

Globalization and governance: an introduction

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This volume contributes to an understanding of the implications of globalization by examining three sets of issues. First, what is meant by governance in the study of international relations and international political economy? Two competing perspectives – the new institutionalist and the constructivist – are presented. Second, how will the processes of globalization impact on governance? Are territorial-based systems of governance obsolete or increasingly incapable of efficiently and equitably performing the functions expected of them by actors (whether citizens or firms) living in their jurisdictions? What kinds of changes can we expect? What are the politics of such changes? Third, what kinds of policy innovations at the country-level may be required and are politically feasible in the domains of administrative law, tax policy, monetary policy, and trade and industrial policies to deal with the challenges of globalization?

Both globalization and governance are contested terms with respect to their meanings, etiologies, and implications. Some even dismiss globalization as a fad (Chase-Dunn, 1994). Unlike other works on these questions, this volume does not advocate any particular perspective on globalization, governance, or the linkage between them. We endeavor here only to identify the areas of agreement and disagreement among the scholars contributing to this volume and to learn from their debates.² To structure these debates, we provide our own definitions of both globalization and governance below.

First, what is governance and what are the key units of governance in the study of international political economy? It is almost a cliché to point out that international relations scholars (and to a certain extent domestic politics scholars as well) tend to focus on the state as the pre-eminent unit of governance – the primacy of “methodological nationalism” (Cerny, 1997) in the study of politics. This focus was perhaps appropriate in the examination of issues of national security, given that the state did not have many credible economic or political rivals in that arena. Consequently, scholars tended to treat governance as synonymous with government. The pendulum, however, seems to have swung to the other end; some scholars believe that governments are now marginal players (or will soon become marginal) in the international political economy (Strange, 1996; Ohmae, 1991). We return to this debate

later. For now, we define governance simply as organizing collective action. In the instrumental sense, governance entails the establishing of institutions; institutions being the rules of the game that permit, prescribe, or prohibit certain actions (Ostrom, 1986; North, 1990).³ Formal organizations are often required to establish, monitor, and enforce rules, as well as to resolve disputes.⁴ Nevertheless, institutions may operate successfully without organizations and one should not assume a one-to-one correspondence between them. It is also important to note that the traditional notions of the state do not explicitly distinguish between its organizational and institutional dimensions. This volume focuses primarily on the institutional dimensions – the rules and policies and how they are affected by the processes of globalization.

By altering incentives, governance institutions encourage actors to adopt strategies that overcome collective action dilemmas. Successful collective action enables actors to cooperate in pursuing their individual and communal goals. The eventual outcome could be Hicks-Kaldor superior (generating net benefits at the aggregate level) if not pareto-superior (at least one participant is better off and no one is worse off than the *status quo*). However, if the benefits and the costs are asymmetrical across actors, institutional evolution and change could be conflictual. Institutions are therefore political artifacts. Also, once established, institutions may take on a life of their own and become political actors in their own right (Keohane, 1984). In some instances, institutions may be established even though they are Hicks-Kaldor inferior: the losses of the “losers” outweigh the benefits of the “winners,” but the latter can impose their preferences. Since institutions consequent to such collective action may not be efficiency-enhancing (Libecap, 1989; North, 1990; Knight, 1992), it is important to examine how governance institutions evolve, whose preferences they reflect, and how they influence human behavior.⁵

This conceptualization of governance is not limited to governments since other social institutions may provide governance services as well. As societies become more complex with modernization and industrialization, the opportunities for both governmental and non-governmental governance increase. Thus, one can witness governance within private organizations, such as business enterprises, as well as within less formally organized communities.⁶ Some of the key issues in the study of governance are: what is the most efficient and equitable way to provide governance services, through what institutional means, and for which aggregations of individuals?

This volume examines the impact of economic globalization on governance. Globalization or transnational integration, whether conceptualized at the level of the world system, a country, a sector/industry, or a firm, needs to be differentiated from internationalization. With a firm as his unit of analysis, Kobrin (1991) points out that international firms produce in a single country and ship their products worldwide to independent distributors or source raw materials and intermediate products from independent suppliers abroad. On the other hand, transnationally integrated firms exploit assets through

internalization within the firm. They rely less on independent distributors or suppliers.⁷ A similar distinction may be made at the country-level between an international and a global economy (Metaph and Michalet, 1978, cited by Mittleman, 1996). In an international economy, cross-national trade and investment flows are regulated by the state, or supra-national institutions established by states. In contrast, production in a global economy is organized in cross-border networks or value-chains largely out of the control of states. Since a significant proportion of cross-border trade takes place within firms, cross-border networks supersede resource allocation by markets as well.

Though globalization has many dimensions, economic and non-economic, this volume focuses primarily on economic globalization and how it affects governance at the country-level.⁸ This is because currently there is better evidence for economic globalization than other forms of non-economic globalization.⁹ The contributors to this volume have agreed to employ the term globalization to refer to a set of processes leading to the integration of economic activity in factor, intermediate, and final goods and services markets across geographical boundaries, and the increased salience of cross-border value chains in international economic flows.¹⁰ This of course leads to the question: how do we measure globalization, and at what stage of integration can we claim that a country is indeed globalized?

Ipsa facto globalization refers to processes that potentially encompass the whole globe. The process does not have to have actually encompassed the whole globe to be associated with the phenomenon of globalization but there has to be at least a potential for its omnipresence. Thus, one should be able to identify the degree to which a particular globalization process has actually attained globality. This again calls for efforts to measure or assess the extent of globalization, and on this count, justifies our focus on economic globalization.

