

Coping With Globalization

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Coping With Globalization: An Introduction¹

Aseem Prakash and Jeffrey A. Hart

This volume examines the challenges posed by economic globalization to business and public policy and how governments and firms may address them. We begin with the premise that actors seek to cope with economic globalization because they perceive it as changing their economic and political landscapes, thereby creating new opportunities and threats. Unlike many other works on the subject, this volume does not advocate either resisting globalization (Boyer and Drache, 1996; Mittleman, 1996; Gills, forthcoming) or embracing it (Ohmae, 1991). Everyone does not benefit from economic integration: there are "winners" and "losers." Since the distribution of its costs and benefits is asymmetrical across countries, sectors (Midford, 1993), firms (Milner, 1988), and factors (Rogowski, 1989), there is a need to "cope" with it.

Firms and governments, the relevant actors in this volume, may choose not to respond to every opportunity or threat. Their responses may be inefficient, ineffective, or equitable, only serving to accentuate the maladaptation. Thus, the first issue addressed in this volume is: how does globalization impact a given actor's set of opportunities and threats, and consequently, why should the actor respond to it? Second, what strategies are available to the actor? Actors could cope either individually or collectively or some combination of both. They could modify extant institutions or create new ones. Of course, institutional changes may require confronting collective action dilemmas that themselves could be affected by the processes of globalization.

¹ We thank the participants of the *Coping with Globalization* workshop held in Alexandria, Virginia, July 31-August 1, 1998, for their input. Virginia Haufler, Debora Spar, and Susan Sell provided useful comments on the previous drafts. Research and editorial assistance of Jun-ho Kim, Sue Seeley, Jennifer Baka, and David Herman is gratefully acknowledged.

Third, strategies available to firms and governments may also differ -- firms are mobile while states are not; states can retreat to autarchy while firms cannot. On the other hand, both firms and governments can restructure -- firms can outsource their components and governments can privatize production of public services. Thus, what are the similarities and differences between firm and government responses to globalization? Fourth, why should firms and governments choose specific coping strategies? What are the political, ideational, and/or economic factors behind these choices? Fifth, assuming that these strategies have well-defined objectives, what is our assessment for their future success? Finally, what lessons can be distilled and generalized to other actors or issue areas?

Economic globalization is not an inexorable and irreversible process. Its impact is not ephemeral; it is causing long-term structural changes in the global economy, especially in the nature and extent of integration of factor, input, and final product markets (for an opposing view, Chase-Dunn, 1994). Non-economic dimensions of globalization also pose policy challenges that overlap with those created by economic globalization.² We will focus here only on the implications of economic globalization because we believe that there is better empirical evidence about the impact of economic globalization than other forms of globalization (Strange, 1996; Rodrik, 1997).

Defining Economic Globalization

Economic globalization (henceforth globalization) is the increasing integration of input,

² For a discussion on various dimensions of globalization, see Prakash and Hart (1998).

factor, and final product markets coupled with the increasing salience of multinational enterprises' (MNEs) cross-national value-chain networks. MNEs are the key agents of globalization. The importance of MNEs in global trade can be empirically verified by observing, *inter alia*, the ratio of intra-firm trade to global trade. As the *World Investment Report* (UNCTAD, 1997) indicates, this ratio has been increasing steadily since the end of World War II and now exceeds 50 percent. The implication is that many final products are now composed of inputs procured from different countries. Thus, the critical function of resource allocation that was previously undertaken by markets or by state planning agencies is increasingly being undertaken within the MNE system. Further, since value-chains lead to the development of "rent-chains" (Barron, 1995), MNEs impact domestic politics of multiple countries. In our view, the rise of the cross-border value-chains is the critical discontinuity between economic integration since the 1980s and previous eras and constitutes the defining characteristic of globalization.

Traditionally, MNEs have been viewed as synonymous to foreign direct investment (FDI) (to cite a few, Vernon, 1966; Hymer, 1976; Dunning, 1993; for a review of MNE theory, Caves, 1996). However, MNEs access foreign territories for securing inputs and for selling final products through a variety of means, FDI being one of them. MNEs are now increasingly entering into long-term contracts with other firms that fall short of mergers or ownership. These contracts include alliances, joint ventures, licenses, research and development (R&D) consortia, and dedicated suppliers. The term value-chain networks is therefore more appropriate to describe this wide gamut of relationships and their impact on market integration.

The fact that value-chains and rent-chains spread across countries does not imply that

MNEs should always diffuse their activities (say, R&D) across locations. MNEs face conflicting pulls to concentrate and disperse different elements of their value-chain networks (Porter, 1985; Prahalad and Doz, 1987). In some instances, economic imperatives (economies of scale) may require concentrating activities in a given location while political considerations (locational subsidies or other requirements) lead to locating it in some other place or spreading it across locations. Thus, the decisions on value-chain management such as, in how many sites should an activity be undertaken, where to locate these sites, and how to coordinate activities across sites, reflect the specific economic and political imperatives of functioning in a given industry.

Globalization and Internationalization

Is globalization different from internationalization? Milner and Keohane, for example, prefer to use the term “internationalization.”

Measurable flows, such as the vast increases in international capital movements over the last few decades, reflect more basic shifts in the costs of international relative to domestic transactions. Indeed, shifting opportunity costs are more fundamental than the flow themselves: the *potential* for international movements of capital, in response to shifts in interest rates or changing expectations about exchange rates, can exert profound effects on national economic conditions even if no capital movement actually takes places ... In this volume, therefore, internationalization is measured by such indicators as changes in trade as a proportion of gross domestic product (GDP) or the ratio of a country’s net foreign investment to its total domestic assets. *Internationalization, as used in this volume, refers to the processes generated by underlying shifts in transaction costs that produce observable flows of goods, services, and capital* (1996: 3-4).

Other scholars prefer to use the term “globalization” to describe the same phenomena. Some view globalization as having two components: first, market integration or internationalization (similar to the definition of globalization adopted in this volume); and

second, the evolution of a global mind-set among key decision makers.³ A global mind-set implies that managers do not limit their visions to a given country or region in deciding their value-chain management strategies or the attributes of the products they wish to manufacture or sell. In the literature on international business, managerial orientations have been given greater importance than in the social sciences. For example, Perlmutter (1969) differentiates among three categories of managerial attitudes and orientations: ethnocentric, polycentric, and geocentric. Employing this classification, one could hypothesize that managers in international firms have polycentric perspectives while in global firms they have geocentric attitudes.

