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Rearticulation of the State in a Globalizing World Economy¹

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Introduction

In this Chapter we discuss the implications of globalization for the post World War II order based on 'embedded liberalism' – the marriage of free trade with domestic demand-side intervention.² We suggest that the increasingly oligopolistic nature of world markets, and the scramble among states for attracting and retaining high-technology industries, is creating incentives for state interventions in forms of strategic trade and investment policies (STIPs). STIPs enable countries to develop architectures of supply³ that are major pull-factors in attracting investment from multinational corporations (MNCs). Thus STIPs are an important element of state strategy to resist the de-nationalizing impact of globalization and to preserve the industrial base of the country.

However, a widespread use of STIPs undermines free trade, and at the domestic level, it refocuses allocations of state resources from demand-side social interventions to supply-side initiatives. For these reasons, STIPs undermine the postwar order based on embedded liberalism. Since the new order offers little except by way of trickle-down prosperity to the losers in globalizing economies, it is resisted by both the political left and the political right.⁴ There is a need to reconsider arguments for the whole-scale scrapping of demand-side interventions, hallmarks of the Keynesian welfare state, and to retain mechanisms or create new ones that offer losers from a globalization a stake in the well-being of the system. Such compromises have been a defining feature of modern capitalism.⁵

Globalization: financial integration, MNCs and technologized production

The Great Depression of the 1930s is often viewed as an important contributor to the rise of Fascism and to World War II. The post-war Bretton Woods institutions were created to prevent a repeat of the mistakes that led to the Great Depression. These institutions were predicated upon what Ruggie calls embedded liberalism. Globalization is viewed as undermining embedded liberalism.⁶ In this Chapter we focus on economic globalization, paying particular attention to evidence that important economic actors increasingly treat the globe, and not any particular country or region, as the unit of analysis for key economic decisions. We assume that promoters of economic globalization are primarily multinational corporations, although the actions of states to take advantage of or cope with globalization certainly affect the direction and rate of globalization processes.⁷ Economic globalization is not making the state irrelevant. Rather, we believe, it is creating conditions for its rearticulation, particularly with respect to influencing market processes. States are not capitulating to de-nationalizing processes of globalization; rather states are employing a variety of strategies to protect their domestic industrial base and national well-being. As Boyer and Drache observe, even though specific Keynesian policies may not be useful in a globalized economy, his larger vision that markets are not self-organizing and state interventions may be necessary to pursue national goals, remains valid.⁸

The three hallmarks of economic globalization are financial integration, an increased importance of MNCs in global economic activity, and the technologization of economic activity, that is, the increasing salience of high technology products in global trade and investment. Let us briefly examine data on these variables. Increasing levels of financial integration are evidenced in the following:⁹

- 1 The stock of international bank lending (cross-border lending plus domestic lending denominated in foreign currency) has increased from 4 per cent of the combined Gross National Product (GDP) of the OECD countries in 1980 to 44 per cent in 1990.
- 2 In 1992, the daily turnover of currency markets was around \$900 billion.
- 3 In 1994, the market capitalization of stock markets all over the world totaled about \$15 trillion, more than 2.5 times the Gross National Product of the USA, the world's largest national economy.

Indicators on the activity of MNCs are equally dramatic:

- 1 By 1995, the internationalization of production had reached unprecedented levels with foreign direct investment (FDI) stocks at \$2.6 trillion.
- 2 In 1992, the global sales of foreign affiliates of MNCs stood at \$5.2 trillion exceeding arm's length trade of \$3 trillion.
- 3 About one-third of the arm's length trade takes place on an intra-firm basis.¹⁰

Economic activity has also increasingly become technology-intensive and firms are allocating ever higher sums to research and development. High technology could be embodied in final products, intermediate products, or capital goods. Consider the following trends: (1) Between 1975 and 1990, the share of technologically-intensive industries in total FDI devoted to manufacturing increased from 27 per cent to 40 per cent;¹¹ (2) MNCs have significantly increased their spending on research and development. For example, the research and development expenditures of US-based MNCs (in constant 1987 dollars) grew by 43 per cent during 1982-91.¹²

In this Chapter we focus on implications of technologization of economic activity and the resulting incentives for states to use STIPs to develop domestic architectures of supply in critical technologies. By employing such policies, states attempt to maintain their domestic manufacturing base, high labour productivity levels, and the concomitant high standards of living of the domestic workforce. One could therefore interpret STIPs a policy response of states to resist the homogenizing and de-nationalizing pressure of economic globalization.

