
POLITICAL ECONOMY OF ECONOMIC INTEGRATION

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ABSTRACT

An examination of the impact of globalization requires a careful study of its microfoundations. Policy scientists should not rush to judgment about the

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implications of existing levels or trends in cross-border integration. Such integration has multiple dimensions having varying implications for public policy. Declarations about the withering away of the state as well as its continued vibrancy need to be carefully examined. The crucial next step for a conceptually grounded debate is the development of a common vocabulary to categorize various kinds of globalization and a careful assessment of varying levels of economic globalization.

Globalization has three dimensions: cultural-ideational, politico-institutional, and economic. There are three ordinally ranked levels of economic integration: existence of global infrastructures, harmonization and convergence of economic policies and institutions, and/or borderlessness. To understand the policy implications of cross-border economic integration, we need to focus on flows of goods and services as well as factors of production—land, labor, capital, entrepreneurship, and technology. ©1998 John Wiley & Sons, Inc.

INTRODUCTION

This article states and defends three propositions. First, there is disagreement among scholars and policy makers on the causes, extent, and implications of globalization. This has led to contested diagnosis and prescriptions on how public policy ought to respond to it. At one extreme, some authors say that with increasing capital mobility, governments now exercise little discretion in formulating economic policies. They proclaim the demise of the welfare state (the “end of welfare as we know it”). It is also suggested that the existing state-centered Westphalian system is on its last legs, and the world is heading towards some sort of a new political order that resembles the (non-state-centered) medieval period.¹ The same authors recommend that to ensure a country’s economic well-being, governments should focus on attracting investments from “stateless” multinational enterprises (MNEs). The best strategy for doing this in the long run is to upgrade the country’s human capital²—the assumption being that MNEs prefer to invest in countries with a highly educated and appropriately skilled workforce. For such scholars, globalization has either arrived or its arrival is imminent; it is an inexorable force, merciless to those who defy its logic.

Others question the fuss over globalization, whether governments have actually become so powerless compared to 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.³ For them, the proclamations of the imminent arrival of a globalized

economy are ruses to undermine the power of labor and other supporters of an activist state. Furthermore, if there are discernible trends towards globalization, they recommend resisting them from “above” (transnational alliances) and from “below” (local level opposition).⁴

In view of such polarization, this article attempts to sort out critical aspects in the globalization debate. One reason why scholars are talking past each other is that there is terminological confusion; a common vocabulary is lacking. This is not surprising because globalization has come to subsume so many meanings that it has lost its analytical utility. Consequently, this article aims to provide a taxonomy for classifying different aspects of globalization. This would help scholars to appreciate the complexity of this subject and perhaps deter them from advocating sweeping measures to swim with or resist globalization.

Our second proposition is that globalization or cross-border economic integration is not a new phenomenon. Extensive sea- and land-based trading linkages among ancient civilizations of India, China, Egypt, and Tigris (to name a few) suggest that humans have actively engaged in trading of goods and services for thousands of years. Global firms such as the East India Company are also a well-documented part of history. Based on trade-gross domestic product (GDP) ratio and volumes of cross-border capital flows, the world economy was perhaps more integrated on the eve of World War I than it is in the 1990s.⁵ We therefore need to provide evidence for the assertion that global economic integration during the last two decades is indeed a discontinuity from the past. This again requires that we identify various notions of economic integration, rank them or measure levels of integration they represent, and then examine whether levels of integration have indeed accelerated during the last two decades.

Effective public policy needs to be conceptually grounded; policymakers should not over- or underreact to the challenges of globalization. If globalization is indeed taking place at an unprecedented pace, extant institutions of political and economic governance can be expected to come under assault. If globalization is a fad, it can perhaps be ignored and resources focused on more urgent public needs. Careful definition and measurement of cross-border integration would therefore be a valuable input for both policymakers and scholars to think about appropriate ways for responding to globalization.

Our third proposition is that economic integration creates “winners” and “losers.” That foreign trade benefits factors of production asymmetrically is well established: factors used intensively in import-competing industries lose, and factors used intensively in exporting industries gain.⁶ 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. To understand the political economy of integration, we therefore need to examine impacts of specific policies facilitating cross-border flows across sectors and factors of production. To achieve this end, economic integration needs to be measured in terms of both trade and factor flows. Thus, in this article we seek to develop indicators that reflect cross-border integration of trade and factor flows.