The evolution of a global or geocentric mind-set is engendered by the reconfiguration of the economic, political, and social landscapes, both by deterritorialization and reterritorialization of the policy spaces. One could therefore argue that the increasing flows of ideas across countries are key agents (or an independent variable) of globalization, playing important roles in redefining the various identities possessed by actors as well as their relative salience to them (Polanyi, 1957; Appadurai, 1996; Scott, 1997). Globalization, therefore, has important cultural and ideational dimensions. Notions such as the spread of Anglo-Saxon capitalism, policy convergence, or harmonization can also be included as indicators of economic globalization since they result from evolved or imposed common identities.

The flow of ideas is indeed important for shaping identities and giving legitimacy to market integration. We, however, view the flow of ideas as being embedded in flows of factor inputs, services, and final products.⁴ Developing a global identity or a mind-set, adopting an

³ We thank Peter Katzenstein for this point.

⁴ Scholars adopting the perspectives of Foucault, Gramsci, and Habermass, however, view ideas as key factors in furthering market integration. The roles of the global media and entertainment

Anglo-Saxon model of capitalism, and policy convergence or harmonization can all be conceptualized as one of the many *coping strategies* (and therefore dependent variables for the purposes of this volume) at the firm and government levels, with the processes of globalization being the independent variables. Of course, in the medium to the long run, coping strategies may themselves affect the pace and extent of globalization. For example, as Ostry suggests chapter 2, the widespread adoption of rules and institutions premised on “deep-integration” will facilitate market integration and further develop cross-border value-chains. Thus, while acknowledging the importance of ideas, this volume adheres to the view that globalization combines deepening market integration with the increased salience of cross-national value chains.

It is also suggested that in an internationalized economy, nation-states remain the key units for political and economic decisions and governments continue to have the capacities and willingness to exercise policy making power within their jurisdictions (see Kudrle’s chapter in this volume; Millteman, 1996). Security issues requiring active state involvement remain important in world affairs. In contrast, a globalized economy functions in a post-Westphalian paradigm where governments lack the capacities and willingness to enforce policies within their jurisdictions. Kobrin, for example, argues that “national markets are *fused* transnationally rather than linked across borders” (1997: 148). Consequently, the primacy of “methodological nationalism” does not hold in world affairs and governance is articulated at various levels of

industries, in particular, have been carefully examined. The contention is that the monopoly of MNEs over information flows tends to create cultural hegemony and “manufactured consent” in favor of continued market integration (to cite a few, Poster, 1995; Babe, 1996; Gerbner et al., 1997, Perry, 1998; Douglas, forthcoming). An important issue for future research then is: how do the flows of ideas (as independent variables) impact the cross-border flows of inputs, factors, and final products (dependent variables)?

aggregation, the national level being one of them (Cerny, 1997; forthcoming).⁵

Along similar lines, and from a business perspective, it could be contended that international firms, though operating in multiple countries, still fly the flag of given country. Their critical functions -- R&D, systems of innovation and corporate finance -- continue to carry distinct imprints of the parent country. If national character leads to national loyalties, governments begin to have incentives to defend and promote domestic firms and home-based MNEs.⁶ Global (or transnational) firms, on the other hand, cannot be associated with any particular country. They represent “footloose capital,” locating their critical activities in countries that best serve their interests (Ohmae, 1991).⁷

Yet another perspective is provided by Kobrin (1991) who differentiates between internationalized and integrated firms. The former produce in a single country and sell to independent distributors in other countries or procure inputs from independent suppliers from other countries. Integrated firms, in contrast, internalize all these activities within their administrative hierarchies. They exhibit high ratios of intra-firm exchanges of inputs, technology, and final products.

Instead of taking sides in the globalization versus internationalization debate where they are treated as *end-states*, this volume views globalization as a *process* of market integration,

⁵ In the context of domestic political economy, Ostrom, Tiebout, and Warren (1961) have argued that public goods, governance function being one of them, can be provided efficiently at multiple levels, the country-level being one of them. Thus, methodological-nationalism may not hold in the domestic political economy as well.

⁶ We owe this point to Virginia Haufler.

⁷ For measuring the degree of internationalization/globalization of firms, see Sullivan (1994); Ramaswami et al. (1996); UNCTAD (1997); and Makhija et al. (1997).

primarily through the establishment of value chains that are increasingly dispersed geographically. If internationalized and globalized economies are conceptualized as end points of a continuum, most industrialized countries and MNEs are between these extremes, depending on the policy arena or industry sector. The power of governments has diminished in certain areas but governments still have instruments to respond to globalization (Helleiner, 1994; Cohen, 1996; Evans, 1997; Falk, 1997). MNEs retain their national character (Pauly and Reich, 1997) even though their critical functions are being spread across countries. The Westphalian system has weakened but the post-Westphalian world order has not yet begun. Three important research questions therefore are: (1) Why have governmental powers and capacities diminished differently across issue areas? (2) How have governments chosen to address this perceived loss of power? and (3) Why are some MNEs more global (and less international) than others and what are the casual variables to explain this variation?

Another conceptual issue needing clarification is the relationship between regionalization and globalization. Specifically, is regional integration a “building bloc” or a “stumbling bloc” to global integration (Gilpin, 1987; Lawrence, 1995; Kobrin, 1995, Ohmae, 1995)?⁸ Market integration is unlikely to be uniform across countries and sectors; some countries within a region may be more integrated among themselves than with the rest of the world. Further, this could vary across industries. Regional integration could be due to either “natural” causes such as geographical proximity or conscious policy mechanisms such as establishing trading blocs. Firms and governments may choose to adopt coping instruments at different levels of aggregation -- subnational, national, regional, or global. Conscious regionalization, which could

⁸ We thank Alan Rugman and John Ravenhill for encouraging us to clarify this point.

take the form of adopting regional corporate strategies, establishing regional trading blocs, or adopting a common regional currency, is therefore one category of strategy adopted by firms and governments to cope with globalization.

Coping Strategies

Globalization processes are redefining economic and political spaces, thereby creating new opportunities and threats. Some policies, institutions, structures, or strategies of firms and governments may continue to remain effective and some may not -- their “vulnerability” and “sensitivity” differ across issue areas (Keohane and Nye, 1977). The new equilibrium may not be stable, efficient, or fair. Importantly, coping strategies may bestow asymmetrical benefits and impose asymmetrical costs across actors. They may also represent rent-seeking in various guises. Coping strategies are therefore political outcomes. Important issues that arise are: what explains the variations in the design and efficacy of coping mechanisms adopted by governments and firms across issue areas? Under what conditions are the choices of coping mechanisms predominantly determined by external (“third-image”) factors, internal (“second-image”) factors, and strategic choices of policymakers? How can external constraints be “unpacked” in terms of their impact on policymakers? What influences the level of autonomy of “agents” (policymakers in firms or governments) in relation to internal and external “structures”? For example, if countries are converging to an Anglo-Saxon model of capitalism across policy realms, one can conclude that “agents” perhaps have little autonomy in the choice of macro-economic and “macro-structural” (Dunning, 1997) coping mechanisms. If they are not, the influence of domestic factors and strategic choice is perhaps significant. At the next level, it is critical to

examine the pace, sequencing, and characteristics of coping policies. Perhaps, at this level, internal constraints and strategic choices have a greater influence in relation to external constraints.