There are three approaches to assess levels of economic integration of a country. First, by examining the extent of institutional convergence or harmonization across countries (Berger and Dore, 1996); second, by focusing on the salience of the international flows compared with the domestic ones (Wade, 1996); and third, by evaluating the outcomes of integration in terms of converging prices of goods, services, and factors (Keohane and Milner, 1996).

Convergence or harmonization of domestic economic institutions reduces obstacles (or transaction costs) to cross-border economic flows. The recent trends in regional and global trade, monetary, and investment agreements signify efforts to reduce transaction costs of cross-border flows. Harmonization or convergence therefore constitutes a necessary condition for globalization. Of course, even if economic and political institutions are harmonized, there is no guarantee that economic actors will indeed undertake cross-border flows. It is therefore important to examine to what extent economic actors have taken advantage of such opportunities. This can be assessed by examining ratios such as foreign trade to GDP (gross domestic product),

foreign direct investment (FDI) to GDP, net foreign investment to domestic assets, and FDI to gross domestic investment. In addition, we also suggest measuring cross-border flows of factors of production (land, labor, capital, entrepreneurship, and technology). Once these multiple indicators have been developed, the salience of cross-border flows relative to domestic ones can be better assessed.¹¹ This is not to say that all flows have similar impacts on domestic politics in a given country or across countries. Countries differ in endowments to negotiate with demands placed by different flows: as the recent economic turmoil in East Asia suggests, countries with substantial foreign exchange reserves (such as China and Taiwan) have greater leeway in influencing their exchange rates and therefore domestic interest rates, than countries with meager reserves (Indonesia and Malaysia). Further, the domestic impact also differs across flows: rising capital flows have a greater constraining influence on fiscal and monetary policy than trade flows (Frieden and Rogowski, 1996).

Third, we need to examine if increased cross-border flows translate into similar levels of prices across jurisdictions. For example, have the rising levels of cross-border capital flows resulted in equalization of real (covered) interest rates? Or, given that labor is theoretically mobile, say within the European Union, has the price of labor converged in member countries? Thus, based on the three categories of indicators, we can assess the levels of globalization at the country level.

Globalization as an independent and a dependent variable

We hypothesize that globalization processes (as dependent variables) were initiated and encouraged by four categories of factors: technological change, spread of market-based systems, domestic politics, and inter-state rivalries.¹² Globalization processes could lead to new or modified governance institutions as they move more toward genuine globality. This is because to capitalize on the opportunities created or to reduce the costs imposed by globalization processes, actors may have the incentives and the resources to modify extant governance institutions or create new ones. Thus, in time, globalization processes will become the independent variables and the new or modified institutions of governance will become the dependent variable. Of course, over time, changes in governance will unleash new forces that may, in turn, impact on the pace and extent of globalization processes. This is summarized in Figure 1.

Globalization as a dependent variable

In this section we briefly review the literature on globalization as a dependent variable and in the next section as an independent variable. If globalization is a consequence, who or what initiated it and for what reasons? We have

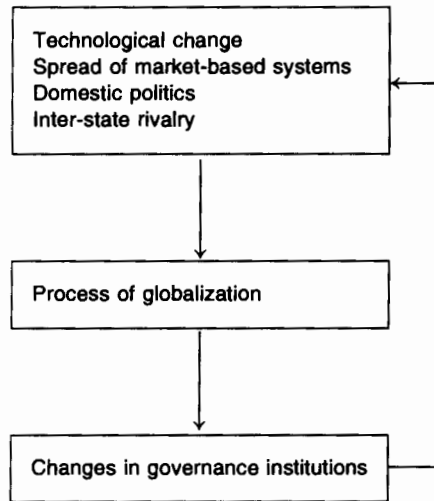


Figure 1 Globalization as independent and dependent variable

already identified four possible culprits: technological change, the spread of market-based systems, domestic politics, and inter-state rivalries. For example, some authors argue that globalization is primarily an outcome of technological change; the latter being necessary and sufficient for explaining the acceleration of such processes. As a corollary, globalization processes driven by technological change are unstoppable unless some new technological breakthroughs reverse the existing trajectories. Structural and domestic politics-based explanations emphasize the role of conscious human agency in encouraging such processes. The latter do not ignore the contributions of technological change; rather, they treat it as only a facilitating condition, or at most, a necessary condition. We briefly discuss these explanations below.

Technological change

Some view globalization processes as outcomes of technological advances, especially in telecommunications, information, and transportation technologies. The level of investment in information technology has reached gigantic proportions: in the United States, information technology accounts for 45 per cent of all business equipment investment (Barshefsky, 1998). Technological advances have enabled firms to delocalize and fragment value-addition processes, thereby locating the various stages across territorial jurisdictions (Sjolander, 1996). The digitization of information flows combined with the spread of fast packet switching for data and voice communications has led to a contraction of space and time (Mittleman, 1996) enabling economic actors to communicate across great distances in real time. The

rapid advances in ground, sea, and air transportation have facilitated international trade by making movements of goods and services cheaper and faster. A good example would be the invention of the wide-bodied jet aircraft, the jumbo jet, which makes the shipping of small and light objects (including people) by air considerably cheaper than shipping those same objects by sea (previously the cheapest alternative). Therefore, in this view, accelerating globalization processes are not conscious policy artifacts; they are *faits accomplis* of a technology-driven economy.