We have divided this article into three sections. In Section 1, we first discuss how globalization compares with other theories of intercountry linkages such as functionalism, neofunctionalism, and complex interdependence. We then elaborate on three notions of globalization: cultural-ideational, politico-institutional, and economic. Finally, we identify three ordinaly ranked levels of economic integration: global infrastructure, policy harmonization, and borderlessness. In Section 2, we suggest indicators to measure the degree of economic integration at the factor of production level. In Section 3, we present the conclusions and policy implications of this article.

NOTIONS OF INTEGRATION

Any form of economic integration challenges the territoriality and the sovereignty of states. Sovereignty has two components: juridical and policy. The juridical dimension implies that states are legally equal in international interactions and are entitled to sign treaties and agreements on behalf of their citizens. The policy dimension suggests that states have the abilities to implement their policies within their respective territories. Although the Peace of Westphalia in 1648 sought to provide both policy as well as juridical sovereignty to states, national governments have seldom exercised absolute policy sovereignty and sometimes are even deprived of their juridical sovereignty. Some sort of civil society in domestic spheres, and a variety of regimes and institutions in international spheres, have constrained states' policies. Further, historically, city-states, principalities, countries, and empires have maintained links with each other across issue areas. Such links have been voluntary as well as forced, benign as well as predatory. Thus, it is up to the proponents of globalization to demonstrate that the last two decades constitute a discontinuity from the past.

International relations scholars have developed some theories to explain, and sometimes predict, trends in economic integration. Because trade and economic exchanges have led to conflict as well as cooperation, scholars have examined both the causes and consequences of economic

integration, particularly at the regional level. In the 1950s and 1960s, theories of regional integration flourished. Western European countries, seeking to institutionalize cooperation and peace, formed the European Coal and Steel Community (1952) and the European Economic Community (1956). Functionalist theories developed to explain such trends towards regional cooperation. Because these countries sought to handle common concerns by creating technical supranational organizations, scholars saw regional cooperation leading to the rise of transnational technical elites. The spillovers —“ramifications” as Mitrany called them—of technical cooperation in politics were predicted to lead to political integration, encouraging peaceful settlement of intercountry disputes.⁷ For such scholars, regional integration was a harbinger of peace in a continent that had suffered two devastating wars in 50 years.

Not everyone shared the confidence that technical elites could bring about peace. Haas, a neofunctionalist, criticized the functionalists' emphasis on technical elites and their neglect of the politics of integration. He contended that integration could take place only with the support of political elites.⁸ Note that both functionalists and neofunctionalists focused on elites; an examination of microlevel politics was not their agenda.

As the pace of European integration slowed in the 1960s, there was a reexamination of the logic of regional integration. Scholars attributed this deceleration to opposition from nationalists such as General Charles de Gaulle as well as contradictions in some of the objectives of integration. Interdependence theories chronologically followed the functionalist and the neofunctionalist theories. In a replay of Angell,⁹ interdependence theorists contended that in a complex world characterized by multiple linkages, international policies of countries had reciprocal effects and reciprocity connoted interdependence.¹⁰ International regimes and institutions were identified as tools for enabling countries to cope with “complex interdependence.” Regimes and institutions were implicit or explicit principles, rules, norms, and decision-making procedures around which the expectation of the actors converged in a given issue area.¹¹ Because cooperation was impeded by transaction costs—the costs of negotiating, monitoring, and enforcing contracts—institutions and regimes reduced such costs to facilitate collective action.

Is globalization the same as complex interdependence? The genesis of the research programs on complex interdependence and globalization differ. Although the complex interdependence perspective challenges the assumptions and implications of neorealism, it continues to operate within the broad Westphalian paradigm, with its emphasis on territoriality.

The notions of globalization, at least some of them, suggest an emergence of world markets for goods, services, investments, and factors that are not constrained by territoriality. The Westphalian model is therefore challenged in the globalization research program. Institutions and regimes, however, remain central to globalization discourse in that they are required to regulate the actions of state as well as nonstate actors such as MNEs.