To structure this discussion, we present a framework that draws upon literatures in organizational theory, business strategy, and international political economy. An important question in these literatures is to explain variations in organizational structure and strategy. The causal variables are identified to lie in the external environment (Burns and Stalker, 1961; Emery and Trist, 1965; Lawrence and Lorsch, 1969), technology (Woodwards, 1965; Perrow, 1967), scale of operations (Blau, 1970), and strategic choices of policymakers (Child, 1972; Granovetter, 1985). In this introductory chapter, we focus on external and internal constraints on governments and firms and how they empower or enfeeble policymakers in devising coping strategies. Given that policymakers are self-interested actors with their own objectives and endowments, coping strategies also reflect their preferences. Coping strategies could be directed at the external environment, the internal environment or a combination of both. The coping response can be expected to vary across issue areas since the coping requirements, external and internal constraints, and perhaps even the strategic objectives of policymakers are different. Of course, over-time coping responses can be expected to impact globalization processes (the exogenous force that upset the status quo and needs to be coped with), the objectives and endowments of policymakers, and internal and external constraints.⁹ This discussion is summarized in figure 1.

⁹ We are treating globalization processes as independent variables. For a discussion on globalization processes as dependent variables, see Prakash and Hart (forthcoming).

[Insert Figure 1 Here]

External Constraints

The external environment is important because countries are seldom autarchic, having some sort of exchanges with the external world. Firms, of course, are constrained by their external economic environment (consumers, shareholders, suppliers, distributors, creditors, and debtors) and non-economic environment (organs and agencies of governments, non-governmental organizations, and the media). For countries, external factors include dependence on foreign markets for selling products and securing raw materials, on capital and stock markets for raising (or investing) capital, and on other countries regarding national security. Countries have to negotiate with multiple external actors such as other governments, MNEs and other economic actors, international organizations, and non-governmental organizations. To cope with globalization, many international organizations seem to propound specific perspectives, discouraging experimentation with other perspectives. Thus, epistemic constraints are embedded in their policy guidelines. An example is the debate on establishing a currency board in Indonesia to combat the loss of confidence in the Indonesian currency, the rupiah. The International Monetary Fund (IMF) strongly opposed this idea and eventually, Indonesians were forced to toe the IMF's line. Thus, one set of ideas (currency boards) was not deemed desirable to cope with globalization.

How do the external constraints influence coping strategies of countries and firms? Child (1972) identifies three types of constraints imposed on firms by the external environment and we can extend Child's insights to understand external constraints for countries as well. Three

characteristics of the external environment are particularly important: variability, complexity, and stress. Environmental variability is a function of the frequency, the degree, and the directionality of change. Consider a firm in an industry that is witnessing frequent reorganization in terms of buy-outs, spinoffs, mergers, and alliances (therefore, a high frequency of change). This is leading to a significant redistribution of market shares among key firms (therefore, a high degree of change). The direction of change is not clear -- in some regions, concentration ratios are rising while in others they are decreasing (therefore, unclear directionality). Since the external environment is highly variable, policymakers may be disinclined to adopt strategies with long lock-in periods. They will perhaps adopt incremental approaches waiting for the turbulence to settle down. Further, to impart stability for internal functioning, they may have incentives to devise institutional buffers to interface with the external environment.

Environmental complexity refers to the heterogeneity in and the knowledge-intensity of demands from the external environment. Policymakers have limited abilities to monitor and understand the implications of such demands. Some demands may also be in conflict. Thus, to monitor and respond to complex external environments, policymakers are likely to establish specialized internal institutions. For example, to cope with the turbulence in financial markets (and given the sophisticated nature of financial instruments) policymakers may establish specialized institutions manned by experts. This is not to argue that decision making will become technocratic, devoid of politics. The internal political economies of countries will now be articulated within a new framework suggested by the technical experts.¹⁰ The power is likely to shift from generalists to specialists. Once established, whether such institutions will persist is

¹⁰ A similar argument has been made to explain the influence of epistemic communities on environmental policy issues (Haas, forthcoming).

a different question, in part, dependent on whether the institutional actors succeed in developing a domestic constituency that supports their existence.

Environmental stress is the “threat” posed by the processes of globalization to countries or firms. The degree of threat depends on the magnitude of retaliation for non-compliance and the urgency of meeting these demands. For example, an international rating agency may threaten to lower the rating of the sovereign debt unless some corrective actions are taken quickly to reduce the budgetary deficit. The magnitude of the threat is a function of the dependence on foreign markets for funds (the cost of funds being a function of country’s rating). The urgency depends on the time for the country’s next review by the raters. If a country is significantly dependent on foreign capital, the costs of non-compliance are likely to be high, and the coping responses need to be implemented quickly. Policymakers therefore have incentives to centralize decision making and discourage pluralistic participation to shape coping strategies. Corporatist structures in small open economies with centralized decision making encourage dialogue among peak associations of labor and capital to cope with rapid economic change (Katzenstein, 1985). Importantly, they create the institutional basis for hierarchically articulated pluralism, not the grass-roots variety that is in evidence in the United States.

Having identified the three components of the external environment, we wish to emphasize that policymakers may perceive the external environment differently. They may also have some options to select their own external environment -- if a firm does not want to remain in an industry with high variability, it could rearrange its portfolio. Further, the external environment is not always given; actors may have capacities to influence structures -- the literature on business “capture” of regulatory and policymaking institutions is well established

(Bernstein, 1955; Kolko 1963; Stigler, 1971). Or, in the international sphere, countries may have some capacities to influence international institutions and other rulemaking bodies. Thus, external constraints in a given industry or policy arena influence, not determine, the choice of coping mechanisms.

