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BACKGROUND PAPER

GLOBALIZATION AND THE DECLINE OF THE NATION STATE

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1. INTRODUCTION

This short paper discusses the decline of authority of nation states and its association with the process of globalization. It asks whether globalization will inevitably lead to a decline and eventual withering away of the nation state as sometimes argued; what the factors are which would contribute to this; and whether other elements would tend to argue for a redefinition and even the resurgence of the nation state as resulting from globalization. I limit the discussion to economic policy making, leaving other dimensions of globalization on one side.

The notion that the power of centralized authority in nation states will inevitably decline as globalization accelerates, to most people seems both natural and quite realistic. In late medieval times, authority structures based on city states began to weaken as wider political groupings based on regions began to emerge, reflecting the presence of trade and flows of labour between cities. In the last 200 or so years, nation states have become the central focus of growth, reflecting a strong emphasis on nation building as perhaps the key element underlying development. At the same time, federal structures have either subsumed smaller pre-existing entities or emerged as power structures beyond actual boundaries (such as with the EU).

All these processes typically reflect a pattern under which elements of economic policy making and authority concerning common but cross jurisdictional problems, such as monetary and fiscal policy, pass to higher levels within the jurisdictional structure, while the particular and different tend to remain under the jurisdictional authority of the lower level. As this has happened over the decades and centuries, lower level entities have tended to recede and higher level entities grow in authority. If globalization, in part, involves the emergence of supra national authorities because of new transnational problems resulting from growing trade, foreign investment, financial market interdependence and rapid technological change within a globalizing economy, then it seems only too natural that this process too will lead to supra national authorities eventually acquiring more jurisdictional power and nation states declining.

The paper argues that indeed while this process might seem likely to occur over future decades it may have elements to it which differentiate it from previous jurisdictional transfers of authority. The arguments in favour of a decline in the nation state have been clearly stated in literature, including weakened policy autonomy under tax competition (see the recent survey in Schulze and Urspring (1998)), and newly created transnational arbitrage opportunities which reduce the power of nation states to enforce regulatory regimes. More generally, the argument is that globalization throws up new problems and challenges within the global economy for which there is initially a void in terms of institutional presence and policy reaction. The later emergence of supra national and even global authority structures dealing with transnational economic policy follows the emergence of such problems, and nation states recede further in their power. The complicating elements include pressures for either new measures or elaboration of existing policies at nation state level because of the problems generated by globalization, such as more extensive needs for social insurance programs. These have recently been stressed by Rodrick (1997a,b), although these arguments also assume that the social insurance function remains at nation state level under globalization rather than passing to supra national level. Thus whether globalization can also exert offsetting pressures which strengthen the nation state is an issue.

The paper concludes by discussing the movement towards global government structures with associated nation state decline which globalization seems to indicate. It suggest that this may not be a simple, smooth or short lived process, and may be accompanied less by a withering away of nation states and more by a further overlay of new transnational governmental process on top of nation states within a global federal structure.

2. THE VOID OF GLOBALIZATION AND STATE DECLINE

Perhaps the most compelling argument in favour of nation state decline associated with globalization is the argument that nation states will increasingly be unable to satisfactorily conduct own country economic policy in an increasingly globalized and transnational economy. The factors at play include ever growing world trade, even more rapidly growing direct foreign investment, accelerating interdependence among national capital markets, global concentration in production in a relatively small number of transnational companies who produce for global rather than national markets, and technological change with evermore rapid and extensive information flows across borders.

If we look back at 200 years or more of evolution of the nation state, as much as anything else the regulatory tax raising and spending authority of nation states has defined the rules of the game for most economic activity. These span legal systems and their enforcement, oversight of financial institutions, antitrust and market structure policy, health and safety regulation, the setting of product standards, sectoral policies (such as utilities, agriculture, services, heavy industries), and many other interventions in economic activity by the state. The strong growth that we have seen both in the global economy and within individual nation states in the post-war years, has in part, reflected the emergence of these regimes, despite an overarching commitment to market process in many if not most countries. Many of these functions have been assumed by nation states over the last 200 years as the political demand for regulation has grown, and it has become ever more widely recognized that the ability of sub national entities to conduct such regulatory activities on a cross jurisdictional basis becomes ever more limited with growing interdependence. Nation states have thus grown, while sub national authority has receded.

