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BACKGROUND PAPER

GLOBALIZATION AND ITS IMPACT ON FEDERATIONS

Earl H. Fry
Professor of Political Science and
Endowed Professor of Canadian Studies
Brigham Young University

Introduction

During the second half of the twentieth century, the number of nation-states has proliferated dramatically. There were 51 nations which originally joined the United Nations in 1945, compared with 185 current members and another half-dozen countries that have not sought UN membership. Roughly 25 of these nations are formal federations or confederations, and they represent over one-third of the world's population. Furthermore, several other major nations have recently devolved substantial governmental authority and are assuming some of the attributes of a federal system, including China, Spain, and the United Kingdom. In all, roughly 80 percent of the world's population lives within nations which have federal structures or at least utilize certain federal-style arrangements.

The Globalization Challenge

Stephen Kobrin has provided useful insights to help differentiate between an "international" economy and a "global" economy. In the former, almost all production takes place within discrete national markets which are linked through cross-border trade and portfolio investment, with the national market retaining its role as the basic unit in the international system. In the latter, the scale of technology has driven the limits of markets well beyond those of nation-states, and electronically integrated networks are gradually replacing traditional modes of organizations as the pivotal players in international economic transactions. Unprecedented technological change, combined with the emergence of almost 40,000 transnational corporations (with the top 400 alone accounting for one-half of global private-sector output), has resulted in a world where national borders remain very important, but are no longer the preponderant unit of economic accounting.

Although this briefing paper will concentrate on the economic sector, one must also be aware that "globalization" or at least "regionalization" is occurring in many other sectors as well. As depicted in Figure I, citizens within modern nation-states are increasingly vulnerable to decisions made or events which transpire outside the borders of their home countries. Governments within individual nation-states can no longer singlehandedly find and implement workable solutions to environmental, energy, and resource problems linked to global warming, ozone deterioration, air and water pollution, the depletion of fish stocks and fossil-based fuels, and a host of other problem areas. National boundaries are almost totally irrelevant within cyberspace, and increasingly so for organized crime and international terrorism. Solutions to these and other major challenges will require far greater cooperation among national governments in order to safeguard and enhance the well-being of their citizens.

In the economic arena, the international mobility of goods, services, capital, technology, and people stands at record levels, and the world is becoming far more integrated than ever before. World trade in goods and services is approaching seven trillion dollars annually, and is growing at a rate almost three times faster than the aggregate growth in national economies. In addition, the growth in commercial services, international direct and portfolio investment, and international tourism is easily outpacing the expansion in merchandise trade.

The most explosive growth has occurred in international currency markets. Daily money flows across national borders were in the range of 20 billion dollars in 1973, 207 billion dollars in 1986, 820 billion dollars in 1992, and over 1.5 trillion dollars in 1998. Only two weeks' worth of these exchanges is needed to finance the annual flows of goods, services, and investment, so most of this activity is based on speculation. Furthermore, liquid financial assets held by private sources are expected to exceed 80 trillion dollars in the year 2000, more than twice the combined annual GDPs of all the nations in the world. A good share of these liquid assets will be employed as “hot money” to chase investment opportunities around the world, and this facet of globalization is perhaps most worrisome to the leaders of national governments. Hot money helped to exacerbate the Asian crisis of 1997, the Russian crisis of 1998, and the Brazilian crisis of 1999. During the height of the Asian crisis, the rapid exodus of investment funds resulted in the Thai and South Korean currencies losing half of their value, and the Malaysian and Philippine currencies being trimmed by 40 percent. Volatile movements in currencies, even in an era of “euroization” and “dollarization,” can have a significant spillover effect on companies and workers in many countries, as exports become less competitive in nations suffering from devaluations, whereas imports from these countries may crowd out locally made products because of their lower prices.

In referring to “globalization,” Dani Rodrik has suggested that depending “on who uses it, the term denotes an opportunity, an imperative, a source of anxiety, or at worst a curse.”