Internal Constraints

The choice of coping strategies of firms and governments, their timing, sequencing, and the pace of implementation also depend on internal constraints faced by policymakers (Shonfield, 1965; Katzenstein, 1978; Zysman, 1983; Hall, 1986; Hart, 1992). These constraints include policymaking rules and procedures, voting rules, distribution of veto points, interest-group dynamics, and organizational “slack” (Cyert and March, 1963).¹¹

As Public Choice scholars point out, voting rules have a crucial bearing on the final outcome of collective endeavors (Mueller, 1989). Rules and procedures structure policy processes, often asymmetrically empowering actors. They often determine who votes, who could veto, and what weights different votes have in final outcomes. For example, the United States Administrative Procedures Act (APA) requires regulators to seek input on proposed regulations from affected parties. This empowers interest groups that may have the resources to impact the electoral processes. On the one hand, the APA makes policy processes equitable, but on the other hand, it slows down their implementation. In general, institutions and procedures influence how individual preferences are transformed into collective outcomes.

¹¹ The “second-image reversed” tradition views internal factors as dependent variables and external factors as independent variables. In this perspective, international actors impact domestic politics, and hence foreign policies (Gourevitch, 1978; Katzenstein, 1978). While acknowledging the impact of external factors on internal constraints and vice-versa, we do not privilege one over the other. Their relative salience is a function of many variables including the characteristics of the industry or a policy arena and policymakers.

If domestic institutions empower the executive over the legislature and the judiciary, and the federal government over the state or provincial governments, policymakers can be expected to be less constrained in the choice of coping strategies. In highly decentralized systems that require provinces to ratify major decisions, the federal government can be expected to face difficulties in adopting policies that entail large scale structural changes. As Aman points chapter 4, the recent judgements of the United States Supreme Court on the subject of federalism have empowered the states over the federal government, reducing latter's flexibility to cope with globalization, especially in its negotiations with international actors.

The same logic can be employed to understand firm-level coping mechanisms. Different systems of capitalism have different perspectives on the division of power between the shareholders and other stakeholders. Thus, laying off workers or closing factories is easier in the Anglo-Saxon model than in the German model. Thus, macro-institutional structures have a crucial bearing on firm level strategies. However, even in the United States, many states have passed laws, making it difficult for firms to make decisions without consulting other stakeholders:

Recent court decisions and new legislation have weakened the so-called "business judgement rule," which vests management with exclusive authority over the conduct of the company's affairs ... At last count, at least 29 states have adopted statutes that extend the range of permissible concerns by board of directors to a host of non-shareholder constituencies, including employees, creditors, suppliers, customers, and local communities ... the well-known Delaware Supreme Court decision in *Unocal*, although requiring corporate directors to show that a "reasonable" threat exists before fighting hostile takeovers offers, nonetheless allowed a number of concerns to affect the determination of such "reasonableness," including, "the impact [of the takeover] on 'constituencies' other than shareholders .." (Donaldson and Preston, 1995: 184-185).

Domestic policy outcomes are critically influenced by the relative power of the potential “winners” and the “losers,” the distribution of costs and benefits (concentrated versus diffused), and the ability of affected parties to undertake collective action (Lowi, 1964; Wilson, 1980). Thus, an important challenge for policymakers is to mobilize a winning coalition that supports the new policies. This may require them to make concessions, modify policies, and/or make side-payments. Domestic “slack” or underutilized resources then become an important resource at their disposal, giving them some discretion in responding to various pressures, in postponing divisive policies until an appropriate political climate can be created, and “paying off” the losers. As suggested earlier, these insights can be extended to discuss the politics of firm-level coping strategies as well.

Policymakers and Strategic Choice:

How policymakers respond to processes of globalization depends on the external and internal constraints as well as their preferences and endowments. Though business managers often wish to remain in the good books of the financial markets, especially the key institutional investors, they still have some leeway in devising strategies that serve their interests.¹² Since the ultimate objective of most politicians is reelection or maintenance of their regimes, they can be expected to choose the coping instruments accordingly. Politicians facing reelections can be expected to postpone decisions that impose sizeable costs concentrated on few constituencies. However, once elected, they may seek to implement policies they previously opposed -- the recent experiences in South Korea and Brazil being cases in point.

¹² In addition, policymakers within firms or governments may pursue different objectives. Hence, there are collective action dilemmas at the policymakers’ level as well.

The exercise of strategic choices by policymakers is evident when they employ external constraints to push their internal agenda and vice-versa (Putnam, 1988; Mastanduno et al., 1989; Evans, Jacobson, and Putnam, 1994). In recent years, the governments in Italy, Greece, and Portugal have used the desirability of joining the Euro as the external constraint to push through domestic budgetary reforms, and perhaps overturn the “embedded liberalism” compromise (Ruggie, 1982).¹³ In particular, exogenous shocks provide opportunities to policymakers to forge new domestic coalitions and push through controversial policies (Haggard and Maxfield, 1996). Further, since there could be conflicting pressures from the external environment, policymakers could strategically choose the mechanisms that best serves their objectives. For example, in the recent crisis in East Asia, most governments were under pressure from the IMF to “reform” their domestic financial institutions while retaining some degree of openness on their capital account. In the midst of this crisis, Paul Krugman suggested that in some circumstances, countries may be better off with capital controls:

In short, Asia is stuck: Its economies are dead in the water, but trying to do anything major to get them moving risks provoking another wave of capital flight and a worse crisis. In effect, the region’s economic policy has become hostage to skittish investors. Is there anyway out? Yes, there is, but it is a solution so unfashionable, so stigmatized, that hardly anyone has dared suggest it. The unsayable words are “exchange control” (1998:1-2).

To be fair to Krugman, other notable economists have also supported, albeit conditionally, the idea of capital controls. For example, Bhagwati acknowledges that the cases

¹³ It is suggested that increasing exposure to global economy may in fact require more governmental intervention to compensate the losers, perhaps leading to an expansion of the welfare state (Cameron, 1978; Pierson, 1996; McGinnis, forthcoming).

for free trade and free capital flows are not identical, primarily because of the speculative element in the latter. He notes that:

Capital flows are subject to what the economic historian Charles Kindleberger of MIT has called “panics, manias, and crashes.” In a classic response to these concerns, Milton Friedman famously argued that speculative flows would tend to be “stabilizing,” hence welfare enhancing, because the speculators who betted against the “fundamentals” would be wiped out in the marketplace. But the unfortunate fact is that speculation can be self-justifying. The fundamentals may change to reflect the speculation (1998: A38).

Given this epistemic divergence among key external actors on the usefulness of capital controls, President Mahathir Mohammad established currency controls in Malaysia. He also used this issue in his political battle with the ousted deputy, Anwar Ibrahim, who was closely identified with IMF prescribed policies. Though subsequently, Krugman has retracted his views, President Mohammad strategically invoked Krugman to push his own agenda.