The performance of political leaders in advanced industrial countries is increasingly judged on the basis of economic indicators such as economic growth, unemployment, inflation rate, etc. To deliver on these indicators, policy-makers need to attract and retain capital investments. To do this successfully, they are required by globalized financial markets to control government expenditures and to reduce budgetary deficits so that public borrowing will not crowd out private investments in the capital market. Consequently, states are adopting two kinds of strategy. First, they are undertaking supply-side initiatives such as creating physical infrastructure, lowering transaction costs, protecting intellectual and other property rights, investing in human capital, etc.¹³ States may also indulge in beggar-thy-neighbour policies ('regulation arbitrage', as Cerny puts it),¹⁴ for example, by competitively lowering economic, social, and environmental

regulations.¹⁵ In addition, we suggest that states have incentives to employ STIPs to create and maintain domestic architectures of supply in critical technologies.

Along with undertaking supply-side initiatives, states are downsizing their demand-side interventions. The presumable reason is to rein in the fiscal crisis that has resulted from the expanded scope of welfare policies and the 'agency costs'¹⁶ of administering them.¹⁷ State interventions can be conceptualized as collective goods. Unlike Cerny, we do not consider all outputs of state interventions to be public goods.¹⁸ Public goods are a specific category of collective goods in that they are non-rival and non-excludable. Other collective goods such as common pool-resources and club/toll goods are associated with different category of governance issues.¹⁹ One can classify welfare support to individuals in distress as some sort of common-pool resource which is rival but non-excludable. Such common-pool resources are bound to be 'over-grazed', resulting in the degradation of the resource (fiscal crisis in this context). In contrast, since corporate welfare in the form of direct support for enterprises from the budget is often an excludable club-good or private good, its beneficiaries have incentives to organize themselves and safeguard their privileges. Though globalization is leading to a downsizing of corporate welfare for the state enterprises (as in Europe), there is little clamor for downsizing corporate welfare for private actors. This probably reflects the politics of globalization since its main champions are private corporations.

Globalized financial infrastructure and the increased economic power of the MNCs is perceived to have limited the efficacy of traditional economic interventions. The globalized financial infrastructure is marked by internationally mobile capital, especially short-term capital. International capital mobility makes it more difficult for domestic monetary authorities to control inflation by manipulating the money supply. When credit is tightened in order to stem inflation, foreign capital will flow in to take advantage of higher interest rates. When credit is loosened to promote economic growth and reduce unemployment, foreign capital will flow out. In theory at least, financial globalization takes away two degrees of freedom (the control over money supply and exchange rates) from the menu of policy instruments available to the state. As Tinbergen argued, the number of policy objectives can never exceed the number of policy instruments,²⁰ the state is presumably forced to shed some policy objectives just to grapple with internationally mobile capital.

We observe simply that it is tempting to deal with this problem by removing social safety nets because the beneficiaries of such programmes are actors who cannot 'vote with their feet'.²¹ The expanded cost and scope of supply-side interventions, particularly those justified in terms of theories of strategic trade and investment, crowd out demand-side interventions. In sum, globalization erodes the political support among financially powerful and mobile economic actors for Keynesian demand-side interventions and at the same time as it creates new demands for supply-side spending.

States vary in their willingness and capability to engage in supply-side interventions or to downsize demand-side interventions. Willingness and ability to intervene critically depends on the history of state-society relationships (Waltz's second image) as well as the state's place in the international system (the third image). For example, under the Structural Adjustment Programmes of the International Monetary Fund (IMF) and World Bank requiring domestic deflation, states have mixed success in reducing domestic absorption. Especially in democratic societies, states face considerable domestic opposition to downsizing welfare policies. It is difficult, however, to predict *a priori* which type of state-societal arrangement (corporatist, pluralist, statist, etc.) will best equip a country to cope with globalization. A number of scholars argue that there are different forms of capitalism and that only some forms are consistent with supply-side interventions.²² For example, the United States has rarely engaged in active supply-side interventions, partly because of the ideational and institutional grip of neo-classical economics, but also because of its key role in setting up the postwar multilateral system (based on Keynesian embedded liberalism). On the other hand, since both neoclassical and Keynesian ideas are less influential in Japan than in the United States, the Japanese government faces less political opposition to its supply-side interventionist role. In this paper we will not be able to analyse the various categories of state-society arrangements and their impact on a state's capacity to confront economic globalization. We also will not be able to analyse how a nation's position in the international system may impede or facilitate its willingness or ability to cope with economic globalization. Instead, we will focus on how globalization creates incentives for states to adopt STIPs and how a widespread adoption of STIPs can undermine the political and economic order based on embedded liberalism.

Strategic trade and investment policies

Trade policies are supposed to encourage or inhibit exports and imports. Tariffs and non-tariff barriers (of which there are hundreds of different kinds) are examples of trade policy instruments. Two questions that have been hotly debated since the time of Adam Smith are: should there be a trade policy at all and what kinds of trade policies can benefit a specific country?