Revolutionary advances in communications and transportation are increasingly negating the importance of distance, space, and national boundaries. The dominance of market systems around the world, when combined with extensive deregulation and privatization, has also eroded the role of governments in protecting and enhancing the interests of their constituents. For example, with the growth in the internationalization of production, transnational corporations can easily shift jobs to low-wage countries or other nations providing special advantages, but workers who previously held these jobs are not themselves transferred; rather, they often wind up on the unemployment line. As a concrete illustration, more than 100 U.S. firms now outsource their software code cutting to sites in India, where the work is completed and then returned overnight through electronic networks. In all U.S. industries, perhaps four million “virtual aliens” are employed abroad and are connected via electronic telecommunications networks. These foreign-based workers may improve the competitiveness of individual U.S. companies, but they do not pay taxes within the United States and they may adversely affect the job prospects for U.S. residents. Richard Longworth refers to globalization as “a revolution that enables any entrepreneur to raise money anywhere in the world and, with that money, to use technology, communications, management, and labor located anywhere the entrepreneur finds them to make things anywhere he or she wants and sell them anywhere there are customers." This new world of globalization in the twenty-first century may place an inordinate burden on national governments, because in spite of rising economic interdependence and interconnectedness, voters still expect "expensive social welfare programs and low taxes, full employment and low inflation, and above all, they expect steady income growth."

Federalism and Globalization

Federations divide authority constitutionally among national and over 350 subnational government units such as states, provinces, cantons, länder, and autonomous republics. Often, a federal system was adopted in the first place to placate the desire for a degree of autonomy among the constituent units, to take into account the exigencies found in huge territorial expanses, or, more commonly, to compensate for diversity or cleavages in a variety of areas (see Figure I). In the end, some are not successful in containing these centrifugal forces, as manifested by the recent disintegration of federal systems in the USSR, Yugoslavia, and Czechoslovakia.

In an era of globalization, subnational governments in several federations have decided that they must be actively engaged in the international sector in order to protect the interests of their local constituents. In most federal systems, international trade, investment, and tourism now represent a record percentage of overall jobs. For example, upwards of 18 million jobs are directly linked to the international economy in the United States, or roughly 1 in 6 full-time jobs in the private sector, and in Canada the number is 1 in 3. Indirectly, even more jobs are tied to the international economy because import penetration is at record levels and local companies must compete in their own domestic marketplace against goods and services originating abroad. Because such a large percentage of subnational government revenues is generated from local business activity, these governments consider that it is imperative to be engaged both nationally and internationally.

Secondly, the intrusiveness of the international level onto the local level is also prompting activism on the part of subnational governments in federal systems. In an age of interdependence, Joseph Schumpeter's notion of capitalism as "creative destruction" is more appropriate than ever before. Between 1980 and 1997 in the United States, 74 million jobs were created and 44 million disappeared. The net creation of 30 million jobs is quite impressive, but some human tragedies were inextricably linked to the 44 million jobs which were terminated. Globalization and rapid technological change combine to have an uneven effect on businesses and regions. For example, among the Fortune 500 companies listed in 1955, 70 percent no longer exist. Detroit has lost 70 percent of its manufacturing jobs since its peak productive years of the 1960s, whereas employment in Silicon Valley has increased by almost 1000 percent over the past two decades. With many subnational governments in federations having primary responsibility for business regulation, unemployment programs, and social-welfare functions, they must deal on a daily basis with this turbulent creative destruction in an era of globalization. In addition, international or regional agreements entered into by their national governments, such as membership in the World Trade Organization (WTO), the European Union (EU), or the North American Free Trade Area (NAFTA), have also intruded into areas of responsibility constitutionally mandated to these subnational governments. This intrusiveness limits policy prerogatives at a time when state, provincial, länder, or other subnational governments are increasingly engaged in a range of activities which often overlap the local, national, and international arenas.

The expansion of subnational government involvement in the international arena is impressive. In the United States, 4 states maintained offices abroad in 1970, compared with 42 states and Puerto Rico which currently operate 180 foreign offices in almost 30 different countries. Many governors and big-city mayors lead at least one international mission annually, and state governments are allocating about 100 million dollars per year to their international programs, in addition to pledging billions of dollars in grants, loans, or tax holidays to foreign companies setting up subsidiary operations on American soil. The Canadian provinces have historically had more offices opened overseas and spent appreciably more on international programs than their counterparts in the United States. German länder, Swiss cantons, and Australian states are among the other subnational governments in federations which have been actively engaged in international activities, as well as some subnational governments in unitary systems such as France and Japan. In all likelihood, these international pursuits sponsored by subnational governments will increase in the future, a reflection of their own growing professionalism and revenues, their continued concern with representing the interests of their local constituents, the steady proliferation of "intermestic" issues that have both domestic and international implications, and the inextricable march toward globalization and regionalization.