Policymakers may also strategically employ internal constraints to ease demands from external actors. For example, during the NAFTA negotiations, the Clinton administration managed to include side-agreements on labor and environmental issues (that Mexico opposed) on the grounds that they were necessary for building a winning coalition in the Congress.¹⁴

Coping Strategies: Competitive and Cooperative

Processes of globalization reconfigure policy landscapes, upsetting the status-quo. In devising coping strategies, policymakers are constrained by structures internal and external to

¹⁴ On the other hand, NAFTA also locked-in Mexican economic reforms -- an example of policymakers strategically employing external constraints to push through internal reforms. We owe this point to Virginia Haufler.

their organizations. Coping strategies may seek to relax or modify internal and/or external constraints. When multiple policymakers are required to cope with similar issues, they could act competitively as well as collaboratively. Benjamin Cohen's chapter is instructive on this count. He explores how governments may cope collectively as well as individually to the challenges posed by growing deterritorialization of money.

When addressing issues of global finance, we often think of money as effectively insular: each currency is sovereign within the territorial frontiers of a single state or monetary union. In fact, cross-border competition among currencies has become increasingly prevalent. Money today is effectively deterritorialized, posing a new and critical challenge to national monetary authorities. So long as governments remain the main issuers of money, the state still retains a degree of monetary sovereignty. However, where once existed monopoly, we now find oligopoly – a finite number of autonomous suppliers, national governments, all vying ceaselessly to shape and manage demand for their respective currencies. Globalized money, at its most basic, is a political contest for market loyalty.

Cohen points out that like firms in an oligopolistic industry, states have only a limited number of strategies available to defend their currency's market position. Inter alia, these include policies of market leadership, market preservation, market followership, alliance, and neutrality. All involve some combination of persuasion and coercion designed to influence user preferences – in effect, to “sell” a particular brand of money. He analyzes both the conditions that determine state choice among the alternative strategies and the factors determining their practical success or failure.

His variables in explaining the choice of the strategy include factors external to

governments, domestic constraints and strategic choices of policy makers. For example, why countries of the European Union have chosen to join or stay out of the Euro -- an example of market alliance among countries -- can be fully explained only when constraints internal and external to countries as well as strategic choices of the policymakers are taken into account.

Cohen identifies a menu of strategies, competitive and cooperative, that governments can adopt to cope with deterritorialization of money. One such competitive strategy that could be employed in multiple sectors is participating in a race-to-the-bottom: competitively lowering standards to attract “footloose” capital, ever ready to “exit” (Hirschman, 1970). The contention is that the increasingly mobile MNEs search for lower levels of wages or regulation, forcing national governments either to converge towards lower standards or lose the economic benefits that MNEs can bring.¹⁵ Of course, the MNEs are seeking to cope with the globalized stock markets where institutional investors continually appraise their financial performance. To cut costs, they have incentives to shop around for low taxes, cheap labor, and lax regulations. In the process, however, the crucial functions of governance effectively slip from the grasp of national governments. Their eroded sovereignty reduces their capacities and willingness to enforce stringent environmental, health, safety, and labor laws.

To curb such races, states could seek to cooperatively establish supra-national institutions -- governance-from-the-top; the new rules of the game could mitigate incentives for governments to participate in such races. Consequently, governments that were locked into “prisoner’s dilemma” types of payoff structures create new rules, whereby “defection” or

¹⁵ The subject of the power of MNEs versus governments (both home and host) is rather vast. To cite a few, Vernon (1971), Gilpin (1975), Hymer (1976), Stopford and Strange (1991). For a review, see Rugman and Verbeke (1998).

competitive lowering of standards is no longer a “dominant” strategy.

In this context, Debora Spar and David Yoffie’s chapter identifies conditions under which globalization processes create races- to-the-bottom and governance-from-the-top. Races are due to similar coping strategies adopted by firms and governments: to remain competitive, one needs to cut costs. Spar and Yoffie suggest that races occur when border controls are minimal while regulations and factor costs differ across national markets. Once these necessary conditions are met, races are most likely to occur when products are relatively homogeneous, cross-border differentials are significant, and both the sunk and transaction costs are minimal. Note that conditions external and internal to a country together create conditions for races-to-the-bottom. Spar and Yoffie hypothesize that governance-from-the-top is more likely when there are significant negative externalities, races-to-the-bottom cascade through consecutive stages, and there are domestic coalitions with an interest to curb such races. Thus, factors external to an industry (pressure from interest groups), internal to it (structural characteristics of the industry), and initiatives of key policymakers together lead to the evolution of such governance mechanisms.

Since MNEs are allegedly the main abettors of races-to-the-bottom, it is instructive to examine the theoretical bases of such races from a business strategy perspective. As suggested earlier, there is a widespread (incorrect) belief that MNEs are relocating to developing countries with lax environmental laws (Low and Safadi, 1992; for an opposing view, Daly, 1993). Nevertheless, there are fears that to stem the “industrial flight” from developed countries with stringent laws to “pollution-havens” in developing countries, the former will have to dilute their environmental laws. These allegations were vocally stated during the debates on NAFTA and

more recently, on granting “fast-track” authority to President Clinton.

In this context, adopting a resource-based view of the firm, Alan Rugman and Alain Verbeke’s chapter examines how MNEs are coping with environmental regulations that differ across jurisdictions. Some MNEs can afford to ignore environmental regulations while others must develop new green capabilities, given that costs of adhering to them are non-trivial in most industries. They correctly note that most MNEs need a coherent strategy to relate their traditional commercial functions to environmental laws, particularly in light of the media power of environmental NGOs. Environmental regulations differ not only among countries but also within countries. The authors present a framework that identifies five different levels of environmental regulations that firms need to examine: local, sub-national, national, regional, and multilateral. The salience of various levels would vary across four categories of firms: domestic, home-based exporters, home-based centralized MNEs, and decentralized transnational MNEs.

It has been argued that stringent environmental regulations help firms since they enable them to look for efficiencies and capture the “low hanging fruit”(Porter and van der Linde, 1995). Further, if policymakers correctly predict the future course of international regulations, home firms having “first-mover” advantages are better prepared to compete in world markets. On this count, there is a “double-dividend” from strict regulations (cleaner environment and increased profits) since they are “win-win” for firms as well as governments. Rugman and Verbeke critique the contentions on first-mover advantage: whether such advantages (primarily, in response to domestic regulations) are critical given that, in some instances, firms may benefit by postponing their investments. In fact, late mover-advantages may be reaped when there is high uncertainty about the evolution of environmental regulations. We have previously

suggested that in responding to highly variable environments, firms may postpone major structural changes and opt for policies with short lock-in periods. Finally, Rugman and Verbeke examine how environmental regulations may impact MNEs' configurations of firm-specific advantages and country-specific advantages.