Another argument associating globalization with technological change starts with the observation that intra-industry consolidations often have effects that cross national boundaries. Thus, when Chrysler had to downsize its operations in the late 1970s, employees in France and Britain had to bear some of the costs. Similarly, its merger with Daimler-Benz will significantly impact on its US operations. More recently, American employees of the troubled French defense and electronics company, Thomson CSF, faced job cuts when the French government decided to privatize the firm in 1996. Similarly, the Boeing Corporation worked collaboratively with contracting firms in Europe and Asia to build its latest wide-body jet aircraft, the 777, effectively making it a multinational enterprise. The need for such firms to operate in more than one industrialized region is increasingly viewed as an outcome of skyrocketing research and development (R&D) costs: the minimum efficient scale to amortize such large R&D investments is greater than any single national or regional market can offer (Kobrin, 1995). Ohmae also notes that:

As automation has driven the variable cost of labor out of production, manufacturing has increasingly become a fixed-cost activity. . . . In a fixed-cost environment, the focus switches to maximizing marginal contributions to fixed costs – that is, boosting sales. This new logic forces managers to amortize their fixed costs over a much larger market base and this drives them towards globalization.

(1991: 6–7)

Spread of market-based systems

Technological change, however, is only part of the story. Since markets and market-supporting governance are important in fostering and disseminating technological innovations, the spread of market-based systems and explicit governmental policies for promoting technological innovation have accelerated globalization processes. Drawing upon Polanyi's (1957) contention that economic relations, especially the notion of free markets, are rooted in specific political philosophy, Scott argues:

[I]t remains insufficient to analyze globalization exclusively as though it were the outcome of social and economic processes, however complex.

Globalization must be seen in part at least as the outcome of an idea, and specifically the idea of a free market; “free” in the sense of freed from political, social, or “*gemeinschaftlich*” constraints.

(1997: 9; italics in original)

Therefore, an important cause for the pace and extent of globalization processes is the increasing legitimacy and spread of market-based systems for allocation and exchange both within and between countries. With the expertise and legitimacy of the state to intervene in the domestic economy increasingly under attack, there are calls for deregulation and privatization. As Evans (1997) points out, state bureaucracies are now blanket labeled as either corrupt or vulnerable to “capture” by vested interests.

The same logic is applied to assessing state intervention in international economic activity, adding to the demands for reducing state-created institutional obstacles to flows of goods, services, and investments.¹³ This of course has often led to establishing regional and global institutions. Paradoxically, supra-national bureaucracies are not viewed as having the same problems as national bureaucracies. One expects that due to greater physical and cultural distance between transnational bureaucrats and the governed, and the lack of democratic accountability (or even accountability to the market), they will suffer from even greater principal-agent conflicts (Berle and Means, 1932). Until recently, the ability of states in the developing countries to manage their economies was criticized widely in the United States but not the ability of the World Bank’s or the International Monetary Fund’s (IMF’s) bureaucracies. The recent East Asia crisis, however, has changed this. There are now calls for greater accountability and transparency of the decision-making processes of the World Bank and the IMF.¹⁴

The deregulatory agenda has resonated well with the ideological thrust of the neo-liberal political forces that rose to power in the United States and the United Kingdom in the 1980s. This alliance received further ideological and policy legitimacy with the end of the Cold War, interpreted by them as the triumph of market-based systems over centrally planned systems. The defeat of the Republicans in 1992 and 1996 by the “New Democrats,” led by William Jefferson Clinton, and the defeat of the Tories in 1997 by Tony Blair’s “New Labour,” has not altered this situation significantly. Recent developments also suggest that the victory of the Socialists in France, not withstanding their pledge to prioritize jobs over deficit reduction, will not alter the neo-liberal thrust of the French economy. In the 1997 European Union (EU) summit in Amsterdam, the French proposal for a launching public works programs to create jobs did not find support and the “stability pact” that stipulates deficit reduction as the top EU priority could not be dethroned. Not surprisingly, Tony Blair and Helmut Kohl spoke out against the French proposal. Mr Blair noted that “the European Union’s role in employment is to encourage the exchange of ideas and best practice, and not to launch major new spending programs” (*New York Times*, 1997b).

A widespread adoption of market-oriented policies across countries suggests globalization of the model of a liberal economy. However, the adoption of a specific economic model *per se* does not suggest globalization. For example, the universal adoption of a state interventionist model will not facilitate globalization (Berger, 1996). As Hart and Prakash argue in this volume, states may now have greater incentives to intervene in technologically intensive industries in a globalizing world economy in order to create domestic “architectures of supply.”

Domestic political economy

Another category of explanations focuses on the role of conscious policy interventions in initiating globalization processes; domestic political and economic actors are viewed as the key driving forces behind such policy changes. The main actors in such “second-image” explanations are domestic firms with substantial export interests, multinational enterprises (MNEs), and financial traders. The policy changes advocated by these actors are of three kinds: encouraging internationalization of the domestic economy through the liberalization of trade and investment regimes, deregulation of domestic regulated markets, and liberalization of domestic financial markets.

As discussed previously, deregulation and privatization, especially of government-controlled utilities and state enterprises, has become a major factor in accelerating transnational capital flows in recent years, often through mergers and acquisitions (Julius, 1990; UNCTAD, 1995). For example, in the first six months of 1998 only, the value of mergers and acquisitions in the United States is projected to reach \$910 billion (\$1.3 trillion worldwide), equal to 1997 (full year level) and about ten times the 1988 (full year) level (*New York Times*, 1998). Previously, such consolidations were discouraged by anti-trust laws or competition policy, governmental ownership of utilities and state enterprises, and active opposition to foreign ownership. Once such restrictions were lifted, there was an upsurge in cross-national mergers, acquisitions, and alliances. Of course, the success of domestic forces in pushing through deregulation shows considerable variation across countries and issue areas. In the case of financial deregulation, the degree of central bank independence was often the crucial factor in determining the extent and character of financial liberalization (Goodman, 1992). In the case of telecommunications services in western Europe, the power of telecommunications workers’ unions is often cited as a factor inhibiting deregulation.