We have suggested that globalization has become a buzz word encompassing many concepts. As a first step towards bringing analytical rigor to policy discussions, it is instructive to identify three dimensions of globalization: cultural-ideational, politico-institutional, and economic. Globalization may occur at a cultural-ideational level, marking the first step towards a global society even though it is unlikely that a global culture will completely displace national and subnational cultures. The role of the mass media is critical in diffusing the global culture as well as sometimes enabling local cultures to cope better with this challenge. A notable indicator of cultural globalization is the new level of acceptability of English as the preeminent language of international politics and commerce. Not surprisingly, this has caused consternation in some parts of the world, especially France, where it is viewed as a victory of the Anglo-American social and economic values.

Importantly, trends towards cultural globalization coexist with an unprecedented resurgence in civil society and local cultures (cultural localization). The end of the Cold War, the consequent redrawing of the national boundaries, and emergence of fundamentalist religious movements in various parts of the world may partially explain these trends. Hence, it is difficult to tease out the impact of processes of cultural globalization on the revival of local cultures.

Politico-institutional globalization refers to the moves towards common political, policy, and legal practices across countries. As discussed earlier, this figured prominently in the research programs on regional integration, complex interdependence, regimes, and institutions. Political-institutional globalization can take place through three routes: (1) the creation of supranational, regional, or global institutions that replace national institutions; (2) policy convergence across countries because of technological imperatives, imitation, or diffusion of best practices; and (3) conscious policy harmonization through recognition of principles such as national treatment and nondiscrimination.¹²

Economic globalization is probably the most commonly understood manifestation of globalization, connoting increasing levels of integration of final goods and services, intermediate products, and factor

markets across countries. We identify three levels of economic globalization:

Global Infrastructure

This is the minimal form of economic integration in which the presence or absence of a matrix for interconnecting major economic regions is the key criterion for globalness. Global infrastructure is both an end product of global integration as well as a necessary condition to move towards it. The creation of sea- or land-based global trading networks is an example of such globalization processes. In recent times, global telecommunications networks provide evidence of global economic integration. It is not clear, however, how we measure levels of globalization of infrastructures and whether all kinds of infrastructure are equally important indicators as well as agents of global integration.

Creation or existence of global infrastructures may not significantly challenge a state-centered world. Such infrastructures primarily facilitate economic flows among actors with well-defined territorialities. Ships continue to fly flags of particular countries, countries zealously guard their territorial waters, and exported and imported goods still have to pass through customs. Even telecommunication networks may not defy territorialities; division of spectrum and allocation of slots for satellites are very much within the purview of the Westphalian system. The discontinuity is that new forms of "traffic" carried by global infrastructures pose difficulties of control for states. Examples are many. Governments are facing problems in regulating information flows on the Internet. Until recently, European governments tried to protect the monopolies of their local telephone companies in overseas calling. This led to a system of highly unequal charges for international telephone calls. A technological innovation called dial-back option, which allowed international callers to initiate a call easily from the country with the lowest rate, made it possible for European customers to circumvent such restrictions. Thus, along with creation of infrastructure, we need to focus on the characteristics of the traffic or exchanges they support.

What are the public policy implications of such new infrastructures? On the whole, governments have been supportive of creating them as long as private actors are paying most of the costs and as long as they continue to exercise some sort of a control over their functioning. Governments are especially sensitive regarding erosion of their abilities to influence commerce supported by such infrastructures. Totalitarian governments, however, are concerned about loss of control over information flows, po-

litical or economic in content, that such infrastructures generate. The recent Chinese regulations on the ownership and use of the Internet are a case in point.

Global infrastructures often require uniform standards. As a consequence, there is increased interstate competition about whose standards would prevail. The classic case is the fight over high-definition television, for which European, U.S., and Japanese companies are espousing different standards, with active support from their respective governments. This again suggests that the era of the “stateless corporation” has yet to arrive. Nationality of firms is important, and governments try to retain key roles in safeguarding the commercial interests of domestic firms in international markets.

Institutional Harmonization and Convergence

The next stage of economic integration is harmonization or convergence of economic institutions. Institutional heterogeneity often creates impediments to cross-border flows, and may provide unfair advantages to some firms. For example, differences in antitrust policies may give some MNEs an unfair advantage in that they could use their monopoly power at home to subsidize their exports.

Institutional harmonization can occur bilaterally, regionally, or globally. As we have noted previously, institutional harmonization at the regional level appears to be most popular perhaps because countries in geographical proximity often have similar cultures and levels of economic development. This invites low resistance from domestic constituencies towards institutional harmonization [the North American Free Trade Area (NAFTA) being an exception]. Furthermore, such countries often already have substantial economic and social linkages, and harmonization only formalizes such linkages.