Intergovernmental Relations and Globalization

There are certain disadvantages facing federations in an era of globalization that might not face unitary systems of government where authority is concentrated at the national level. First of all, subnational activism abroad may make it more difficult for the nation-state as a whole to speak with "one voice" in the foreign policy arena. Ottawa has had its share of disagreements with the government of Quebec over international representation, and the current Parti Québécois (PQ) government is pushing for some form of representation in such international bodies as the World Trade Organization and UNESCO. Indeed, a recent PQ working paper suggests "why fight over Quebec's place in Canada, when the real debate from now on will be about Quebec's place in the world?" Massachusetts has attempted to place sanctions on trade with Burma (Myanmar), California and New York City levied sanctions against two Swiss banks until they reached an acceptable settlement on the allocation of assets belonging to Holocaust victims, and various cities in the United States continue to impose economic sanctions on selective nation-states. In almost all cases, the national government has opposed these subnational government edicts and warned that they weaken the ability of Washington to conduct foreign affairs.

Other weaknesses linked to federalism may include (1) the lack of intergovernmental cooperation in addressing solutions to the challenges of globalization, (2) the duplication of international programs, (3) intensive and costly competition among subnational governments to entice foreign corporations to their areas of jurisdiction, (4) the lack of national standards in a variety of important areas, including liability laws, fiduciary responsibilities, environmental regulations, etc., (5) subnational protectionism and other barriers which impede the free flow of goods, services, and workers within the federation, thus hindering local companies in their efforts to become internationally competitive, (6) frequent skirmishing in the field of fiscal federalism, and (7) periodic disputes involving which level of government is best equipped to tackle a broad range of problem areas. Globalization may also accentuate national unity problems in fragile federations on the precipice of disintegration.

On the other hand, federal systems may have certain advantages over their unitary counterparts in adapting to the challenges of globalization. Their extensive experience in intergovernmental relations has equipped them to interact with national and subnational governments abroad. Moroever, regional and municipal governments in federations usually have a much better grasp than their national governments of local conditions and what needs to be done to enhance the well-being of their constituents. They also have the authority, flexibility, and often the fiscal resources to implement experimental programs, which, if successful, can be replicated by other subnational entities within their federation. Constant competition among these subnational governments to provide conditions conducive for economic development also affords little room for complacency and fosters a need for continuous innovation. Ideally, this flexibility and creativity will be accompanied by a strong commitment to national economic union and the absence of trade and other types of barriers that impede exchanges among the federated units themselves.

Without any doubt, more intergovernmental consultations and collaboration will be needed if federal systems are to take advantage of the many opportunities and to minimize the negative effects of globalization. As an illustration, one pressing issue will be how all levels of government can develop a common policy toward electronic commerce which is no respecter of national or local boundaries. Rapid growth in e-commerce may threaten bricks-and-mortar retail establishments in local communities, lowering sales and property tax revenues and bolstering the ranks of the unemployed. Some national governments have even decided to postpone levying taxes on e-commerce, providing this cyberspace venture with an additional competitive advantage over local retail stores. Both the globalization phenomenon and technological advances will result in a plethora of challenges similar to e-commerce, and will therefore require extensive intergovernmental consultations and public-private sector deliberations.

As we enter the new century, the odds are very high that the trend toward globalization will intensify and that the interconnectedness of local, national, and international economies will solidify. This is not to imply that borders are irrelevant (especially in terms of the exchange of goods), because trade within borders, measured in terms of distance and economic size, is still several times greater than cross-border trade. Nevertheless, further global and regional trade and investment liberalization linked to the WTO, EU, NAFTA, the proposed Free Trade Area of the Americas, and other international accords will most certainly close the gap between the flows of domestic and international commerce.

Governmental units within federations must ask themselves what are acceptable institutional and procedural guidelines for fostering an effective interaction among all levels of government, the business and labor sectors, and other pertinent groups in the private sector. Representatives of municipal governments must also be actively engaged in the process, because most federations are highly urbanized and larger cities, in the words of Saskia Sassen, are “a new geography of centrality and marginality.” This means that many of the best-educated and highly skilled people who can take full advantage of globalization are concentrated in major metropolitan areas, but it also means that many of those least prepared, such as the impoverished, school dropouts recent immigrants, and disadvantaged minority groups are often clustered within large urban agglomerations. This intergovernmental dialogue must deal with a host of issues linked to globalization and the well-being of local citizens, including (1) an educational system geared to the Information Age, (2) worker training and retraining commensurate with rapid technological change, (3) the development and maintenance of a world-class infrastructure, (4) new social-welfare strategies which adapt to demographic and globalization trends, and (5) reasonable tax and regulatory climates which enhance business competitiveness while at the same time permitting governments to protect the basic needs of their citizenry.