Smith made a case for free trade based on absolute advantage. The Ricardian trade theory, also known as the classical trade theory, argued for free trade based on comparative and not absolute advantage.²³ The neoclassical trade theory, pioneered by Eli Hecksher and Bertil Ohlin, also identified comparative advantage as the basis of international trade.²⁴ The Hecksher-Ohlin (H-O) model assumes declining or constant returns to scale (growth of output can never grow faster than the growth of inputs), perfect competition in product and factor markets (there are many producers and few barriers to entry for new producers), and perfectly mobile technology. Since, in Smithian, Ricardian, and H-O models free trade benefits all the participants, states are advised not to have trade policies but should simply open their economies to free trade.

New Trade Theories or Strategic Trade Theories (STTs) relax the assumptions of the H-O model.²⁵ STTs assume imperfectly competitive markets and increasing returns to scale. They then deduce that domestic firms can benefit asymmetrically from international trade if the state intervenes on their behalf. By doing so, the state can shift the supernormal profits, and eventually jobs, associated with industries in imperfectly competitive markets from one country to another. Given the importance of economic issues on political agendas, states are tempted to adopt strategic trade policies that STTs suggest will do this.

Industrial policies, state intervention in domestic economy to promote critical industries, also have a long history of intellectual discourse – starting with the earliest defenses of infant-industry policies²⁶ and including the vigorous defense of import-substitution policies by Latin American economists like Raul Prebisch.²⁷ Industrial policies differ from macroeconomic policies in that they target only a subset of the economy. Whereas macroeconomic policies (such as tax rates, level of government spending, interest-rate policies, etc.) generally do not discriminate among types of firms or industries, industrial policies (such as R&D subsidies, tax subsidies,

preferential loans, preferential credit allocations, etc.) can be granted to some firms or industries and not others.

Industrial policy theories (IPTs) fall in three broad categories: technological trajectory theories,²⁸ structuralist theories,²⁹ and institutionalist theories.³⁰ Though these categories overlap, they provide different rationales for industrial policies.

The technological trajectory theories argue that technological flows across national boundaries are imperfect even when capital is highly mobile. State intervention may be needed to secure 'first-mover advantages'³¹ for domestic firms in high-technology industries for which initial investments are large, learning curves are steep, and architectures of supply are difficult to reproduce. In this case, it is extremely risky for firms to make the necessary investments without governmental support of some kind. However, if they fail to do so, the country loses the chance to earn revenues and generate employment in that particular industry for a reasonably long time. Such industries are often designated as 'strategic' for this reason and have a larger claim on governmental resources than other industries. It helps, of course, if they involve technologies which also have military applications. Examples in recent years would include the computer, semiconductor, and aerospace industries.

The structuralists argue that industrial policies are one way that non-hegemonic countries can challenge the power of the hegemon, primarily through free riding on the liberal trade and monetary institutions established by a hegemon by promoting exports of domestically-produced goods and capital to the rest of the world while protecting their domestic economies from international competition in the form of imports and capital inflows.

Institutionalist theorists focus on the historically-rooted differences in state-societal arrangements and their impact on competitiveness of domestic firms. Some institutional configurations systematically create barriers to imports and inward investments and thereby shelter domestic firms from international competition. For example, contrast the relatively open nature of the US system, marked by low government-industry collaboration, with the relatively closed Japanese system marked by significant business-government collaboration. Institutionalists argue that these differences create advantages for Japanese firms to compete in global markets.³²

In this Chapter, we focus on the technological trajectory version of industrial policy theorizing and link it to theories of strategic trade. As suggested earlier, we identify three distinguishing

characteristics of globalization – financial integration, increasing economic clout of MNCs, and the technologization of economic activity. To be globally competitive in high-technology products, firms must have adequate and timely access to related technologies (e.g. for materials, components, and manufacturing equipment). This can only be ensured by a well developed architecture-of-supply in those products and technologies. In high technology industries, it is very important for suppliers to be located near producers because suppliers and producers often must collaborate on designing both products and production processes. Even if the suppliers are not locally owned, they must have a local presence for this sort of collaboration to be practical.³³ According to Borrus and Hart, architectures of supply refers to:

[T]he structure of markets and of other organized interactions through which component, materials, and equipment technologies reach producers . . . Technology diffusion, like technology development, is a path-dependent process of learning in which today's ability to exploit technology grows out of yesterday's experience and practices . . . The speed and degree to which technical know-how flows across national boundaries thus depends crucially upon the character of local capabilities . . . In this context, 'effective access' exists when technological capabilities are available in the required amount and quality, in a timely fashion, and at a competitive cost.³⁴