Examples of regional level institutional harmonization are many. The pursuit of a single European market, despite hiccups, is making steady progress. NAFTA survived the Mexican peso crisis of 1994. Although President Clinton was rebuffed by the Congress in 1997 over granting of fast-track authority for trade negotiations, there are already moves afoot to extend NAFTA membership to other Latin American countries, and to institutionalize its relationship with MERCOSUR (Mercado Común del Cono del Sur). The Association of South East Asian Nations (ASEAN) continues to be a functioning economic bloc (despite the current crises), with Vietnam as its latest member. There is a discussion to forge a Pacif-

ic-Indian Ocean bloc comprising the APEC (Asia-Pacific Economic Cooperation) and ASEAN countries.¹³

What drives institutional convergence? It is suggested that the renewed interest in aspects of institutional convergence draws not on Marxist notions of technological determinism but on how competition and mobile capital create incentives for countries to adopt similar policies and practices. As outputs of such processes, one expects to see similar interest rates, profits levels, wages, as well as rates of economic and productivity growth across countries.¹⁴ The 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 economic integration. For example, the universal adoption of a state interventionist model will not lead to economic integration. This issue is important because states may intervene in heavy industry and the infrastructure sector to ensure internalization of positive intersectoral and intertemporal externalities. The East Asian countries, and more so Japan, are viewed as having adopted such policies. Strategic trade theorists also recommend selective state interventions to transfer supernormal profits from foreign to domestic firms in industries with increasing returns to scale. Such interventionist policies do represent policy convergence but not global economic integration.¹⁵

Policy harmonization, voluntary or forced, also reflects economic integration. For example, in the Structural Impediment Initiative talks between Japan and the United States (1989–1990), the U.S. negotiators demanded changes in Japanese domestic economic policies that were perceived to rig the market against foreign economic actors. Politico-economic pressures favoring harmonization could also be witnessed in the European Community over the debates on the mutual recognition of each others' health, safety, and environmental policies.

It is important to note that this stage of economic integration corresponds to what we have described previously as politico-institutional integration. States or any other sources of coercive power are the guarantors of property rights. For markets to work efficiently, such rights should be defined and enforced at low transaction costs. It therefore follows that for cross-border integration to proceed, politics needs to keep pace with economics, and this is sought to be achieved by a conscious harmonization of policies and institutions across jurisdictions. Note that policy harmonization still takes place within the confines of the Westphalian systems; states negotiate among themselves on what institutions to harmonize and what authorities to cede to supranational bodies. Howev-

er, this also marks a dilution or undermining of political and economic power of states in influencing cross-border economic activity.

Borderlessness

The third and most ambitious stage of economic integration is borderlessness. In a borderless economy, political boundaries and territorialities become unimportant in influencing policies of economic actors. There is unfettered flow of goods, services, investments, and factors of production. Ohmae observes:¹⁶

On the political map, the boundaries between countries are as clear as ever. But on the competitive map, a map showing real flows of financial and industrial activity, those boundaries have largely disappeared.

Consequently, political risk analysis as an input into economic decision making is no longer useful.¹⁷ Borderlessness is therefore predicated on the demise of the Westphalian system. At the firm level, borderlessness requires MNEs to become “stateless.” Because the Westphalian system continues to function albeit with some changes, and MNEs retain links with their home countries, the arrival of borderlessness is not on the immediate horizon.

Not all actors welcome borderlessness. MNEs are often viewed as the prime beneficiaries of unconstrained capital flows, and labor, especially unskilled labor, as the main loser. Some scholars are also apprehensive about implications of moves towards borderlessness on the natural environment, as evidenced in the debate over NAFTA, and more recently on granting fast-track negotiating authority to President Clinton.¹⁸

Having identified three levels of cross-border economic integration, we now proceed to suggest indicators of integration in terms of flows of goods, services, and factors of production. As discussed previously, economic integration needs to be grasped at a disaggregated level, and for scholars of public policy it is critical to focus on microfoundations of integration processes. This helps in thinking about appropriate responses to, as well as predicting political ramifications of, particular policy initiatives.