Governance-from-the-top could manifest as formal international organizations with specific mandates as well as the not-so-formal international regimes and institutions (Krasner, 1982; Young, 1986). Some of the key institutions of international economic governance were formed in mid 1940s with an objective of preventing a repeat of the Depression of 1930s. The key causes of the Great Depression were the competitive devaluation of currencies, a race-to-the-bottom, and protectionism. To curb incentives for protectionism, the General Agreement on Tariffs and Trade (GATT) was established in 1947. The GATT has done an admirable job of reducing trade-barriers (fostering shallow-integration) and has initiated important steps to roll-back non-tariff barriers (deep-integration). In chapter 2, Sylvia Ostry describes how deep-integration is a strategy adopted by states to cope with the processes of globalization and the new incarnation of the GATT, the World Trade Organization (WTO), is the institutional mechanism to carry out this task. Such deep-integration reflects the properties of Spar-Yoffie's notion of governance-from-the-top.

The increasing integration of the world economy after World War II, primarily through increased cross-border trade, was facilitated by reductions in tariff barriers. However, with the increasing role of MNEs, such shallow-integration is proving insufficient for further integration, primarily because some governments continue to discriminate against firms of foreign origins. Or, broadly speaking, in some countries, the systems of industrial organizations provide

restricted access to domestic markets for foreign firms. This issue was very salient during the Structural Impediments Initiative negotiations between the United States and Japan in 1989. To ensure a level playing field, there were demands to harmonize economic institutions internal to both countries.

The pressures for such convergence or deep-integration can be grouped into two broad categories: “natural” or market-led, and policy-led. Market forces, constituting the external constraints for policymakers, include technological change and locational competition among jurisdictions for mobile factors of production, especially capital and knowledge. Policy-led or planned convergence was initiated by the American multi-track trade policy of combining unilateralism, bilateralism, minilateralism, and multilateralism. Due to American prodding, the Uruguay Round launched the deeper-integration agenda in the negotiations on services and other new issues. Post-Uruguay negotiations have continued this thrust which is now also a central focus of policy in many regional fora. Further, with the information and communication technology revolution, the onset of “investor capitalism,” and the growth of electronic commerce, there is a pressure for system convergence (perhaps towards Anglo-Saxon Capitalism); with deep-integration being a conscious step (and also a natural step, as Ostry correctly point out) in this direction. However, the benefits of deep-integration are contested in the domestic sphere. In particular, WTO’s dispute settlement procedure, an essential institution in making deep-integration functional, is viewed as encroaching upon domestic sovereignty.

While the pace, extent, and sequencing of planned convergence depend on strategic choices of and internal constraints on policymakers, its agenda is strongly influenced by external actors as well, importantly the MNEs and international non-governmental organization (INGOs).

Conflicts between MNEs and INGOs, the fundamental conflict stemming from the erosion of sovereignty, and the distributional impact of globalization present a formidable challenge for policy-makers pursuing deep-integration as a coping strategy.

Governance-from-the-top and deep-integration require domestic political support. Domestic institutional structures therefore become key variables affecting the abilities of the federal government to mobilize such support. As discussed previously, one of the key resources national governments possess is constitutional flexibility to devise new policies through appropriate legislative or executive measures. Alfred Aman points out in chapter 4, the United States Supreme Court has not been helpful in this context: it has stepped in to redefine important constitutional parameters (especially, pertaining to the Commerce Clause and the Tenth Amendment) of federalism by empowering the states. This leaves the federal government with little constitutional flexibility to undertake the necessary legislative measures to cope with globalization. Similarly, if the federal government cannot implement international agreements domestically or is faced with significant opposition from the states, its credibility is eroded. Aman believes that the Supreme Court has taken a somewhat conservative and rigid view of the federal-state relationship. Further, the Supreme Court has encroached upon the political arenas by interpreting laws that should have been dealt with by the legislature. Consequently, it has enfeebled the federal government, leaving it with less autonomy to respond to the demands of globalization, both domestically and internationally. His conclusion is that just as the Supreme Court of the early days of the New Deal went too far in imposing a 19th century conception of the economy on lawmakers, the current majority on the Supreme Court risks creating similar problems with its approach to federalism.

As discussed previously, one of the enduring themes in the globalization literature is the declining capacity and willingness of governments to intervene in economic activity. Increasing capital mobility implies that governmental attempts to tax capital create incentives for firms to pack up and leave. Thus, the threat of capital-mobility constrains governmental efforts to raise taxes. Governmental programs are often viewed as inefficient, further reducing the legitimacy of high taxation to finance them. Taxes are also viewed to “crowd-out” private investment, thereby increasing the cost of capital for the private sector.

In this context Robert Kudrle (chapter 8) examines whether globalization has indeed diminished the fiscal power of the state, and if so, how states can cope with it. There is a burgeoning literature on international taxation issues that has paralleled the more general literature on globalization. Kudrle marries them systematically with an explicit focus on how state action is constrained and what options are available to governments. He examines two sets of questions: (1) has globalization resulted in a race-to-the-bottom in the taxation of labor and capital incomes, and, if so, (2) what sort of coping mechanisms can states employ to counter these trends? Specifically, Kudrle examines five tax categories: (i) capital taxation, (ii) personal income taxation, (iii) taxation on consumption, (iv) social security taxation, and (v) new taxes – “green taxes” and the Tobin tax. He concludes that with governance-from-the-top, states can still exercise substantial power to tax both capital and labor incomes.

Coping Strategies in High-Technology Sector

One of the hallmarks of economic globalization is the increased technological-intensity of traded goods and of the different activities in the value-chains. The fast pace of technological

innovation coupled with increasing R&D costs is leading to the restructuring of many industries. The perception is that most high-technology industries cannot sustain more than a couple of players, hence the need to be global in scope (Kobrin, 1995). Strategic trade theory suggests that in industries with supernormal profits and steep learning curves (this characterizes high-technology industries), the first-movers reap substantial profits (for a review, see Hart and Prakash, 1997). Further, it is suggested that domestic “architectures of supply” in such industries that governments can help to create, provide competitive advantages to “domestic” firms in terms of timely and cost-effective access to critical inputs (Borras and Hart, 1994; also, Porter, 1990; Palan and Abbot, 1996). Which firms will be the winners in global markets and whether national governments can empower home-based MNEs remains a debated question in the literature. Government support includes domestic macro-economic and macro-organizational policies (industrial, trade, environment, educational) as well as interventions in international negotiations to ensure that home-based MNEs have access to markets and investment opportunities abroad.