A good example of this can be found in the relationship between semiconductor producers and the makers of tools used in semiconductor manufacturing – e.g. photolithography equipment, chemical vapour deposition devices, steppers, etc. It is often difficult for US semiconductor manufacturers to obtain access to state-of-the-art tools from Japanese equipment manufacturers because the main customers of the latter are in Japan and the tool-makers do not have sufficient resources to locate a subsidiary near their potential US customers. A similar problem exists currently for US liquid crystal display (LCD) firms, since most of the suppliers are currently in Japan servicing Japanese customers (even if they are not Japanese firms). The Japanese semiconductor industry faced the same problem when it tried to compete with the US industry in the 1960s and early 1970s. It succeeded only after it received fairly substantial assistance from the Japanese government during the mid and late 1970s to create its own set of suppliers.

This suggests that countries having appropriate architectures of supply will have an easier time than those without them in keeping domestic firms internationally competitive and in attracting inward investments by foreign multinational corporations interested in participating in the global market for a particular high technology product. An example of this would be IBM's decision in 1986 to work with Toshiba in a joint venture in Japan to manufacture active matrix LCDs. Similarly, Hewlett-Packard works with Canon in Japan via its Japanese subsidiary to manufacture engines for its laser printers. The technological trajectory version of industrial policy theorizing, in our view, best frames the challenge globalization poses to embedded liberalism.

Erosion of the distinction between trade and industrial policies

How are industrial policies related to trade policies? Trade and industrial policies overlap if promoting exports or restricting imports affects the international competitiveness of domestic firms. Economic globalization blurs the boundaries between domestic and international markets. Domestic firms can tap international markets either through exports, foreign direct investment,³⁵ or through international cooperative arrangements with foreign firms.

The essence of industrial policy – as supported by strategic trade and industrial policy theories, is to keep foreign competition at bay for a period of time while government subsidies combined with private sector investments can create an internationally competitive domestic industry and, by implication, a viable local architecture-of-supply. Keeping the foreign competition at bay may require a combination of import restrictions and restrictions on inflows of foreign investment, while at the same time encouraging foreign firms to share needed technologies at the lowest possible price.

So it is clear that at least one key component of industrial policy, especially as it has been practised in Asia, is trade policy in the form of FDI restrictions.³⁶ What are the implication of restricting inward FDI? First, at a general level, impediments to inward FDI are similar to tariffs in that they reduce the amount of competition that domestic firms face in servicing the domestic market.³⁷ Unlike tariffs, such impediments do not generate revenues for the state in the form of customs receipts, but like tariffs they generally increase the prices of goods that might have been imported or produced

locally by foreign investors in the absence of FDI restrictions.

Second, restrictions on inflows of FDI can be used to bar foreign supplier firms from participating in local architectures of supply. This is what happened, for example, after the Japanese government and semiconductor industry were successful in fostering the growth of a domestic semiconductor tool-making industry. It became much more difficult for US suppliers of lithography equipment, for example, to sell machines to Japanese semiconductor firms. It is important to note that often the technologically-advanced sectors are most vociferous in demanding such kinds of techno-nationalism.

Third, the combination of import and inward investment barriers encourages foreign firms to set up joint ventures or licensing arrangements with domestic firms as a last resort for getting some foothold in the domestic market. This tends to give domestic firms greater bargaining power to obtain access to needed foreign technology without paying exorbitant prices. This only occurs, it should be noted, if the combination of public and private resources actually creates an internationally competitive industry. Otherwise, foreign firms will not be so desperate to get a piece of the market by sharing or licensing technology.

Fourth, MNCs often invest in each other's home markets because they do not want their competitors to have safe-havens.³⁸ This is to deny competitors the opportunities to earn super-normal profits in their home market and use these profits to subsidize their operations in foreign markets. Japanese firms, in particular, are often accused of employing such dumping strategies. Such tit-for-tat strategies adopted by MNCs get impeded if there are impediments to FDI flows.

STIPs and embedded liberalism

Ruggie's notion of embedded liberalism links the rise of the Keynesian welfare state to an agreement among the major industrialized nations to keep the global trading system as open as possible. Keynesian states frequently employ two categories of demand-side interventions. First, are the social safety-net interventions, such as unemployment benefits, medical benefits, and old age pensions, to compensate the losers from free trade as well to provide for the vulnerable sections of society. Second, are the macroeconomic interventions to stabilize the economy. Of course, social safety nets also stabilize aggregate demand. Similarly, counter-cyclical policies also have a social

multiplier in addition to the economic multiplier. The Keynesian state is under attack for undertaking both these categories of interventions.