MEASURES OF ECONOMIC INTEGRATION

Trade flows relative to the GDP or gross national product (GNP) are commonly used to measure cross-border economic integration. For example, it is claimed that the Organization of Economic Cooperation and Development economies have become more globally integrated during the last

few decades since their export-GDP ratio has increased from 9.5% in 1960 to 20.5% in 1990.¹⁹

Historically, trade has been the main vehicle for cross-border economic exchanges. Currently, however, a sole focus on trade flows is questionable, given the higher growth rates of foreign direct investment (FDI) flows versus trade flows: during 1991–1996, inward FDI flows grew at 17.1% annually versus 7.4% annual growth in trade flows.²⁰ FDI flows are also transforming the nature of trade flows; instead of market-based transactions, trade is increasingly being handled within the administrative hierarchies of firms. Consequently, intrafirm trade now exceeds arm's-length trade (\$5.3 trillion versus \$4.8 trillion in 1993).

Instead of viewing trade and FDI as substitutes, scholars now emphasize their complementarities. Furthermore, they contend that trade and FDI are two of the many vehicles used by MNEs to access foreign resources and markets. Others include strategic alliances, nonequity partnerships, licensing, and joint development of technology. A sole focus on trade or FDI flows therefore clearly underrepresents levels of economic integration.

A more serious problem is that a focus on macroaggregated flows such as trade and FDI ignores the microfoundations —flows of factors of production—of economic integration. An economy is integrated only if its sectors are integrated. Similarly, if economic sectors are composed of firms, economic integration should be conceptualized and measured at the firm level. Extending this logic further, if firms are coalitions of factors of production, integration should be observed at the factor level. As discussed previously, economic integration asymmetrically benefits various factors of production. The pace of integration may also vary across factors of production. One can then hypothesize that the “demand” as well as the “supply” of economic integration at the country level is critically influenced by dynamics at the factor level: preferences of factors, politico-economic resources at their disposal, and how collective action dilemmas and intrafactor politics empower or enfeeble them in articulating their collective interests.

Traditionally, four factors of production are identified — land, labor, capital, and entrepreneurship. In an era of technologization of economies, we also add technology or intellectual property to this list. We discuss issues involved in assessing integration at the factor level below.

Labor

Cross-border labor flows are often restricted because of sociocultural as well as economic externalities associated with them. Migration is driven by

TABLE I
Remittances-Gross Domestic Product Ratios

	1980	1989
World	0.2	0.2
Yugoslavia	5.6	8.0
Portugal	12.0	8.3
Morocco	6.9	6.5
Egypt	11.8	10.6
Pakistan	7.4	4.8
Mexico	0.2	1.1

Source: Adapted from S. Russell and M. Teitelbaum, *International Migration and International Trade*, World Bank Discussion Paper no. 160 (Washington, DC: The World Bank, 1992) p. 60; *World Development Report* (Washington, DC: The World Bank, 1991) p. 183.

a variety of "push" as well as "pull" factors that can be economic, ethnic or sociological, and/or political. It can be short term as well as long term. International migrants include settler-migrants, temporary contract laborers, skilled migrants ("brain drain" in some cases), students, and refugees/asylees. Given the heterogeneity in skills, reasons for migration, and propensities to settle down permanently, labor flows need to be disaggregated.

In-migration is concentrated in few regions of the world. Of the estimated 80 million international migrants, 35 million are in Sub-Saharan Africa, 15 million in the Middle East and Asia, and 13–15 million in Europe and North America. Remittances often contribute significantly to the national incomes of many countries. As shown in Table I, remittances-GDP for Portugal were as high as 12% in 1980, declining to 8.3% in 1989. However, for Mexico, this ratio was as low as 0.2% in 1980, rising to 1.1% in 1989.

What are the politico-economic reasons for and implications of restricting labor flows? The industrialized economies are witnessing a declining share of manufacturing and increasing share of services in their GNPs. If service delivery requires the physical presence of deliverers, free labor flows are necessary for free trade in services. Services are of two types: the ones that can be provided without the physical presence of providers (such as long-distance banking) and the others that require the physical presence (such as hotels). With the information revolution, the share of the former is expanding. Because this revolution is limited to industrialized countries and a few tax havens, restrictions on labor flows will continue to impede economic integration and impose asymmetrical costs across countries. However, as the information revolution diffuses to poorer and more peripheral nations, perhaps the reverse will occur.