Inter-state rivalry

Cerny (1997: 251) declares that “the transformation of the nation-state into a ‘competition state’ lies at the heart of political globalization,” thereby implying that globalization processes may have been encouraged by inter-state rivalries.¹⁵ Such “third-image” explanations treat technology-based

and domestic political economy-based explanations as being under-specified since they cannot explain the timing and character of state policies that led to deregulation and financial liberalization. To have fully specified explanations, these theories suggest a focus on state preferences and strategies. For example, policy harmonization across countries, forced or voluntary, exemplifies the critical role of inter-state rivalry in facilitating globalization processes. In the Structural Impediments Initiative talks between Japan and the United States (1989–1990), the US negotiators demanded changes in Japanese domestic economic policies which were perceived to rig the market against foreign economic actors (Kahler, 1996; Kosai, 1996). Such forced policy harmonization sought to integrate some of the protected sectors of the Japanese economy with the world economy.

Consider the role of conscious state policies in fostering the processes of financial globalization.¹⁶ The Interest Equalization Tax of 1963 was the first milestone in this direction. This tax was imposed by the US government to discourage the sale of foreign bonds on the New York Stock Exchange. However, it led to the unanticipated creation of the Eurocurrency markets. The second milestone was the jettisoning of the fixed interest rate mechanism by the Federal Reserve of the United States in the early 1970s. The third was the surge in private foreign lending, again with the blessing of the US government, to recycle petro-dollars. The subsequent debt crisis of the 1980s almost led to a global banking crisis. The IMF–World Bank Structural Adjustment Programs, again inspired by the US desire to protect its domestic international banking industry, forced many developing countries to adopt policies to deregulate and privatize government utilities, to attract foreign direct investment (FDI), and to open up their domestic markets for imports. The fourth milestone was the “big bang” of London in 1987 that led to competitive deregulation of the financial markets, with each country attempting to attract mobile capital (Helleiner, 1994).

The General Agreement on Tariffs and Trade (GATT) is another example of state interests guiding the pace and direction of the processes of globalization. Until the Tokyo Round of the GATT, the United States pushed primarily for tariff reductions. This served the interests of US-based firms since they had competitive advantages in manufacturing. Once non-tariff barriers became important impediments to trade in services, and violations of intellectual property rights became a key concern for US exporters, the United States urged agreements on these issues as well. This began in the Tokyo Round and culminated in the Uruguay Round. In February 1997, the US succeeded in pushing through a global agreement for a complete phase-out of tariffs on information products (*New York Times*, 1997a).

In part, the North American Free Trade Agreement (NAFTA) and the renewed urgency in Europe towards integration can also be viewed as state responses to economic globalization. With the Maastricht treaty, Europe sought to regain its competitive edge against the US as well as Japan/East Asian firms. NAFTA, in turn, can be interpreted as an American response to

European integration. Further, moves to expand NAFTA to South America and the possibility of turning the Asia Pacific Economic Cooperation into a free trade area also suggest that inter-state rivalry is important in encouraging integration. A related issue that emerges is whether the current trends point toward regionalization rather than globalization of the world economy. Further, whether regionalization is a “building bloc” or a “stumbling bloc” (Lawrence, 1995) towards globalization. Since regionalization may also represent a decline of multilateralism (Gilpin, 1987), another key issue is whether multilateralism is necessary for globalization. If so, will the processes of globalization be impeded by the trend towards minilateralism, bilateralism, and unilateralism?

A key agent of globalization is the “stateless” MNE. However, MNEs are really not stateless: they continue to retain their national character and there is little convergence in the fundamental strategies on locating the core research and development (R&D) facilities, internal governance, and long-term financial structures (Pauly and Reich, 1997).¹⁷ States, therefore, continue to have strong incentives to promote firms that are closely identified with their territorial jurisdictions. They are now actively engaging in commercial diplomacy, and ensuring a fair deal for their firms has become a key item on international agendas. It is fairly common for large business delegations to accompany dignitaries in their international junkets. The commercial outcomes are often advertised as important achievements of such trips.

Both internal and external deregulation, important pillars of globalization processes, have been actively encouraged by international organizations such as the World Bank, the International Monetary Fund, and the World Trade Organization. Many view such organizations as serving the interests of particular countries, promoting so-called Anglo-Saxon capitalism, thereby becoming tools in inter-state rivalry. In this context, it is important to note that, while many countries believe that globalization serves US interests, many Americans believe that the US is a prisoner of the globalization processes. Milner notes:

But some claim that globalization is not only a creation of the United States but also a creature controlled by it. Countries such as France and Malaysia have vehemently expressed the view that globalization is basically the extension of American economic practices and ideals to the world, and a tool for the exercise of American power. . . . Ironically, many Americans see globalization as beyond their country’s control. Indeed, in their eyes, the United States is ever more constrained by global forces, just like everyone else.