The logic of embedded liberalism depends on a broad social consensus on the value of preserving free trade. Maintaining this broad consensus on free trade was always somewhat problematic, but since end of the 1970s that task has become substantially more difficult. There are at least three ontological strategies of conceptualizing opposition to free trade. First, the Stolper–Samuelson theorem explains why foreign trade creates asymmetrical benefits across domestic factors of production: greater foreign trade tends to benefit the relatively abundant factor of production disproportionately.³⁹ Second, the Ricardo–Viner approach uses industries as the unit of analysis. It predicts that free trade will be opposed by import-competing industries.⁴⁰ Third, when preferences for free trade are observed at the firm level, it is suggested that domestic firms with substantial exports as well as MNCs having substantial intra-subsidary trade will favour free trade since any form of protectionism disrupts their established business arrangements.⁴¹

Free trade increases a country's exports as well as its imports. A country has comparative advantages in products which use its relatively abundant factor intensively. Since the relatively abundant factor is intensively used in exports, free trade increases its earnings. On the other hand, since the relatively scarce factor is intensively used in products which compete with the imports, its earnings fall. Then why should the scarce factor accept free trade? Clearly, some sort of side-payments to the scarce factor are required to make free-trade Hicks–Kaldor superior for all the factors of production.⁴² Similarly, sectors and firms hurt by free trade have incentives to oppose it and lobby for protectionism.

Keynesian social interventions therefore can be interpreted as side-payments to domestic actors hurt by the multilateral trade regime established at Bretton Woods. The popular perception is that imports into industrialized countries typically consist of low-technology products produced in low-wage countries which hurt the domestic sunset industries. Some sort of side-payments are therefore made to the constituencies dependent on such industries. Since the fiscal crisis confronting most of the industrialized countries is downsizing such side-payments, actors hurt by free trade are demanding protection from imports. Thus, globalization and free trade is being opposed by organized labour in sunset industries as well as other

constituencies which hitherto were beneficiaries of the embedded-liberalism compromise.

Social interventions may also be justified as tools of counter-cyclical demand management. Keynesians view such payments as built-in stabilizers – they reflate the economy during recessions and deflate it during booms. However, such side-payments have exhibited a kind of ratchet effect and have kept on increasing without regard to the willingness of taxpayers to be taxed further. As long as there is some faith in the efficacy of Keynesian demand-management policies to smooth out economic cycles, Keynesian free traders can justify social interventions on purely economic grounds. The assumption is that taxpayers will go along with changes in spending and tax levels that are designed to reduce economic cyclicality. As the Keynesian demand management becomes more difficult because of economic globalization, however, the advocates of counter cyclical macroeconomic and social policies find it more and more difficult to justify them politically.

We have argued that STIPs are attractive to cope with economic globalization, particularly the technologization of traded products. Because access to critical technologies has become one of the primary considerations for locating new investments by multinational corporations (see Porter (1990) and Dunning (1993)), robust architectures of supply are vital to international economic success. Firms with access to such architectures of supply are more likely to be able to develop and commercialize high technology products and to be 'first-movers' in global markets. Since first-movers earn super-normal profits, a substantial portion of which can be transferred to subsequent research and development to preserve first-mover advantages, countries with more such firms will be better able to create jobs and prosperity in the domestic economy. The resemblance with the Schumpeterian idea of monopoly profits financing the 'perennial gales of creative destruction' is not coincidental.⁴³

As the technologization of traded products proceeds, market imperfections (particularly the rise of giant firms capable of enjoying a monopoly or quasi-monopoly status) may be accentuated. Since technology development and commercialization is very expensive, markets cannot support a large number of players in high technology sectors. Hence, the technologized global markets will tend to be oligopolistic or monopolistic. The resulting growth in super-normal profits will create further incentives for state interventions leading

to a further undermining of the international regimes that were established under 'embedded liberalism'.

We have argued above that a separation of trade and industrial policy in international regimes has become increasingly difficult. The General Agreement on Tariffs and Trade (GATT), with its emphasis on reducing trade barriers, was useful when manufacturing industries dominated world trade. The compartmentalization of trade policy and industrial policies was also legitimate at that time. However, with the rising share of the service industries in world trade, the technologization of trade, and the growing subsidies and restrictions on foreign investment flows in high technology industries, the premises under which the GATT (now the World Trade Organization) operated have changed. The failure of the GATT to address investment issues along with trade issues has become, in the age of strategic trade and industrial policies, a major deficiency. The same can be said for the Bretton Woods regime's failures to adequately address trade in services, intellectual property protection, and R&D subsidies.

In sum, we see STIPs as challenging the order based on embedded liberalism on two grounds. At the domestic level, they crowd out demand-side social interventions. At the international level, STIPs undermine free trade. STIPs are attractive for two reasons. First, they help to create internationally competitive domestic firms with local architectures of supply, a key factor for attracting the investment of MNCs in a globalized world economy. Second, they become a bargaining chip to ensure that domestic firms are not discriminated against in foreign markets, especially in foreign markets where STIPs are already being used to discriminate against foreign firms. In this way, globalization is undermining the multilateralism that was based on the embedded-liberalism compromise by encouraging the wider adoption of STIPs.

