fiscal, social, and industrial. Globalisation is seen to be intrinsically constraining because openness involves the fall of national barriers to trade, investment, and financial flows, exposure to increasing capital mobility (via the multinationalisation of production and growth of global financial markets), and also conformity with intergovernmental agreements requiring, for example, that governments open their markets to foreign trade and financial institutions as well as eliminating certain subsidies to industry.

Openness is therefore seen to constrain and limit severely what governments can do across a range of policy areas. Globalisation analysts propose that economic openness not only drastically reduces scope for expansionary fiscal and social protection strategies, but that it also renders unviable a host of trade, financial, and industrial policies supporting national wealth creation, since these would conflict with

international agreements. Such are the conclusions of the more 'moderate' globalists[1] who differentiate themselves from those who posit the end of the nation-state (Ohmae 1990; Horsman and Marshall 1994), the so-called 'hyper-globalists'. Since few scholars of the international political economy seriously hold to the minority view of the hyper-globalisers, we waste little time in that direction, turning our attention instead to the claims of the more moderate majority (hereafter, the 'constraints school').

In the language deployed by the constraints school, the state is changing and the changes are not generally reinforcing or strengthening its capacities, its autonomy, or control. On the contrary, according to this influential view, state powers are being severely 'constrained', and ultimately 'transformed'. To 'constrain', according to the dictionary, means 'to compel'; 'to force or produce in an unnatural or strained manner'; 'to confine'; 'to hold back by force'. This constraints view of globalisation has many adherents, and although they disagree about many things, they are united in the view that changes in the international political economy have radically restricted policy choice and forced policy shifts that play to the preferences of global investors and mobile corporations, rather than to the needs of the domestic political economy and its citizenry.[2]

Proponents of the constrained state thesis thus advance strong claims about how much political autonomy states have lost (compared with some usually unspecified previous era); about how restricted are their policy choices; and ultimately about how little states can do to provide decent social protection and promote wealth creation. From this perspective, managing the national economy to promote growth, industrial upgrading, and employment – whether by maintaining or raising taxation and spending levels, coordinating an investment strategy, encouraging industrial upgrading, or supporting technological innovation, and so on – are nowadays seen to be increasingly beyond the capacities of territorially centred states.

Moreover, this view of the 'constrained state' is often accompanied by another claim about the 'erosion of national capitalisms'. This is the contention that – from East Asia to continental Europe – we are witnessing the end of an era of 'coordinated market economies' (read also 'organised' and 'managed capitalism') and moving towards a world more consistently 'liberal market' in orientation. In such a world, government's role is restricted to providing rule of law, basic regulation, and minimum social safety nets.

There is clearly something to these claims. It is not hard to recognise that national governments are at times constrained by various pressures beyond their borders and that some of these pressures can be ascribed to international interdependence and economic openness. After all, who could fail to be impressed by the 'electronic herd' which – as Thomas Friedman (1999) and many others endlessly point out – can readily move vast amounts of capital in and out of countries in accordance with the herd's perceptions of their political and economic merit?

In short, the idea of 'globalisation' can certainly help to shed *some light* on national governance issues. But the general point should be clear: before we abandon the *darker place* and go heading off in the general direction of the light, we need to strain our eyes and look more carefully at what is going on *inside* nation-states – particularly as national authorities set about responding to the global economy.

That is the starting point for this volume. The issue to be explored in this book is the extent to which the global economy has the potential not only to *constrain* but also to *enable* governments to pursue their policy objectives. It asks: 'To what extent does the outcome depend on the character of the domestic institutional context (including its normative and organisational aspects)?' It is the central contention of this volume that if we wish to account for impacts of globalisation in any particular national setting, we must start with the domestic institutions of governance, which mediate the challenges of openness. Such institutions embody regnant ideas and normative orientations (especially ideas about the state's economic role and public purpose) as well as organisational structures (in particular, arrangements which produce cohesive or disunified elites, structure policy networks linking state and society, and more generally aggregate and represent interests in the political and policy process). This book proposes that rather than national states being generally constrained, hollowed out, and transformed by global markets, domestic institutions – especially, *but not only*, political ones – are key to understanding the effects of openness and where interdependence may be heading. In general, one cannot deduce the impacts of global markets – whether constraining or enabling – because these are mediated by domestic institutions, which in turn shape the ways in which national authorities choose to deal with the challenges of openness.[3]

In this introductory chapter I analyse in the first section the key claims of the constraints hypothesis at the core of the standard account along with its strengths and weaknesses; the main critical response – the

so-called 'measurement critique' of globalisation – and its limitations are detailed in the second section. Subsequent sections (three and four) then outline the approach developed in this book, which is represented in Figure 1.1 below. Section three sets out the case for studying globalisation as a process with *enabling* – not just constraining – effects on policy. Section four explains why institutions are important and how they matter to an analysis of globalisation's impacts, and summarises aspects of existing research on domestic institutions of relevance to this volume. I conclude with an outline of the main propositions of the present study.