(1998: 121)

To summarize, it appears that globalization processes have been encouraged by all four factors even though there is still much debate over their relative

importance. For example, Beinart (1997) sees global integration since World War II as stemming more from politics than from technology. According to Beinart, there have been two important institutional shifts attributable to politics: establishment of liberal trading and monetary regimes in the late 1940s and the abolition of controls over the movement of foreign capital in the 1970s. Mittleman (1996), in contrast, views globalization processes as primarily market induced and not policy led.

We view technological progress as a necessary condition without which policy interventions would be less successful in fostering globalization processes. However, the political support of domestic constituencies, the response of governments to inter-state rivalries, and the spread of market-based systems have also been critical. An interesting future research agenda then would be to identify economic sectors with varying strengths of globalization processes and to test hypotheses for teasing out the relative contribution of the four independent variables. This would enable us to identify conditions under which different independent variables had the greatest impact on globalization processes. Having discussed globalization processes as dependent variables, we now treat them as independent variables and examine their impact on the institutions of country-level governance.

Globalization as an independent variable

How will globalization impact governance at the country-level? Will the Westphalian system and the Keynesian welfare state survive its onslaught?¹⁸ Do we expect changes in domestic institutions to vary across policy areas and across states? How will the power of domestic actors impact on these changes? What may be the impact of extant institutions, especially the political institutions, that privilege certain actors over others? Will “strong” states be more successful in adapting domestic institutions to the demands of footloose capital? Will the corporatist structures that were designed to produce policy consensus in the wake of rapid economic change survive the test of globalization (Katzenstein, 1985)? Clearly, there are no simple answers to the above questions and assessing the impact of globalization at the country-level is a complex task.

In the Westphalian system, the state is the major agency to supply collective goods and state-centric security considerations play a dominant role in international relations. The notion of a welfare state is predicated on the “embedded-liberalism” social compact (Ruggie, 1982) and the Keynesian philosophy that markets are not self-regulatory. The former suggests that costs imposed by liberalized trade on labor and other domestic actors are to be offset by side-payments in the form of social safety nets such as unemployment insurance, old-age insurance, welfare payments, and other redistributive social policies.

There are three broad categories of views on how globalization may impact on the Westphalian system and the welfare state. First, it is suggested that

the nation-state will wither away; perhaps, not physically but in terms of policy options it can effectively exercise in the economic realm. Further, in the emerging “new world order,” economics will increasingly dominate security considerations. Thus, globalization heralds the demise of both the Westphalian system and the welfare state. The second perspective, in contrast, views business-as-usual for the state. It is suggested that the existing instruments of economic policy, perhaps with some modifications, are sufficient to handle the challenges posed by globalization. Further, the security imperatives of international relations will remain important. The third perspective is that the state will neither wither away nor remain unchanged. Rather, states will rearticulate themselves by shedding some political and economic functions and adopting new ones. Also, though national security considerations will remain important, a new perspective on security will evolve.

Since the pace and extent of changes in governance institutions will vary across states and sectors, an important research area is the development and testing of hypotheses to explain such sectoral as well as country-level variations. The reader will note that we had raised a similar issue previously in the discussion on globalization as a dependent variable. We believe that for the discourse on globalization to evolve into a coherent research program, it is important that scholars study the impact of globalization on institutions of governance representing multiple levels, particularly, the country and the sectoral levels. We now elaborate on the three categories of response to the processes of globalization.

The end of the Westphalian and the welfare state

Some suggest that the Westphalian system is on its last leg, and the world is heading towards some sort of a new political order that resembles the (non-state-centered) medieval period. For these scholars, the arrival of a “borderless world” (Ohmae, 1991) is imminent. This global village will be governed by supra-national institutions and the European Union is often identified as a plausible model. Others suggest that the new governance institutions will resemble an order with governance at both the subnational and the supra-national levels and citizens having loyalties to multiple jurisdictions (Kobrin, this volume).

Since the ability of the state to influence economic processes is predicted to greatly diminish, what policies should be adopted to enhance the economic welfare of citizens, particularly the ones that no longer have a “voice,” cannot “exit,” and have little hope of successfully employing “loyalty” to change the system from within (Hirschman, 1970)? It is recommended that governments should focus on retaining and attracting investments from MNEs. A key strategy is to upgrade the country’s human capital – the assumption being that MNEs tend to invest in countries with a skilled workforce (Reich, 1992). For such scholars, globalization has either arrived or its

arrival is imminent; it is an inexorable force, merciless to those who defy its logic (O'Brien, 1992).

It is also predicted that the Westphalian system of security-conscious states will give way to a new world order where economics will prevail over politics. Echoing the ideas popularized by Normal Angell ([1910] 1933) on the eve of World War I, they suggest that national security will not remain a critical factor in international relations. Ohmae notes that:

Under cold war assumptions, government officials fall back on arguments that countries have to be prepared for emergencies – that is, war. Inefficient industries are subsidized in the name of national security. . . . Meanwhile, Singapore and Hong Kong don't worry about ifs. In theory Singapore can't exist because it has no insurance, either in the form of military or strategic (read protected) industries. Yet, it enjoys current prosperity. I believe that the Singaporean solution is the right one, because in the global economy, economic linkage increases security.

(1991: 13–14)

Further, since globalization processes have led to the spread of democracy, and democracies almost never fight each other (Russett, 1993), national security will be relegated to economic issues. However, the recent enlargement of the North Atlantic Treaty Organization, the strife in the Balkans, the continuing stalemate in the Middle East, and more recently, the nuclear blasts in the Indian subcontinent suggest that security considerations remain important in international relations.¹⁹ The recent controversies in the US involving the sale of dual-use technology to China remind us that many key policy makers actively resist the idea that commercial considerations should prevail over national security issues.