Conclusions: coping with globalization; resisting de-nationalizing tendencies

STIPs can be viewed as policy instruments to harmonize national political economy to the demands of the globalized economy; as strategies of states to resist the de-nationalization tendencies of globalization by emphasizing the space coordinates of technology generation and diffusion. Though both STIPs and Keynesian economics recommend state interventions in the economy, they provide

different rationales and distinctive visions for them. STIPs are selective supply-side sectoral interventions to enhance the competitiveness of specific domestic industries by facilitating the emergence of local architectures of supply. Keynesian interventions are macroeconomic in focus and operate mainly from the demand side.

Economic globalization is increasingly marked by a high degree of technologization of traded products leading to market imperfections. Market imperfections create a potential for super-normal profits. STIPs are instruments to transfer such super-normal profits from foreign to domestic firms. Thus, it not surprising that in the US, technologically-intensive industries such as semiconductor, telecommunication, and aircraft manufacturing have been in the forefront of demanding some kind of technological policy to better equip them to safeguard their home turf as well as remain competitive in global markets.

In an increasingly globalized economy, there is a significant overlap between trade and industrial policies. Hence any interventions to enhance the competitiveness of domestic firms or to enhance the attraction of one's country for foreign capital can be subsumed under STIPs. To cope with globalization, states adopt supply-side interventions which tend to crowd-out previous demand-side interventions because of budgetary constraints.

However, the free trade and internationalization of production is causing massive domestic dislocation. As a result, a large constituency is emerging that is feeling threatened by the pace and extent of globalization. They link globalization with the shrinking of the welfare state and the various entitlement programmes. This constituency extends well beyond blue-collar labour; it includes important groups such as retirees who are numerically significant in rapidly aging populations across industrialized countries. This opposition creates electoral incentives for politicians to continue with demand-side interventions. Since globalization challenges embedded liberalism, it is also resisted by the constituencies which benefited from the embedded-liberalism compromise.

Further, the use of STIPs to gain national advantage has been criticized (mainly by economists) because of the problems inherent in measuring externalities, differentiating normal from super-normal profits, differentiating domestic from foreign firms in a globalizing world economy, and preventing public officials and/or private interest groups using STIPs for rent seeking. Even though these criticisms are quite reasonable, STIPs remain attractive for governments trying

to cope with the increasing technologization of traded products in an increasingly global world economy. The political power of the idea of emulating the success stories of Asia is difficult to resist. It is also clear that a widespread adoption of STIPs may lead to increasing allocative inefficiencies in the world economy, if not massive trade wars, by undermining the multilateral norms of the GATT/WTO and other postwar international economic regimes. Thus, the debate on STIPs provides a powerful stimulus to rethink how the institutions linking states and markets within and across countries may be restructured. Further, they challenge us to work through the implications of economic globalization and state policies to resist certain aspects. Globalization is clearly forcing a reorganization of existing politico-economic arrangements. However, states and societies still retain considerable leeway in resisting the de-nationalizing tendencies of globalization and protecting the domestic technological and industrial base.

Notes

- 1 This is a revised version of our article: 'The Decline of "Embedded Liberalism" and the Rearticulation of the Keynesian Welfare State', *New Political Economy*, Vol. 2, No. 1 (1997), pp. 65–78. We thank Barry Gills, Brenda Bushouse and Larry Schroeder for their comments.
- 2 John G. Ruggie, 'International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order', *International Organization*, Vol. 36 (1982), pp. 379–415.
- 3 Michael Borrus and Jeffrey A. Hart, 'Display's the Thing: The Real Stakes in the Conflict over High-Resolution Displays,' *Journal of Policy Analysis and Management*, Vol. 13 (1994), pp. 21–54.
- 4 Krugman argues that domestic economic problems cannot be attributed to international trade. This is disputed by many on both theoretical and empirical grounds. For a review of this debate, see *Foreign Affairs*, March/April (1994) for Krugman's piece: 'Competitiveness: A Dangerous Obsession,' and *Foreign Affairs*, July/August 1994, for rebuttals to it.
- 5 Peter J. Katzenstein, *Small States in World Markets* (Cornell University Press, 1985); and Jeffrey A. Hart, *Rival Capitalists* (Cornell University Press, 1992).
- 6 For a discussion on various notions of globalization and the implications of globalization on governance, see Aseem Prakash and Jeffrey A. Hart, 'Introduction', *Globalization and Governance* (forthcoming).
- 7 Philip G. Cerny, 'Globalization and the Changing Logic of Collective Action', *International Organization*, Vol. 49, No. 4 (1995), pp. 595–625.
- 8 Robert Boyer and Daniel Drache, 'Introduction', in Robert Boyer and Daniel Drache, *States Against Markets: The Limits of Globalization* (Routledge, 1996), pp. 1–30.
- 9 The data are from Robert Wade, 'Globalization and its Limits', in *National*