This debate was evident in the Uruguay Round of General Agreement on Tariffs and Trade (GATT) negotiations because the industrialized countries wanted inclusion of high technology services such as banking and insurance (in which they have comparative advantage) within the purview of the World Trading Organization without any relaxations in immigration laws. Because developing countries have competitive advantages in labor-intensive services that require physical presence of providers, they unsuccessfully attempted to link the issue of high-tech services with easier labor flows across borders.

To measure economic integration of the labor force, we suggest two indicators: (1) foreign workforce (skilled and unskilled) as a proportion of total labor force (skilled and unskilled) (physical indicator); (2) remittances-GDP ratio (financial indicator).

Capital

Capital, as the most mobile factor of production, is portrayed as the main agent of economic integration. As end products of integration, financial markets are viewed as being most integrated and getting more so over time. The volume of financial flows is also seen to overwhelm the flows on the current account.

Financial flows fall into three categories: FDI, portfolio, and external borrowing. FDI is a long-term commitment giving parent MNEs ownership or control over real assets of their foreign affiliates. In accounting terms, FDI is the sum of equity and debt held by parent MNEs in their foreign affiliates and the retained earnings of affiliates. Since the 1980s, FDI inflows have increased dramatically: from \$57 billion in 1982–1986 to \$347 billion in 1996. Current FDI stocks are valued at \$3.2 trillion.²¹

Portfolio flows includes investments of country funds, depository receipts, and direct purchases of common stocks (as long as they are less than 10% of the total outstanding shares of a company) in foreign markets. External borrowings refers to bank loans, bonds, certificates of deposit, commercial papers, trade financing, leasing facilities, and private placements.

To measure economic integration of capital flows, we suggest three measures: (1) the ratio of FDI to gross fixed capital formation (GFCF); (2) the ratio of portfolio capital flows to GFCF; and (3) the ratio of external borrowings to GFCF. These ratios indicate the contribution of foreign capital (as FDI, portfolio or external borrowings) in creating domestic productive capacity.

TABLE II
Worldwide Venture Capital Growth (in \$Billion)

	1986	1987	1988	1989
United States	24.1	29.0	31.1	33.4
Europe	8.9	15.6	20.1	24.8
Japan	3.2	4.5	6.2	7.5

Source: Adapted from W. Bygrave and J. Timmons, *Venture Capital at the Crossroads* (Boston: Harvard Business School Press, 1992) p. 70.

Entrepreneurship

Entrepreneurship is often viewed as being embedded in capital and technology flows. Entrepreneurs, however, perform a specific function—risk taking—for which they receive profits.²² The institution of venture capital has separated the functions of technology provision and capital provision.²³ The first venture capital—ARD—was established in 1946 in Massachusetts. Since then, the number of venture capitals has increased to 1,355 in 1989.²⁴ Venture capitals are well established in Europe and Japan. As shown in Table II, in 1989, the venture capital pool in Europe and Japan totaled \$24.8 billion and \$7.5 billion, respectively. Thus, the combined venture capital pool outside the United States (\$32.2 billion) is comparable to that in the United States (\$33.4 billion).

Venture capitalists are increasingly treating the globe as the relevant arena for raising capital as well for deploying their funds. Consequently, to measure economic integration as reflected in entrepreneurship flows, we suggest two indicators: (1) The proportion of investments made by venture capitals outside their home countries. For example, in 1990 only 13.5% of the investments by the European funds were outside their home countries. (2) The proportion of noncountry finance compared to domestic finance flowing in such funds. For example, in 1988, 14% of finances for venture capitals in the United States came from nondomestic sources.²⁵

Land

Land flows pose an interesting puzzle. Because land is immobile, with the possible exception of icebergs and iceflows, it may appear to be outside of our analysis of geographical flows. However, the issue can be framed in the following way: Does a country allow foreigners to own land or real estate and to what extent does foreign capital support the domestic real estate industry?

The increasing globalization of financial markets, coupled with the huge Japanese balance of payment surplus in the 1980s, has encouraged massive flows of foreign funds into the real estate sector. For example, during 1985–1993, Japanese real estate investment in the United States amounted to about \$77 billion.²⁶ With increasing linkages between capital and real estate markets, some scholars now talk in terms of a global real estate market. Previously, banks and insurance companies provided finances for commercial real estate. Increasingly, the real estate industry across countries is now relying on global capital markets for its financial needs.²⁷

Land ownership, or some sort of usufructuary rights, is often necessary for the functioning of industries such as hotels and plantations. Impediments to real estate investments therefore translate to impeding FDI. However, land ownership by foreigners is politically sensitive and countries erect nontariff barriers to discourage foreign ownership. This problem figured in the Structural Impediment Initiative talks between the United States and Japan in 1989–1990. Hence, many countries, instead of providing outright ownership to foreigners, encourage hybrid functional arrangements such as long leases.