International interventions can take place in bilateral, minilateral or regional, and multilateral fora that are engaged in establishing new institutions for governance-from-the-top or modifying extant ones. As Ostry points out in chapter 2, the debates during the Uruguay Round of the GATT and the continued debate on the Multilateral Agreement on Investment under the auspices of the Organization for Economic Cooperation and Development suggest that governments seek to ensure that the new rules of international commerce and investment are beneficial to their firms. New or reformed “free” and “fair” trade and investment regimes are high on the international economic agenda. However, Rugman and Verbeke point out in chapter 3 that

since some countries have comparable levels of inwards and outwards FDI flows, the role of governments in defending home-based MNEs becomes problematic. They contend that instead of regimes based on power or domestic politics, most MNEs and governments favor rule-based international trade and investment regimes which do not simply reflect state's power relative to others, or a particular industry's influence in domestic politics. A rule-based international regime for FDI would require national treatment for foreign firms in every member country.

The pattern of competition differs among industries, even within the high-technology sector. With industry groups as the unit of analysis, Porter (1986) distinguishes between multi-domestic industries (the competitive position of a firm in a given country is independent of its position in other countries) and global industry (the competitive position of a firm in a given country is significantly influenced by its position in other countries). He argues that the competitive strategies of firms in multi-domestic industries are country-specific, while in global industries firms need to integrate their value-chain competencies across countries. Since high-technology industries are global in scope, they require a global strategy. Two crucial issues therefore are: (1) Can governments meaningfully intervene to support their home-based MNEs' global strategies? And (2) If they can, should they?

In this context, Hart, Lenway, and Murtha's chapter examines the business and policy dimensions of a crucial high-technology industry -- Flat Panel Display (FPD) -- specifically, whether "technonationalism" is a viable government strategy to support domestic firms. Technonationalism implies a desire to replicate key parts of the technology commercialization processes using "domestic" capabilities. The objective of a technonationalist policy is to equip domestic firms to compete in global markets.

FPD are thin screens used predominantly in laptops and notebook computers. With a decline in their prices, they are also being used on desk top computers and have begun to replace Cathode Ray Tube (CRT) displays in computers. It is projected that ultimately FPDs will replace all CRTs. Hence, the FPD industry has significant ramifications on a wide gamut of high-technology industries. FPDs are also key components of electronic systems essential for military preparedness. On this count, the strength of domestic FPD industry has national security implications as well.

Japan leads the world in both product and process technology in advanced displays. The Korean industry in advanced displays got started in the mid 1990s by adopting Japanese production methods and using Japanese tools. The Korean government began to worry about the extent to which the Korean display industry had become dependent on Japanese tools. Similar concerns were voiced in the United States. The Hart-Lenway-Murtha chapter illustrates the difficulties in pursuing technonationalist policies in a highly globalized industry. Their preferred coping strategies at the firm level are: (1) “wintelism”: domestic firms own industry standards but share them with cross-national production networks, and (2) developing abilities to tap into competencies dispersed around the globe. The two strategies overlap; the latter, however, does not require that domestic firms define industry standards. The chapter concludes by decrying the technonationalist perspective adopted by the United States Department of Defense and by hypothesizing that firms that are less exposed to international competition (primarily defense-oriented firms) are more likely to be technonationalists.

An argument against technonationalism does not imply that governments no longer have legitimate roles in safeguarding the commercial interests of home-based MNEs. An important role

for governments is to ensure that such interests are taken into account in establishing international regimes and institutions. This becomes important as the levels of cross-border integration differ across countries – the more globalized countries want deeper-integration while the less globalized countries seek to retain some measure of government control over the domestic economy. In this context, Cowhey and Richards' chapter examines how states (or supra-states as in the European Union -- EU) should address the incomplete globalization of telecom markets -- fully globalized markets entail freedom of entry and the promotion of effective competition. This issue is important because of a wide divergence in the preferences of states (primarily, acting as safeguarders of national monopolies) on the desirability of complete globalization. They describe how the dominant powers (the US and the EU) are working towards increasing levels of integration of telecom markets. Three types of strategies are being adopted by the U.S. Federal Communications Commission (FCC) and the EU: establishing multilateral regimes, taking unilateral initiatives, and a mix of both. The preferences of the FCC and the EU for the three routes are different, primarily because of their different domestic political economies. Thus, Cowhey and Richards view the coping strategies of governments as a function primarily of internal constraints faced by policymakers.

Structure of the volume

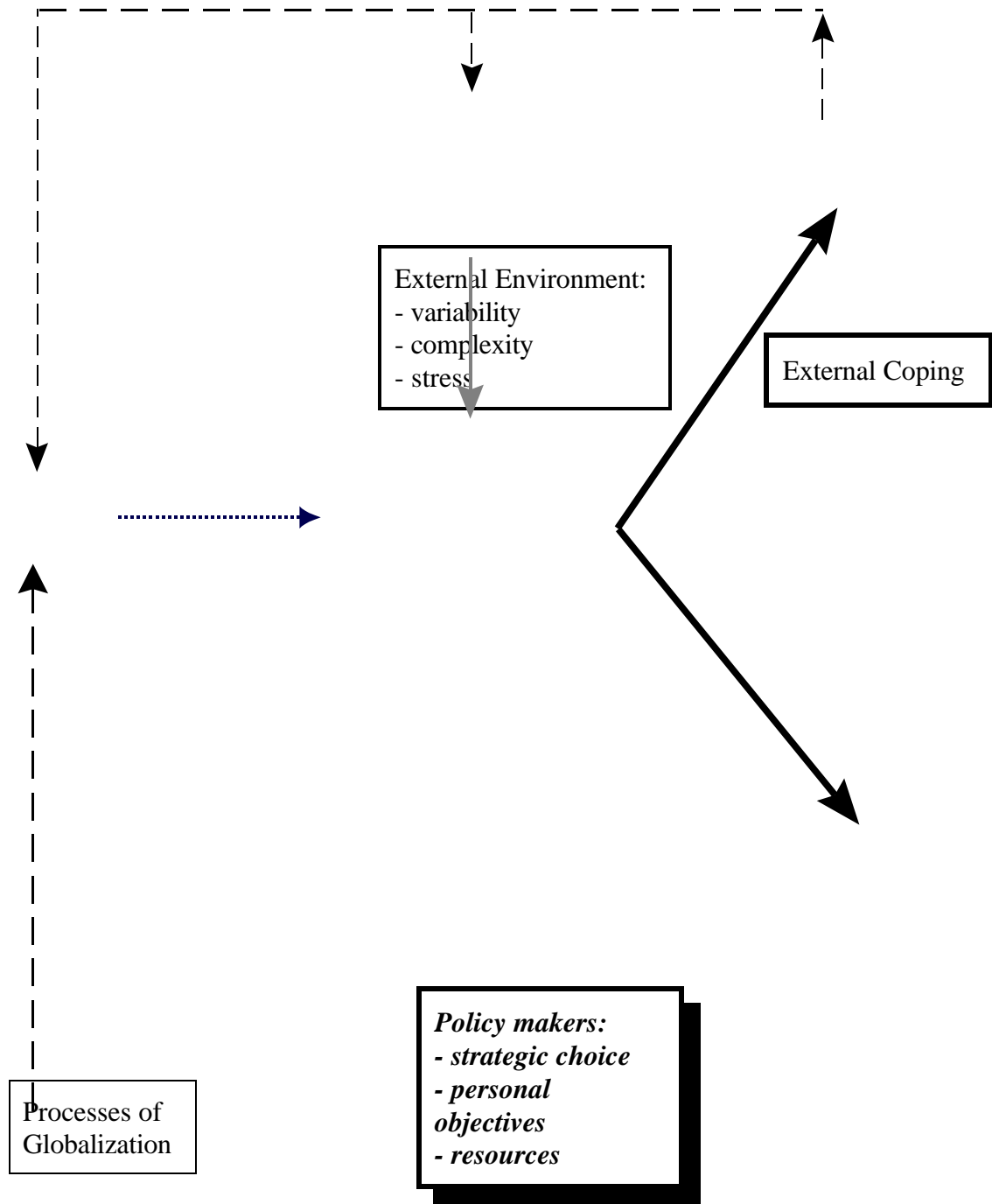
This volume has three parts. Part One focuses on conceptual issues pertaining to coping strategies of governments and firms. Debora Spar and David Yoffie examine conditions that facilitate races-to-the-bottom and governance-from-the-top. Sylvia Ostry discusses the politics of deep-integration, focusing on the challenges for the WTO. Alan Rugman and Alain Verbeke