- Diversity and Global Capitalism*, ed. Suzanne Berger and Ronald Dore (Cornell University Press, 1996, 60–88); International Finance Corporation, *Emerging Stock Markets Factbook 1995* (International Finance Corporations, 1995); and Livingston Douglas, *The Bond Market* (Probus, 1995).
- 10 United Nations Conference on Trade and Development, *World Investment Report 1995* (United Nations).
 - 11 Sylvia Ostry and Richard R. Nelson, *Technonationalism and Techno-Globalism: Conflict and Cooperation* (Brookings Institution, 1995).
 - 12 United Nations Conference on Trade and Development, *World Investment Report 1995* (New York: United Nations). This report also notes MNCs account for nearly 75–80 per cent of civilian research and development expenditures.
 - 13 For example, the works of Michael E. Porter, *The Competitive Advantage of Nations* (Free Press, 1990); Robert Reich, *The Works of Nations* (Vintage, 1992); and John H. Dunning, *The Globalization of Business* (Routledge, 1993).
 - 14 *Op. cit.*
 - 15 Herman E. Daly, 'Problems with Free Trade: Neoclassical and Steady State Perspectives', in Durwood Zaekle, Paul Orbuch and Robert F. Housman (eds), *Trade and Environment: Law, Economics, and Public Policy* (Center for Study of International Environmental Law, 1993), pp. 147–57.
 - 16 Charles Wolf, Jr, 'A Theory of Non Market Failures', *Public Interest* (Spring, 1979), pp. 114–133.
 - 17 This is often operationalized as the budget deficit as a proportion of the GDP. For example, one of the eligibility conditions for joining the Euro is that the country's budget deficit must not exceed 3 per cent of its GNP.
 - 18 *Op. cit.*
 - 19 For an extended discussion see, Elinor Ostrom, Roy Gardner and James Walker, *Rules, Games and Common-Pool Resources* (University of Michigan Press, 1994).
 - 20 Jan Tinbergen, *On the Theory of Economic Policy*, 2nd edn (North Holland, 1966 [1952]).
 - 21 Charles M. Tiebout, 'A Pure Theory of Local Expenditures,' *Journal of Political Economy*, Vol. 64 (1956), pp. 416–24.
 - 22 Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* (Harvard University Press, 1962); Stephen D. Krasner, 'US Commercial and Monetary Policy: Unravelling the Paradox of External Strength and Internal Weakness', *International Organization*, Vol. 31 (1978), pp. 635–71; Peter J. Katzenstein, 'Conclusions', in Peter J. Katzenstein (ed.), *Between Power and Plenty* (University of Wisconsin Press, 1978), pp. 295–336; Philippe Schmitter, 'Still a Century of Corporatism', in Philippe Schmitter and Gerhard Lehbruch (eds) *Trends Towards Corporatist Intermediation* (California: Sage, 1979), pp. 7–52; Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford University Press, 1982); John Zysman, *Government, Markets, and Growth* (Cornell University Press, 1983); Peter A. Hall, *Governing the Economy* (Oxford University Press, 1986); Peter A. Hall, 'Conclusions: The Politics of Keynesian Ideas', in Peter A. Hall (ed.),