To measure economic integration as reflected in land flows, we suggest two indicators: (1) foreign-owned holdings as a proportion of total real estate (physical indicator); and (2) foreign funds as a proportion of total funds invested in the real estate sector (financial indicator).

Technology

This refers to flows of intellectual property and industrial knowledge. Research and development (R&D) and FDI flows reinforce each other. Because about 80% of civilian research is undertaken within MNEs, the increasing volumes of FDI flows suggest increasing levels of technological diffusion. Also, MNEs do not centralize their R&D in their parent coun-

TABLE III
Ratio of U.S. Patents of Foreign Firms for Research and Development Outside Home Country to All U.S. Patents Granted to Firms from That Country (in percentages)

	1969–1972	1973–1977	1978–1982	1983–1986	1987–1990
Europe	29	26	25	27	30
Japan	3	2	1	1	1
United States	10	11	11	11	11

Source: Adapted from United Nations Conference on Trade and Development/UNCTAD, *World Investment Report* (Geneva: United Nations, 1995) p. 152.

sion because of its multiple meanings and its asymmetrical benefits across actors. Ironically, both the potential losers and winners from globalization

TABLE IV
Measures of Economic Integration: A Summary

<i>Measures of Integration</i>	
Macro	
Trade in Goods and Services	Trade/GDP
Micro	
Labor	1. Foreign Workforce as a proportion of Total Workforce 2. Remittances as a proportion of GDP
Capital	1. FDI Flows as a proportion of GFCF 2. Portfolio Flows as a proportion of GFCF 3. External Borrowing Flows as a proportion of GFCF
Entrepreneurship	1. Proportion of Investments of Venture Capitals Outside Their Home Countries 2. Proportion of Noncountry Finance in Venture Capital
Land	1. Foreign Holdings as a Proportion of Total Holdings 2. Foreign Funds as a Proportion of Total Funds Invested in the Real Estate Industry
Technology	1. Proportion of Patents Granted to Foreigners Versus Total Patents 2. Cross-border Royalties and Fees

GDP, gross domestic product; FDI, foreign direct investment; GFCF, gross fixed capital formation.

tend to exaggerate current levels of cross-border integration, the difference being that the losers focus on its negative consequences whereas the winners on its benefits for the domestic economy.

Any judgment on levels and consequences of globalization is perhaps premature. First, a common vocabulary needs to be developed and indicators of cross-border established. Only then can we assess levels of globalization. Second, once we have developed indicators reflecting integration at the factor of production level, we can begin examining how economic integration impacts the domestic political economy. Based on the same logic, we could develop measures for assessing integration at sectoral and industry levels. Trade and factor-based indicators are summarized in Table IV.

We have argued that globalization is a complex subject that is not amenable to simplistic and sweeping policy prescriptions. To handle the complexity as well as the richness of the subject, we differentiated among three dimensions of globalization (cultural-ideational, politico-institutional, and economic) and various ordinally ranked levels of economic globalization (global infrastructure, institutional harmonization, borderlessness). The objective of creating taxonomies is not to compound complexity, but rather to enable us to conceptually grapple with it. For example, if economic policies are best suited to confront issues arising from economic globalization, calls for curbing inflows of FDI to protect local

cultures are misplaced. Cultures do not change in the short run, and certainly not primarily because of government-dictated economic policies. Cultural changes often take place only over generations from multiple causes, economic factors certainly being one of them. Policy scholars should therefore guard against blaming "globalization" for most societal problems ranging from falling moral standards to increasing crime rates.

To assess levels of cross-border integration, we have suggested examining both trade and factor flows. Our contention is that to have a meaningful policy debate on the political economy of integration, an understanding of microfoundations of globalization is essential because only a factor-level disaggregated analysis would enable us to predict the actual winners and losers. If winners (or losers) have sufficient political economic resources, and are able to overcome their collective action dilemmas, we can expect to observe demand (opposition) for (to) economic integration. Both the successful passage of NAFTA through the U.S. Congress and the failure of the same institution to grant the fast-track authority to President Clinton are examples of how the domestic political economy influences policies toward economic integration.