The resilient state

Others question the fuss over globalization, whether governments have actually become so powerless compared to the MNEs and financial markets, and whether the “stateless corporation” has indeed arrived. For them, the state-centered Westphalian model still holds, governments continue to remain powerful in the economic sphere, and the national origins of MNEs remain important for both business strategy and public policy (Tyson, 1991; Carnoy *et al.*, 1993; Pauly and Reich, 1997). Further, the novelty of the levels of economic integration is also questioned: based on trade and capital flows as proportions of the GDP, economies were perhaps more globalized on the eve of World War I (Krugman, 1989). Japan exported a greater proportion of its total production during the interwar period than it does currently (Rodrik, 1997). In spite of the rhetoric that market forces will coerce governments to shrink welfare payments, evidence does not suggest radical restructuring of the welfare state (see below). Thus, the proclamations of the

imminent arrival of a globalized economy are viewed as ruses to undermine the power of labor and other supporters of an activist state. If there are discernible trends towards globalization and downsizing of the welfare state, they recommend politically resisting them from “above” (transnational alliances) and from “below” (local level opposition) (Boyer and Drache, 1996; Gills, forthcoming).

Kudrle, in his chapter for this volume, disputes that economic integration has narrowed the scope of effective policy instruments that states can employ to advance the welfare of their citizens. He debunks four common misperceptions: “reinventing government” can be attributed to globalization, devolution is a manifestation of globalization, after-tax income inequality in industrialized countries has increased due to foreign trade, and deregulation has been forced by globalization. He concludes that most of the challenges associated with globalization admit to effective responses at the national level. Also, those that cannot be handled at the national level can often be dealt with by cross-national policy harmonization.

Krugman (1994) also challenges the widespread belief that globalization is the cause of economic miseries in the industrialized world. He argues that increases in global trade are not the main culprit in the increasing inequalities or the shrinking size of middle income groups in industrialized countries – only 20 per cent reduction in the earnings of low-skilled American workers can be attributed to international trade. Rather, the causal variables are slow growth in domestic productivity, and increases in demand for skilled labor relative to that of unskilled labor. Thus, if globalization has not caused the alleged domestic problems, there is little reason for radically altering the extant systems of governance.

A critical interpretation of the continued importance of state is provided by Falk. He notes that:

[T]he policy orientation of the state has been pulled away from its territorial constituencies and shifted outwards, with state action characteristically operating as an instrumental agent on behalf of non-territorial regional and global market forces. . . . This partial instrumentalization of the state was evident in the Gulf War, properly regarded as the first post-modern war, where the extraordinary mobilization of military capabilities was responsive to severe global market anxieties about the price of oil and the future control of Gulf oil reserves.

(1997: 129)

The rearticulated state

The third set of scholars believe that given the pressures from the processes of globalization, states will not be able to do business-as-usual. They will not collapse either; rather, they will rearticulate themselves by modifying their institutions and policies. Further, though national security concerns will

remain important in international relations, the notion of security itself will be reformulated and acquire new dimensions.

That new governance institutions will evolve does not necessarily imply that they will be superior or more efficient in some sense to the *status quo*. First, it is difficult to expect that “boundedly rational” (Simon, 1957) actors confronting a world of frenzied technological change (a corollary being that full and complete information is not possible due to both actor-level and structural reasons) can ever devise such institutions in a single iteration. Clearly, the rearticulation will have to be an incremental process. Second, for the rearticulation to be successful (rather than dysfunctional) in meeting the challenges of globalization, state bureaucracies must have the incentives and the abilities to regenerate themselves. They should also be able to overcome the opposition from social actors interested in preserving the *status quo*. Further, they may need to actively involve non-state actors (often with different preferences and endowments) in institutional design and implementation. The politics of rearticulation is complex, and is further complicated by the incomplete understanding of the nature and architecture of the desired institutions.

Nevertheless, two types of modifications are suggested. First, in view of the persistent budgetary deficits and the opposition to both inflation and higher taxation, states will eventually downsize some functions, primarily the social policies traditionally associated with the Keynesian welfare state. They will also adopt new ones, especially to safeguard the interests of their domestic firms in increasingly global markets. This is rooted in the belief that, in order to enhance the economic wellbeing of their citizens, states now increasingly compete for world market shares in key industries (Stopford and Strange, 1991; Strange, 1995). For example, industrialized countries will become aggressive in devising institutions or modifying the extant ones that will protect intellectual property rights, open foreign markets for trade in services, and minimize restrictions for FDI (Sell, forthcoming). Second, states will delegate some of their functions upwards to supra-national institutions as well as downwards to local governments. Thus, federalism and creating of supra-national institutions (regional and global) will go hand-in-hand.

Which functions states shed or adopt depends significantly on structural constraints (for example, commitments to international institutions such as the World Trade Organization), the economic costs of not doing so, and domestic politics. Processes of globalization create “winners” and “losers” in the domestic political economy. That foreign trade asymmetrically benefits factors of production (Rogowski, 1989; Midford, 1993), sectors or industries (Magee, 1980; Frieden, 1991), and firms (G. Helleiner, 1977; Milner, 1988) is well established: for example, factors employed intensively in import-competing industries lose, and factors employed intensively in exporting industries gain. In a pluralistic society, losers can be expected to oppose globalization processes, and winners to support them. Public policy is an

outcome of such conflicting pulls and pressures filtered through multiple institutions.