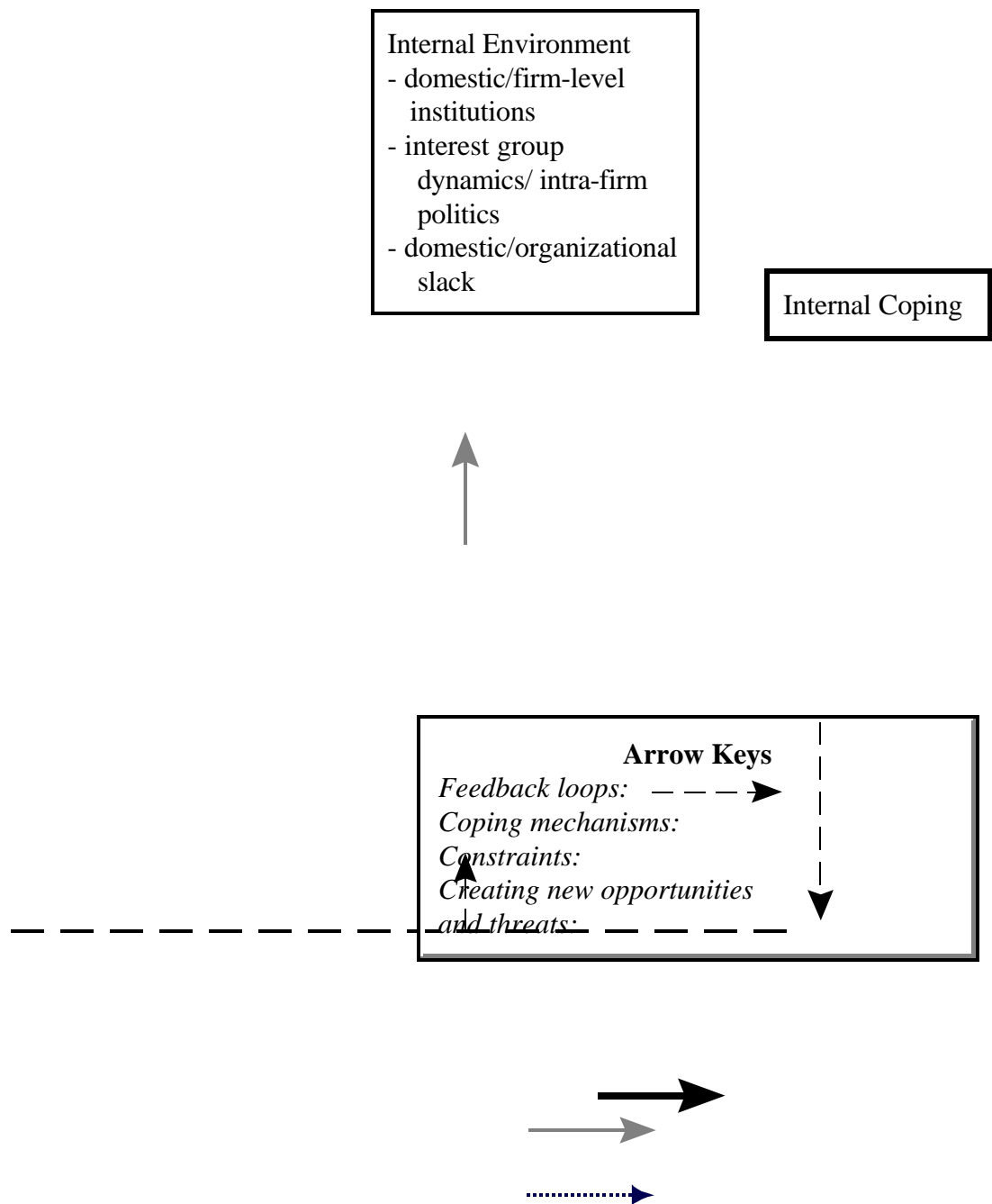
discuss how MNEs can cope with environmental regulations that differ across jurisdictions. Alfred Aman probes the implications of the recent U.S. Supreme Court judgements on the abilities of the federal government to devise effective coping strategies.

Part Two focuses on coping strategies in the high-technology sector. Jeffrey Hart, Stefanie Lenway, and Thomas Murtha examine technonationalism as a coping strategy in the FPD industry. Peter Cowhey and John Richards discuss the role of the FCC in inducing other countries to agree to an international telecommunications regime that creates some sort of a level playing field for American companies.

Part Three focuses on coping strategies in two arenas: currency policy and fiscal policy. Benjamin Cohen examines strategies to cope with the deterritorialization of currencies while Robert Kudrle discusses whether economic globalization saps the fiscal power of the state, under what conditions, and how governments can respond to it.

Figure 1





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