Today, a key argument underlying the position that nation states will decline with globalization is that within a globalized economy the authority invested in nation states is insufficient to deal with the cross border regulatory and other problems facing the global economy. For instance, the Asian financial crises of recent years, which some argue has now largely receded, nonetheless clearly indicates a lack of global banking regulation comparable to that which exists within nation states. For instance, the activities of banks from Japan and other OECD countries in lending to Indonesian financial institutions in the pre crisis period with only limited collateral for the loans (because of the lack of effective bankruptcy laws) seemingly indicates banking practices which would not be admissible under the regulatory banking structure used by most individual nation states. Cross-border activities in this area were seemingly undertaken in ways which would have been unacceptable under nation state regulation. The integration of global financial markets and the resulting volatility experienced in these cross border markets would thus seem to eventually drive a demand for international regulation, perhaps comparable to that we now have within nation states; the transfer of some elements of authority over policy making previously held within nation states to a supra national authority.

Similar arguments can be made in the case of anti-trust policy. Here, once again, the argument is that there is no global policy regime in place which replicates the antitrust policies currently in place within nation states, diverse as they are. Global concentration of production in the form of a relatively small number of transnational corporations is marked. Pressures will build for global regulation. Cross country mergers of the type that we have seen recently in financial service sectors between Europe and North America have already raised issues of supra national regulation and control; relatively unregulated transnational mergers thus also accelerate this process.

Thus, this element of the argument in favour of nation state decline resulting from globalization is that as economic integration and cross nation state penetration occurs through direct foreign investment, technology, and rapid communications, as well as through increased international trade, then globalization will result in more economic activity which crosses state lines and this cannot be easily regulated by nation states. Ultimately, globalization results in an inability of individual nation states to meet the demands for regulation which their residents make. This is the void which globalization creates. The response is the emergence of supra national authority with weakened nation states.

The argument is that the problems produced by a globalizing international economy become ever more apparent to all, and the need for a global response eventually drives institutional change and adaptation at a supra national level. This occurs in a series of regulatory areas, including financial regulation, competition, environment policy, and trade, changing further the global system. The void revealed by global economic disturbance is filled by evolution of supra national agencies which assume powers and authorities which, to some degree, absorb those previously exercised by nation states.(2) The same process of movement from medieval cities to post Westphalian states and to federal structures thus, to some, seems likely to occur under globalization, with supra national authorities increasingly taking on functions and powers at the expense of weakened nation state institutions. The void which globalization creates is slowly filled by institutional evolution and weakened nation states.

3. POLICY AUTONOMY AND NATION STATE DECLINE

Further factors which are widely thought to drive nation state decline under globalization are policy competition and weakened ability to implement policy within nation states in the presence of globalization. These factors can be illustrated by developments in two separate areas.

The first is the reduced ability of nation states to regulate individual markets and actors within national economies, to the point that domestic regulatory schemes break down with initially a global free-for-all, and eventually new global regulation. Nowhere is this more evident than in the area of telecoms. Telecoms globally in the last ten years have seen dramatic policy change, with weakening of domestic regulation and a rapid fall in telephone rates in most countries. To some degree this reflects international liberalization, such as was negotiated jointly by countries in the Telecoms Agreement in the WTO and elsewhere; but the WTO Telecoms Agreement is merely a reflection of the fact that many countries wanted to liberalize and lock in their domestic liberalization by making international commitments to which countries jointly attached themselves.

Why was this the case? With an increasingly globalized economy, by the early 1990's the cost implications of high phone rates and tight domestic regulation for foreign investors within countries increasingly became a major problem for countries who maintained tightly regulated telecom regimes. Commitment to deregulation in telecoms became seen as an important element of policy to spur inward foreign investment into countries; domestic policy autonomy in this area was inconsistent with relatively freely functioning global capital markets.

In turn, any attempt to regulate, particularly smaller, telecom markets tended to be offset by the ability of private providers of telecom services to subvert regulation by various devices. Thus between Canada and the United States, domestic regulation in Canada was effectively undermined by companies who were able to make block purchases of calling capacity from US providers of phone services south of the border, with subsequent retransmission in and out of the Canadian market. Phone calls from Toronto to Vancouver could be routed via Buffalo and Seattle by alternative providers so as to reduce costs. Such developments had the effect of weakening the regulatory authority of domestic regulators. In Europe, phone back services buying bulk capacity abroad and reselling into domestic markets for foreign calls at sharply reduced rates drove down rates, undercutting seemingly regulated national and more major telephone providers. The domestic regulatory telecom structure, which had seemed stable for decades in many countries seemingly crumbled in a short period of time under an assault of arrangements which were legal within the rules of national regulatory regimes but which reflected responses to regulation repeatedly unanticipated by national regulators. Telecoms thus represent a good example of how arbitrage reduced the ability of nation states to regulate, and national regulatory structures weakened and nation state decline followed with a weakening of state authority.