Globalisation as constraint: the standard view

The standard view of globalisation conceives the process as a constraining force that limits what governments can do and ultimately transforms the state into a weaker, meaner, or leaner version of its former self. The globalisation thesis is a two-pronged claim which combines both descriptive and causal statements. It asserts:

(a) that the world is becoming more interconnected through increasing economic openness and the growth of transborder networks that accompany that process, and
(b) that this interconnectedness is increasing the power of global (economic and political) networks of interaction *at the expense of* national (economic and political) networks.

The first is a descriptive claim, the second a claim as to impact or causation. Both are frequently bundled together in various definitions of globalisation. Thus many conceptualisations elide the nature of globalisation (*what it is*) with its effects (*how it impacts*) in the domestic arena. From this confusion stem two features which have framed much of the debate to date. One is the tendency towards 'circularity of argument', whereby globalisation's effects become true by definition.[4] This explains in part the importance attached to measuring interconnectedness through foreign direct investment (FDI), trade, and other such indicators – often seen implicitly at least as a proxy for gauging consequences or impacts, a point taken up in the next section.

The other feature is the embodiment of a 'win–lose logic' in discussions of the global–national relationship. This logic has been expressed in more or less nuanced ways: from the more extreme views positing the extinction of the nation-state or its demise as a sovereign power (Ohmae 1995; Camilleri and Falk 1992), to those of the more 'moderate'

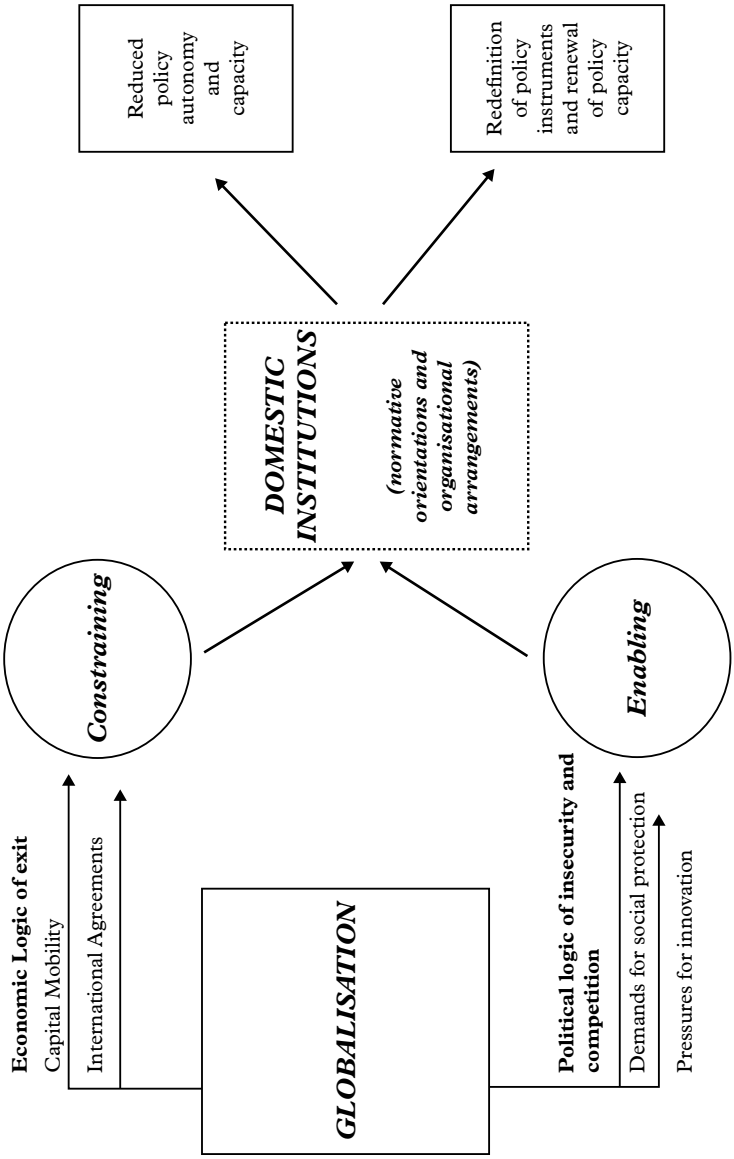

Figure 1.1 The logics of globalisation, domestic institutions, and state responses