As suggested above, welfare provision is expected to be eventually downsized. It is argued that financial markets punish states that are profligate and run chronic budgetary deficits. Further, there are signs of citizen dissatisfaction with high taxes as well. Footloose MNEs are also allegedly ready to locate to countries that offer low tax rates. On this count, the roll back of the welfare state should be imminent. However, data for the 1980s suggest that the welfare state has turned out to be quite resilient: the share of welfare payments as a proportion of GNP has not declined significantly (Pierson, 1996). One reason is that the growth of the welfare state since World War II has transformed the politics of social policy; with concentrated and tangible losses but diffused and uncertain benefits, welfare cutbacks are politically unrewarding. Data also suggests that countries with strong economies and/or significant exposure to external trade have strong welfare states (Cameron, 1978; Rodrik, 1997). This is partly attributed to the increasing capacities of states to fund such redistributive policies as well as the need to placate the losers from free trade (Ruggie, 1982). Further, as suggested by McGinnis in this volume, for any governance system to survive in the long run, it must build legitimacy. This is often done by redistributing some of the gains of collective action from winners to losers. Globalization processes, with their emphasis on quick changes in production technologies and increased exposure to foreign trade, will create many losers. Consequently, institutionalized mechanisms for redistribution or side-payments are required. The existing governance institutions, particularly the state, may be better placed to provide such redistributive services than any new ones. Thus, even on efficiency consideration, the extant institutions of the state may turn out to be efficient providers of welfare services due to their lower start-up costs. This discussion again suggests that the politics of rearticulation is complex. This is not to say that globalization processes have little impact on economic policies due to domestic politics – welfare reforms remain on active agendas in most industrialized countries. Rather, it is important to appreciate that the impact of globalization on domestic governance is mediated through a variety of institutions and contested terrains.

The second modification is that by upwards and downwards delegation of some functions, states will become structurally and functionally differentiated. Thus, as Cerny argues in his chapter for this volume, a single level structural hegemony – statism, regionalism, or multilateralism – will not prevail. Rosenau (1997) also predicts “fraggementation” (the co-occurrence of fragmentation and agglomeration) of governance institutions. The logic is that the Westphalian state is no longer the most efficient unit of aggregation for supplying various collective goods. This resonates well with the Public Choice literature of the 1960s and 1970s that argued in favor of constitutional federalism. Their main contention was that federalism has an efficiency-based rationale since different collective goods are efficiently provided at

different scales, the national scale being only one of them (Ostrom *et al.*, 1961).

For Evans (1997), the re-articulation of the state could take two paths. First, to survive, states become meaner and more repressive. Second, states could develop capacities to co-produce collective goods with their citizens. He points out that in the post World War II era, states took upon themselves more functions and responsibilities than they could handle. Thus, the attrition of the state is a corollary of the “capacity gap.” He, however, notes that the capacity gap cannot be bridged by old strategies, particularly because of the hostile ideological climate; the return of the pendulum is therefore unlikely. His preferred strategy and outcome is:

Engaging the energy and imagination of citizens and communities in the co-production of services is a way of enhancing the states’ ability to deliver services without having to demand more scarce material resources from the society. . . . Since such a strategy simultaneously rewards the reinvigoration of civil society, thereby augmenting the reservoir of the potential participants in co-production, it is certainly subject to increasing returns.

(1997: 86)

Reiterating the theme of re-articulation, Hart and Prakash, in chapter 9 of this volume, contend that states have incentives to reconfigure themselves. For them, the hallmark of globalization is the “technologization” of trade, that is, the increasing salience of high-technology products in global trade. This creates incentives for states to employ strategic trade and investment policies (STIPs) for developing domestic “architectures of supplies” (Borras and Hart, 1994) in critical technologies. Imperfect markets create a potential for super-normal profits and such interventions may shift these profits from foreign to domestic firms. Since “architectures of supplies” may provide high-technology firms located in a country adequate and timely access to new technologies, they will become a major “pull-factor” attracting investment from both domestic and foreign MNEs (also see Porter, 1990; Ohmae, 1991).

Having discussed globalization as an independent variable and governance as a dependent variable, we now briefly describe the structure of this volume.

The structure of the volume

This volume is divided into three parts. Part I deals with the concepts and politics of governance in the context of globalization. Authors present two perspectives on governance: new institutionalist (David Lake and Michael McGinnis) and sociological (Wayne Sandholtz and Peter Haas). In addition, Ian Douglas examines the politics of the globalization and governance discourse.

Part II focuses on the impact of globalization processes on the Westphalian state. Three perspectives are presented. Stephen Kobrin argues that the Westphalian system will give way to a new political organization that, metaphorically speaking, resembles the medieval order. His contention is that since territorial sovereignty has not been privileged historically, looking back may help us to look forward. In contrast, Robert Kudrle argues that the policy instruments at the disposal of the states are sufficient to deal with the challenges posed by globalization. Philip Cerny provides a perspective on the re-articulation of the state. Cerny predicts that the state will become functionally and structurally differentiated.

In Part III, authors focus on policy response in the realms of trade and investment policies, administrative law and monetary policy. Hart and Prakash argue that globalization creates incentives for states to employ strategic trade and investment policies to promote high-technology industries. Alfred Aman provides a perspective on the impact of globalization on administrative law. Michele Fratianni examines the introduction of the Euro as a response to globalization processes.