We have also argued that economic integration is not a new phenomenon; it has existed since time immemorial. There is also a fairly comprehensive literature on the political economy of integration, particularly regional integration. An interesting aspect of current trends towards global integration is that it co-occurs with regional integration. This raises issues about whether regional integration is a precursor ("building block") or an alternative ("stumbling block") to greater global integration.³⁰ Those who see it as a "building block" argue that: (1) as a first step, it effectively confronts limitations of multilateralism by reducing the number and heterogeneity of actors participating in international regimes; (2) because it only formalizes the existing economic linkages among the countries in geographical proximity, it is "trade creating" and not "trade diverting"; and (3) as the product development costs increase, regional markets will not provide the necessary scale economies and would therefore lead to global integration. However, some other scholars view regional integration as an alternative ("stumbling bloc") to global integration, interpreting it as a strategy of regional hegemons (particularly the United States and Europe) to protect their "relative gains" in trade and investment versus Japan and East Asian countries.

At an empirical level, global and regional economic integration are not mutually exclusive in that a country may have a mix of domestically oriented, regionally integrated, as well as globally integrated industries. Factor flows may also have regional as well as global biases. At a norma-

tive level also, we may defend the coexistence of regional and global integration in that they may represent the most efficient scales for the supply of different public goods.

It seems that debates on the political economy of integration overemphasize its “demand” side. There are two versions of demand-side explanations. First, because factors of production and other interest groups have varying preferences for cross-border integration, policies are viewed to evolve in response to pulls and pressures of such actors. Second, it is argued that with mobile capital, governments have little choice but to establish policies that meet the approval of financial markets.

Such arguments ignore the fact that the final equilibrium (nature of the institution) also depends on the supply side of the equation: how would institutions facilitating integration will be supplied? Will such institutions evolve spontaneously in a Hayekian fashion? Will they be constructed by conscious actions of various states? Do the states have the necessary political will and expertise to do so? Or, will they be constructed by MNEs, heralding an era of private governance in place of public institutions?

Perhaps institutions facilitating economic integration would reflect all of the three supply routes. States, markets, and firms are three categories of governance structures; markets and firms cannot operate without states’ support for defining and enforcing property rights, and states cannot permanently ignore the laws of demand and supply. Consider the recent debate on ISO 14000, a series of environmental management systems that have been proposed by Geneva-based International Organization for Standardization. ISO 14000 is often touted as a prime example of economic globalization, rise of MNEs, withering away of the state, and how MNEs are creating institutions outside the ambit of the state system.

ISO 14000 is indeed a private system for environmental governance. It consists of voluntary standards for how firms ought to construct and operate their internal environment management organizations. Importantly, it requires firms to have their environmental management systems certified by an accredited external body. Thus, a private actor (certifier) and not a state regulator is empowered to evaluate environmental systems of firms. However, this does this imply a withering away of the state for regulating environmental issues. Private regimes operate in the shadow of the state. For example, the reluctance of U.S.-based MNEs to have their facilities certified is attributed to the lukewarm attitude of the Environmental Protection Agency (EPA) towards ISO 14000. Hence, the credibility of private law (ISO 14000) is influenced by its acceptability by

regulators (the EPA). Furthermore, an important reason for many European and Asian MNEs to champion ISO 14000 is their desire to preempt states from enacting multiple and business-unfriendly environmental laws. Some observers suggest that ISO 14000's acceptability would be enhanced if the European Union requires it for firms to export to member countries. Hence, at another level, market access to the European Union is creating incentives for firms to first propose ISO 14000, and then to have its certification for their facilities. Clearly, the processes of globalization have unleashed forces that do increase the economic power of MNEs and create incentives for them to propose private regimes. However, states retain a significant degree of influence, and often the effectiveness of private regimes depends on the blessings of states.

An examination of the impact of globalization requires a careful study of its microfoundations. Policy scientists should not rush to judgment about the implications of existing levels or trends in cross-border integration. Such integration has multiple dimensions having varying implications for public policy. The declarations about the withering away of the state as well as its continued vibrancy need to be carefully examined. The crucial next step for a conceptually grounded debate is the development of common vocabulary to categorize various kinds of globalization and careful assessment of varying levels of economic globalization. This article has provided some ideas in this context.

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NOTES

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