majority anticipating erosion of the state's policymaking capacities and virtual retreat from national economic management (e.g., Reich 1991; Cerny 1996; Schmidt 1995; Strange 1996; Held and McGrew 2000; Cox 1997) to the recent transmogrification of this idea into that of the state's 'transformation' or 'reconstitution' (e.g., Scholte 1997; Held *et al.*, 1999; Rosenau 2000).

The 'globalisation-as-constraint' school

While sometimes referring to themselves as 'transformationalists' (globalisation is real but it has 'changed', not 'displaced' the state) in order to distinguish their position from the so-called 'sceptics' (those who question the very existence of a strong globalisation tendency itself), it is none the less reasonable to refer to this moderate globalist majority as the 'constraints' school. This is necessary in order to distinguish the latter from other analysts of globalisation who have also posited or analysed state power changes – as do a number of chapters in this book (Coleman; Levi-Faur; Loriaux; Weiss; Woo-Cumings; Zhu) – but who find unconvincing the negative-sum conclusions more typical of the constraints school. These so-called sceptics (or more appropriately, 'institutional adaptationists'), while often acknowledging important *changes* in the structure of the international political economy, none the less question the *impact* claims proferred by the 'constraints transformationalists'. Among the more prominent sceptics regarding the 'constrained state' and convergence claims of the constraints school are the scholars of comparative politics and comparative political economy whose analyses are informed by a domestic institutions perspective.[5]

In short, while many constraints theorists – like domestic institutionalists – posit state 'transformation' as a major impact of economic openness, the nature of the changes they identify, while not always clearly drawn, are generally taken to imply the emergence of a different kind of beast whose powers, if not eroded, are substantially pared back. In this respect, as we shall see, 'constraints transformationalists' differ markedly from 'institutional adaptationists'.

The propositions

The impact of the international political economy on the state, as espoused by the constraints school, can be encapsulated in two principal propositions. Both focus on the state's policymaking capacities and the ability to pursue its desired goals. The first claims that these capacities are shrinking (or have already eroded) very significantly under

globalisation; that in most cases states are being forced into donning the straitjacket of fiscal conservatism, cutting budgets, taxes, and spending. Capital mobility is seen as the key to this outcome, wreaking constraining effects on fiscal, welfare, and industrial-technology policies. While these effects may sometimes occur through direct political pressure as corporate employers, investors, and even foreign governments may seek to influence the policies of a particular state, such 'strategic' pressures are generally held to be less important than 'structural' ones.[6] For the latter are presumed to hold sway, with or without the existence of strategic pressure.

The structural pressures of openness are supposed to work their effects on policy in the following way: economic openness creates a new capitalism of 'entry' and 'exit'. As barriers to trade, investment, and finance fall, governments increasingly compete to attract and retain mobile capital; they must therefore pursue policies that complement the preferences of multinational corporations (MNCs) and financial markets lest these highly mobile investors exercise the exit option and take flight to lower-tax and welfare-conservative environments. As a result, financial openness and corporate mobility are expected to exert downward pressure on fiscal and social policy, forcing welfare retrenchment, corporate tax cuts, and shifts in the tax burden from capital to labour. This is the effect popularly known as a 'race to the bottom'.

The second proposition about globalisation's impact holds that the rise of intergovernmental agreements and international organisations like the World Trade Organisation (WTO) have substantially stripped states of their autonomy and control over the domestic economy, removing the scope for pursuing trade, industry, and financial policies to strengthen the economy.

So policy choices are deemed to be 'straitjacketed' by the pressures of trade competition, the preferences of MNCs and financial markets, and the rules of multilateralism. As a result of these and other developments, states virtually everywhere have been 'reduced to the role of adjusting national economies to the dynamics of an unregulated global economy' (Cox 1996: 528).