"Think globally and act locally" has been the traditional rallying cry for subnational governments to be actively engaged in the international arena. Within federations, this rallying cry can either be quite productive or somewhat disruptive, depending on who is allowed to participate and whether or not the interaction among governments is generally cooperative or generally confrontational. As Canada pondered joining the Canada-U.S. Free Trade Agreement, NAFTA, and the WTO, the national and provincial governments met on a regular basis to decide how best to approach these landmark commitments which would result in further regionalization and globalization. The process had its flaws and some important groups felt that they were relegated to a peripheral role; nevertheless, these intergovernmental consultations were far more productive than those found in any other federation considering such major forays into the international economy. This Canadian model is perhaps a good starting point for federations to commence the process of developing or refining the intergovernmental institutions and procedures needed to cope effectively with globalization in the twenty-first century.

ENDNOTES

1. Daniel J. Elazar, Federal Systems of the World, second edition (Harlow, England: Longman Group, 1994), xvii.
2. Ibid., xv.
3. Stephen J. Kobrin, "The Architecture of Globalization: State Sovereignty in a Networked Global Economy," in Governments, Globalization, and International Business, ed. John H. Dunning (Oxford: Oxford University Press, 1997), 147-148, 153-154, and Dale Neef, A Little Knowledge Is a Dangerous Thing: Understanding Our Global Knowledge Economy (Boston: Butterworth-Heinemann, 1999), 64.
4. For example, there were 426 million international tourist arrivals in 1989, and these travelers spent 221 billion dollars. In 1998, the number of tourists crossing national boundaries had increased to 625 million, and their spending had more than doubled to 444 billion dollars. See the World Tourism Organization, Tourism Highlights 1999, at <http://www.world-tourism.org/>.
5. BIS statistics found in Richard C. Longworth, Global Squeeze (Chicago: Contemporary Books, 1998), 7.
6. Ibid., 59, and Gary C. Hufbauer, "The Trade and Investment Regime in the First Decade of the Twenty-First Century," paper presented at the Future of Industry at the Onset of the Twenty-First Century Conference, Brasilia, March 23-24, 1999.
7. Dani Rodrik, Trade, Social Insurance, and the Limits of Globalization (Cambridge, Mass.: National Bureau of Economic Research, 1997), 1.
8. Dale Neef, "The Knowledge Economy: An Introduction," in The Knowledge Economy, ed. Dale Neef (Boston: Butterworth-Heinemann, 1998), 3.
9. Longworth, 7.

10. Richard E. Baldwin and Philippe Martin, Two Waves of Globalisation: Superficial Similarities, Fundamental Differences (Cambridge, Mass.: National Bureau of Economic Research, 1999), 29.
11. Neef, A Little Knowledge, 10.
12. Janet E. Kodras, “Globalization and Social Restructuring of the American Population: Geographics of Exclusion and Vulnerability,” in State Devolution in America, eds. Lynn A. Staeheli, Janet E. Kodras, and Colin Flint (Thousand Oaks, CA: SAGE, 1997), 52-53.
13. Earl H. Fry, The Expanding Role of State and Local Governments in U.S. Foreign Affairs (New York: Council on Foreign Relations Press, 1998), 68-78.
14. Quoted in the Gazette (Montreal), 16 April 1999 (Internet), from The Sovereignty of Quebec in the Era of Globalization.
15. See Thomas W. Bonnett, Governance in the Digital Age: The Impact of the Global Economy, Information Technology and Economic Deregulation on State and Local Government (Washington, D.C.: National League of Cities, 1999).
16. As Gary Hufbauer, John Helliwell, and other economists have pointed out using the so-called gravity model, the density of merchandise trade between New York City and Chicago, Rio de Janeiro and Sao Paulo, and the provinces of Quebec and Ontario, may still be at least ten times greater than their respective trade flows across international boundaries. See Hufbauer, “The Trade and Investment Regime.”
17. Saskia Sassen, Globalization and Its Discontents (New York: New Press, 1998), xxv.

Figure 1