In the concluding chapter, we first summarize the findings and the lessons learned from this volume. Then, we briefly discuss an agenda for future research to examine how various actors are coping with globalization and to draw lessons from the successful and unsuccessful coping strategies.²⁰

Notes

- 1 We thank Yu-che Chen, Phil Cerny, Ray Eliason, Marilyn Grobschmidt, Bob Kudrle, David Lake, Marianne Marchand, Mike McGinnis, Henk Overbeek, and the three anonymous reviewers for their comments and Jennifer Baka for her research assistance.
- 2 This volume is the first study of a research program that examines the impact of globalization on governance. We are also working on two other edited volumes tentatively entitled "Coping with Globalization" and "Responding to Globalization". Scholars often assume that globalization is either essentially beneficial or disruptive. We view such perspectives as representing the polar ends of the "response to globalization" continuum and these volumes seek to examine other responses as well. They therefore focus on the "coping" strategies of governments and firms, evaluating the success of such strategies, and drawing lessons from them.
- 3 For a detailed analysis of the various notions of institutions, see Crawford and Ostrom (1995). In a new-institutionalist perspective, regimes and institutions are functional equivalents: they facilitate collective action by encouraging information flows, provide arenas for bargaining, and establish mechanisms for monitoring and enforcing contracts (Krasner, 1982; Keohane, 1984; Young, 1986). For a sociological perspective on institutions, see Scott (1987), March and Olsen (1989), DiMaggio and Powell (1991), Oliver (1991) as well as the papers by Sandholtz and Haas in this volume. For a comparison of the new-institutionalist and sociological perspectives, see Keohane (1988) and Ostrom (1991).
- 4 Even the virtual organizations that exist only in the cyberspace have budgets, personnel, etc.

- 5 Some scholars do not view firms as efficiency-enhancing institutions; rather, they view firms as instruments of capital to dominate labor (Marglin, 1974; Perrow, 1979; Edwards, 1979).
- 6 For example, firms are units of governance for organizing economic activity. As Coase (1937) pointed out, firms economize on transaction costs associated with the functioning of markets. Williamson (1985) also views firms as governance structures to economize costs associated with opportunism of labor given asset-specificity and bounded-rationality.
- 7 For a review of the literature on measuring globalization at the firm level, see Sullivan (1994). For a critique of Sullivan, see Ramaswamy *et al.* (1996). For a discussion on measuring globalization at the sector or industry level, see Makhija *et al.* (1997).
- 8 The literature on non-economic dimensions of globalization is rather vast. For example, key works on the subject of cultural globalization include Featherstone (1990), Robertson (1992), Abramson and Inglehart (1995), Appadurai (1996), and Lipid and Kratochwil (1997).
- 9 This of course raises important epistemological questions such as what constitutes evidence and how do we test hypotheses. Further, it is also argued that globalization as an ideology plays a critical role in sustaining globalization as a phenomenon (Robertson, 1992; also see Douglas' chapter in this volume).
- 10 Our definition is more spartan than Mittleman's (1996: 2). For him, globalization manifests as

spatial reorganization of production, the interpenetration of industries across borders, the spread of financial markets, the diffusion of identical consumer goods to distant countries, massive transfer of populations within the South as well as from the South and the East to the West, . . . and an emerging worldwide preference for democracy.

Unlike our conception, Palan and Abbot view globalization "not as a quantitative change denoting the global integration of markets but as a qualitative change which implies an intensification and extension of capitalist relationships" (1994: 19). We, however, believe that "intensification" and "extension of capitalist relationships" emanate from integration of markets; the latter being a necessary (and perhaps sufficient as well) condition for the former.

- 11 For an elaboration of this argument, see Prakash and Hart (1998). Also see Wade (1996) on assessing the levels of globalization.
- 12 An important question then is: can these four factors also lead to reversal of globalization? For example, can new developments in the domestic sphere lead to conditions whereby countries start withdrawing from the global economy? This poses a broader question: is globalization reversible? If history is any guide, perhaps it is. Globalization measured in terms of trade and capital flows peaked on the eve of World War I and reached its lowest point in the 1940s (Milner, 1998). It again began an upward trajectory after World War II.
- 13 For a discussion on the important role of epistemic community of central bankers in ushering in financial deregulation, see E. Helleiner (1994).
- 14 The Republican criticism of the United Nations and its affiliated organizations such as UNICEF was of a different character. Specifically, many Republicans felt that the UN had been "captured" by anti-US groups, had lost its focus, and spawned a bloated bureaucracy.
- 15 For a discussion on the notion of a "competition state", see Palan and Abbot (1996), especially Chapters 1 and 2.
- 16 For an excellent review of literature on this subject, see Cohen (1996).

- 17 The relationship between MNEs, host and home governments is complex. The traditional model that suggests that home governments support their home-based MNEs and host governments view them as adversaries has been questioned. For a discussion on this subject, see Rugman and Verbeke (1998).
- 18 It is important to note that the Westphalian system is also under attack from a resurgence of civil society as well as the increasing emphasis on the “third sector” (Ostrom, 1990; Putnam, 1993). On the face of it, this should not impact on the globalization discourse. Further, many conservative critics of “big government” and proponents of “family values” and “communities” oppose globalization – Ross Perot and Patrick Buchanan being prominent examples. We contend, however, that these attacks have added to the undermining of the credibility of the Westphalian state and hence paved the way for privatization and deregulation. Thus, by choice or by accident, these movements have played into the hands of the supporters of globalization.
- 19 The clash of civilization thesis also suggests the continued importance of security issues. Huntington (1996), however, identifies the “civilization,” and not the nation-state, as his unit of analysis.
- 20 This is also the thrust of the two other volumes we are co-editing as part of this research project.

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