From this perspective, then, the overarching conclusion is that it is not just the state's policymaking capacities but the state itself as an institution which is being transformed, downsizing its powers and capacities, and distributing authority to other political and economic actors at local, national, and international levels (Strange 1996: 4; Hirst and Thompson 1996: 183–94; Scholte 2000: 238–9; Held *et al*. 1999: 50).

Although constraints theorists often contend that globalisation has impacted on the sovereignty and autonomy (read also 'capacity') of the state in a radical way,[7] they seek to differentiate their position from the 'hardliner' radical globalists who posit demise or retreat of the nation-state. Yet even as 'moderate' globalists, these analysts none the less maintain that the changes they are at pains to identify lead inevitably to a reduced policymaking capacity. In particular, a number of constraints theorists contend that financial globalisation has had a 'radical impact' on the ability of states to decide and pursue their own policy preferences (Held *et al*. 1999: 442–3). More generally, they assert that globalisation is impacting on the power, functions, and authority of the nation-state in a negative-sum way, producing a marked shift towards a 'divided authority system' in which states share the tasks of governance with a multiplicity of public and private institutions at local, regional, transnational, and global levels (Held and McGrew 1998: 221; Rosenau 2000: 186).

It is significant that for these observers authority is not deemed to be 'delegated' but 'divided'. And when you divide something and redistribute the portions to others, you end up with a smaller share for yourself. This is why constraints theorists conclude that national governments are 'no longer . . . the locus of effective political power' (Held and McGrew 1998: 242); that their 'capacities for governance . . . [are] lessening' (Rosenau 2000: 186); and that the state has now lost its centrality, becoming instead just one among many contending rule-making powers, with quite restricted policymaking capacities (Held *et al*. 1999: 50, 442–4), if sometimes heightened rule-making functions in more narrowly defined areas.[8]

Constraints theorists make a number of uncontentious claims about the state's changing context. But the conclusion of most interest to the studies in this volume boils down to the contentious claim that states are losing their independence or autonomy for social goal-setting and that their rule-making authority, decisionmaking powers, and ability to control domestic outcomes – in short, their room to manoeuvre and capacity to govern – are becoming increasingly restricted and specialised over a far narrower terrain than ever before.

However plausible such conclusions seem in the light of so many readily observable changes in the international and domestic political economies, they need to be grounded in systematic empirical research. At the very least, before rushing to easy conclusions, we need to untangle theoretical assumptions: Why, for example, should new forms of

cooperation between states and other power actors – whether public or private, domestic or international – be, in principle, more restricting or less enabling than before; and how, in practice, are we to measure 'more' and 'less' capacity to govern?

We can only make progress on these issues when we stop conceptualising states and their powers in static and negative-sum ways. As discussed in later sections, far from curtailing the state's capacity for independent goal-setting, a number of recent studies have found that the new power-sharing arrangements – public and private, intergovernmental, multilateral, and so on – may well extend the state's infrastructural reach and implementation effectiveness, especially where domestic structures are so oriented.

If this observation conflicts with the conclusions of the governance literature (the source of much 'transformationalist-cum-constraints' thinking), this is because the latter operates with a strictly negative-sum conception of power – if *A* has power, then *B* does not. But this distributive view of state power (as 'power over') seems in many respects more suited to the pre-industrial state; it has more limited value as a *standard* from which to appraise *changes* in state powers in modern times. The biggest state transformation came with the leap into industrialism as states gained in penetrative reach and extractive capacity what they forfeited in despotic power over their subjects. These newly acquired 'infrastructural powers' of industrial (read 'modern') states implied, increasingly, 'power through' collaboration or negotiation with other power actors in society (Mann 1984). It is fruitful to view the power-sharing changes both inside and outside the nation-state currently being discussed in the governance and globalisation literatures as more recent extensions of this 'collective' notion of power, a point we return to later in this chapter.[9]

Critical responses (I): delimiting the constraints

In spite of these conceptual weaknesses, there is unquestionably some basis to the constraints hypothesis. The hypothesis is at its most compelling in the financial realm, appearing most accurate on monetary policy and least accurate on social, trade, and industry and innovation policies. In particular, the loss of monetary policy autonomy – for example, under the standard trilemma[10] or as a result of European Monetary Union (EMU) – is probably the area of economic policy where conventional 'globalisation' (qua 'interdependence') theory is most on the ball.