A further example is tax competition and its effects on the power of nation states. The central analytical formulation of tax competition assuming that capital is freely mobile across countries, but labour is not; governments can only tax capital, and funds raised are used to provide public goods to residents. The result is under provision of public goods, and a smaller public sector in all countries due to tax competition.(3)

Tax competition, for now, is widely believed to be largely limited to competition in the capital tax area, since here, with highly mobile factors of production, changes in country capital taxes are thought to have significant impacts on capital flows. But in reality, even the capital tax competition situation is made more complex by the existence of cooperative double taxation treaties under which reductions in tax rates in one jurisdiction do not necessarily have a direct effect on decisions made by investors in other jurisdictions. However, tax competition effects under which reductions in tax rates in one jurisdiction attract capital flows form another are taken by many as further evidence of the weakening of nation state policy autonomy that occurs under globalization, and further evidence of the process of nation state decline.

4. SOCIAL INSURANCE AND STATE RESURGENCE

However, alongside these factors which seems to point to nation state decline are other factors which may lead to a reorientation of the nation state, and even to some degree a resurgence of state activity as globalization occurs. The clear example of this and the one emphasized by Rodrick (1997a) is social insurance. Here the argument is that under globalization national economies become progressively more open and subject to more severe external shocks, which, in turn, generate potentially adverse income distribution effects. As recent literature(4) on the role of trade on wage dispersion indicates, such shocks often act against lower skilled workers in higher income countries, particularly if import surges occur in labour intensive goods. The response, driven by political pressures within countries, is for an elevation of social insurance programs. Those adversely affected by trade, and globalization more generally, seek compensation. Social insurance programs grow and the degree of intervention undertaken by the nation state may even enlarge as a result of globalization.

Rodrick (1998) produces cross country regressions for OECD countries which seem to indicate somewhat contrary results; that openness and volatility in international trade tend to exert a negative effect on social security and welfare expenditures. The argument seems to be that elevated globalization tends to reduce social security expenditures because of the anticompetitive effects of the financing arrangements associated with them.

However, the case of social insurance illustrates the more general argument that there may be a resurgence of the nation state under globalization. Competition policy and controls on foreign investment are other areas sometimes cited, the emergence of capital controls in response to global financial marketing stability (as in the Malaysian case) is another. These arguments, however, can become yet more complicated again because along with the revival of demands for, say, social insurance comes the issue of whether transnational entities of various kinds could absorb the functions of social insurance and transfer them away from nation states, and whether the void of globalization, in this area as in others, could again be filled by new or changed transnational agencies.

5. CONCLUSION

This short paper discusses the issue of whether the passage from separate national economies to an integrated global economy via globalization will lead to nation state decline in the area of economic policy making. The answer to this question seems to reside as much in political as in economic calculus, but if history is any guide, the progressive transfer of authority to higher levels of government over long periods of time going back to medieval times would seem to suggest that with an increasingly globalized economy such transfers are likely in the longer run.

At the same time, this does not imply an end to the nation state as far as economic policy making is concerned. Rather it implies a redefinition of nation state activity with as in the past, technology and trade and other forms of nation state inter-penetration linking smaller entities and generating authority for larger entities; with the common elements of transnational economic policy making being progressively passed to the new higher level of authority, and with the particular in the policy mix remaining with the lower level. More likely than not, this is likely to happen in the future with globalization as with nation building in the past, and as such represents a weakening and refocusing of the role of the nation state in economic policy.

The paper suggests that how this process plays out is likely to be determined by a number of considerations. The pressures to fill the void which is created by globalization in international regulation and oversight, growing constraints on the policy autonomy of nation states, and the refocusing of nation state activity in such areas as social insurance will all enter.

FOOTNOTES

1. This paper has been prepared for International Conference on Federalism, Mont Tremblant, October 5-8, 1999.

2. The process under which the GATT through eight negotiating rounds grew from a body concerned with tariff bindings in early rounds, to one concerned with intellectual property, agriculture, investment measures, services, and many other matters in the most recent Uruguay Round could be taken as representative of this process.

3. See Bucovetsky (1991) and Wilson (1991) for a discussion of tax competition in this framework where there is a strategic interaction of two asymmetric countries.

4. See Lawrence and Slaughter (1993), Wood (1994), and Leamer (1996).

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