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 - 25 For examples of this work, see Barbara J. Spencer and James A. Brander, 'International R&D Rivalry and Industrial Strategy,' *Review of Economic Studies*, Vol. 50 (October, 1983), pp. 707–22; James A. Brander and Barbara J. Spencer, 'Export Subsidies and International Market Share Rivalry,' *Journal of International Economics* (February, 1985), pp. 85–100; Avinash Dixit, 'International Trade Policy for Oligopolistic Industries,' *Economic Journal*, Vol. 94, Supplement (1983), pp. 1–16; Elhanan Helpman, 'Increasing Returns, Imperfect Markets, and Trade Theory', in *Handbook of International Economics*, edited by Ronald W. Jones, Peter B. Kenen (Amsterdam: North Holland, 1984); Paul R. Krugman, 'Introduction: New Thinking About Trade Policy', in *Strategic Trade Policy and the New International Economics*, edited by Paul R. Krugman (MIT Press, 1986), pp. 1–22; Paul R. Krugman, 'The Myth of Asia's Miracle', *Foreign Affairs*, Vol. 73, No. 6 (1994), pp. 62–78; and Klaus Stegemann, 'Policy Rivalry among Industrial States: What Can We Learn from Models of Strategic Trade Policy?' *International Organization*, Vol. 43, No. 4 (1989), pp. 73–100.
 - 26 Some prominent eighteenth and nineteenth century nationalists such as Hamilton, List, and Schmoller argued for state support and temporary tariff protection for 'infant industries'. See *The Reports of Alexander Hamilton*, edited by Jacob E. Cooke (Harper & Row, 1964 [1791]); Friedrich List, 'Political and Cosmopolitan Economy', reprinted in *The National Systems of Political Economy* (Augustus M. Kelly, 1966 [1885]); and Gustav Schmoller, *The Mercantile System and its Historical Significance* (Peter Smith, 1931 [1895]). In spite of these challenges from the non-British nationalist thinkers, the minimalist view of the state inherent in Smithian economics retained dominance within political economy until the publication of *The General Theory* in 1936. See, John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (Harcourt, Brace & World, 1936).
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- 32 For a review of Japan's industrial policies, see Ronald Dore, *Structural Rigidities* (Stanford University Press, 1986); David Friedman, *The Misunderstood Miracle* (Cornell University Press, 1988); Daniel Okimoto, *MITI and the Japanese Miracle* (Stanford University Press, 1989); Chalmers Johnson, Laura D'Andrea Tyson and John Zysman (eds), *Politics and Productivity* (Ballinger, 1989); Ito Takatoshi, *The Japanese Economy* (MIT Press, 1992); Shigeto Tsuru, *Japanese Capitalism* (Cambridge University Press, 1993); and Kent Calder, *Strategic Capitalism* (Princeton University Press, 1993).
- 33 Boyer and Drache also note that 'The very process of internationalization reveals the persistence of national systems of innovation which are deeply embedded in a web of interrelated political, education and financial institutions which cannot be copied or adapted' (*op. cit.*, p. 14).
- 34 *Op. cit.*, pp. 22–3.
- 35 DeAnne Julius, *Global Companies and Public Policy: The Growing Challenge of Foreign Direct Investment* (Council on Foreign Relations Press, 1990); James R. Markusen, 'The Boundaries of Multinational Enterprises and the Theory of International Trade,' *Journal of Economic Perspectives*, Vol. 9 (1995), pp. 169–89.
- 36 This is not to say that the role of non-governmental arrangements, especially the *Keiretsu* in Japan, was trivial. This is the reason why the Structural Impediment Initiative talks between the US and Japan during 1989–90 focused on institutional obstacles, as opposed to specific government policies, to foreign economic activity in Japan.
- 37 However, the US government has not made active use of FDI restrictions to shield domestic firms. For a discussion on trade restrictions and their impact on inward FDI flows, see, Dennis J. Encarnation, *op. cit.*; and John B. Goodman, Debra Spar and David B. Yoffie, 'Foreign Direct Investment and the Demand for Protection in the United States,' *International Organization*, 50 (1996), pp. 565–91.
- 38 David Yoffie, 'Conclusions and Implications', in David Yoffie (ed.) *Beyond Free Trade: Firms, Governments, and Global Competition* (Harvard Business School Press, 1993), pp. 429–50.

- 39 W. F. Stolper and Paul A. Samuelson, 'Protection and Real Wages', *Review of Economic Studies* (1941); and Ronald Rogowski, *Commerce and Coalitions: How Trade Affects Domestic Political Alignments* (Princeton University Press, 1989).
- 40 This argument is associated with the works of scholars such as Magee and Frieden. See, Stephen Magee, 'Three Simple Tests of the Stolper-Samuelson Theorem', in Peter Oppenheimer, (ed.), *Issues in International Economics* (London: Oriel Press), pp. 138–53; and Jeffrey A. Frieden, 'Invested Interests: The Politics of National Economic Policies in a World of Global Finance', *International Organization*, Vol. 45, No. 4, autumn 1991, pp. 426–51.
- 41 Gerald K. Helleiner, 1977 'Transnational Enterprises and the New Political Economy of US Trade Policy', *Oxford Economic Papers*, Vol. 29 (1977), pp. 102–16; and Helen V. Milner, *Resisting Protectionism: Global Industries and the Politics of International Trade* (Princeton University Press, 1988).
- 42 A change is pareto superior if no actor is worse off in the new situation versus the status quo. However, if some actors lose and some others gain, then new situation is pareto non-comparable. If the aggregate gains of the winners exceed the aggregate loses of the losers (the net benefit is positive), then the change is Hicks-Kaldor superior in that the winners can potentially compensate the losers and still be left with a surplus.
- 43 Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* (George Allen & Unwin, 1976 [1943]).