Responding to globalization

A conclusion[1]

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Economic globalization – the increasing integration of factor, input and final product markets across countries, coupled with the increasing salience of the international value-chains created by multinational enterprises (MNEs) in international economic flows – is reshaping policy landscapes. Because of globalization, societal actors everywhere are faced with new opportunities and challenges. There are both "winners" and "losers." Everyone is trying to maximize the gains and minimize the losses associated with globalization. This volume examined the strategies of governments and firms undergoing four types of institutional transitions:

- From centrally planned to market-based economies (in China, Russia, Bulgaria, and Yugoslavia)
- From import-substituting to export-promoting development policies (in Latin America and Australia)
- From developmental to regulatory states (in Japan and South Korea)
- From country-level strategies to regional-level responses (in Latin America and Western Europe)

In the process of examining these four types of institutional transitions, the volume focuses on the role of ideas and interests, as articulated within given institutional and historical contexts. This chapter summarizes what we learned from preceding chapters and identifies questions for future research.

Globalization continues to unfold in a variety of ways. Though there has been a decided tendency towards greater MNE-led economic integration of the world economy in recent decades, the jury is still out regarding the reversibility of this trend. Further, since globalization accelerated after the end of the Cold War, with the sudden opening of the formerly Communist countries to world trade and investment flows, it is not yet clear whether it was globalization that accelerated the collapse of central planning or vice versa.[2] The collapse of the Soviet empire led to the emergence of new democratic political systems in Central Europe, whose economies were still in the process of making the transition from central planning to markets,

while also permitting suppressed inter-ethnic tensions in these formerly Communist countries to come to the fore. As Solnick (Chapter 7) and Crawford (Chapter 8) pointed out, the need to deal with the problems of nation-building has significantly constrained national governments of former Communist countries from responding effectively to globalization.

The Anglo-Saxon model of capitalism – the "regulatory state" – favors resource allocation through markets rather than central planning and frowns upon the making of industrial policies by state bureaucracies in alliance with *keiretsu*-like industrial groupings, which is referred to as the "developmental state" (Johnson, 1982). The regulatory state requires that contracts be negotiated and enforced at low costs. Common accounting standards and a well-established contract law that enables clear definition and enforcement of property rights are essential. At the macro-economic level, it also requires that governments minimize their intervention in the economic activity, deregulate, privatize, and reduce budgetary deficits.

In contrast with the regulatory state, the developmental state attempts to intervene in the market to improve the competitiveness of individual firms or industries that state bureaucrats think are vital to national security and the economic competitiveness of the nation. The developmental state, like the regulatory state, requires the rule of law and the protection of private property rights in business matters and works to reduce the costs of negotiating and enforcing contracts. But at the same time, the developmental state is much less likely than the regulatory state to require consistency and transparency in accounting methods. Because of the pro-manufacturing bias, it is considerably more prone to collusive and potentially predatory business practices, and to the use of bribery and other corrupt practices on the part of businesses to secure the cooperation of powerful state bureaucrats.

One of the most important lessons of the post-war era was that it was possible for the economies of industrialized countries with both regulatory and developmental states to grow at respectable rates while maintaining or enhancing their democratic political institutions. It was not clear, however, whether this would be possible in either the formerly Communist world or the developing countries. Based on the experience of the East Asian newly industrializing countries (NICs), authoritarian developmental states seemed more likely to achieve acceptable rates of economic growth in the rest of the Third World than democratic regulatory states (Haggard, 1990).[3] With this thought in mind, the leaders of the Chinese Communist Party agreed to abandon central planning (gradually) without dismantling China's authoritarian political structures, hoping thereby to benefit from the enormous dynamism of the East Asian regional economy.

Substantial progress was made toward political liberalization in East Asian countries like South Korea, Taiwan and Singapore by the mid-1990s; progress that was not likely to end with the crisis of 1997–98. But faith in the developmental state has declined as a result of the recent crisis, even in

bastions of developmentalism like South Korea. Now countries in every region of the world are trying to decide whether to adopt the regulatory or the developmental model of capitalism in the face of increasing globalization. Most of the former centrally planned economies (China being a notable exception) have emulated the Anglo-Saxon model. However, the implementation of necessary institutional changes has been spotty and its success is by no means guaranteed. Foreign Direct Investment (FDI) has flowed freely into the new China, but not into Russia and Eastern Europe, suggesting that foreign investors are more interested in political stability and the potential for growth than in political liberalization *per se*.

State shrinking, social bargains and domestic peace

Economic growth requires domestic peace. Governments often serve as guarantors of domestic social bargains that bring about such peace. Such bargains could be between agriculture and manufacturing (the policy of "protection all around" in Australia), among different ethnic groups (as in the former Yugoslavia and Bulgaria), or between labor and capital (as in South Korea and Japan). "Soft" and "hard" states have different strategies available to them to ensure domestic stability.[4] One way to ensure peace is to use coercion. The suppression or cooptation of dissident groups is always an option, but either may sometimes be too expensive. Social bargains that do not require either coercion or cooptation of large disaffected populations are generally preferred. Governments, therefore, have incentives to broker, construct and enforce compacts among competing groups.

These bargains are of many kinds: corporatist bargains in pluralistic institutional frameworks (Shonfield, 1965; Katzenstein, 1985); paternalistic bargains in quasi-pluralistic systems such as Korea and Japan; party-imposed bargains in authoritarian systems. Many bargains involve side-payments or resource transfers by the government to groups disenfranchised in the political or economic processes. As Crawford described in Chapter 8, governments in Bulgaria and the former Yugoslavia were quite successful in imposing social bargains among different ethnic groups, thereby securing domestic peace. The Bulgarian government provided price supports for tobacco, a major cash crop cultivated by the Turkish minority. Due to the pressures of globalization, and the consequent cutting of government budgets, such programs were withdrawn. As the domestic bargain unraveled, the economic hardships of the ethnic Turks were exploited by "ethnic entrepreneurs" who began to call their situation "ethnic genocide." Thus, the shrinking of the state as a policy response to globalization can create domestic unrest by enfeebling the main guarantor – the government – of domestic bargains. Why are some bargains more vulnerable to governmental downsizing than others? How do domestic politics and international pressures affect which bargains will be abandoned and which will survive? These are questions for further research.

Crawford suggests that international aid agencies could protect some social bargains by displaying more sensitivity towards human rights and other societal issues. External powers, superpowers or international organizations, could also help to guarantee domestic social bargains. For example, the United States served as the guarantor of the Dayton Accord on Bosnia. The role and obligations of the guarantor and the credibility of its commitments could vary. If an international organization like the United Nations is the guarantor, there are additional issues of organizing collective action and overcoming bureaucratic dysfunctionalities for forceful and prompt enforcement.

Solnick argued in Chapter 7 that although international actors may become more important in enforcing social bargains, they cannot provide all the necessary public goods that governments provide to citizens. Key public services in Russia were provided at the workplace. With the state-managed enterprises in dire straits and privatization largely unsuccessful, many Russian citizens do not have access to such basic services as healthcare. Undermining the political authority of the government in one sphere often spills over into other spheres. State shrinking as a response to globalization therefore calls out for careful scrutiny, especially when it undermines the basic structures ensuring social peace and stability.[5]

Attracting MNEs

Globalization differs from previous phases of economic integration in terms of key role of MNEs in allocating resources across their cross-border value-chains. In this context, the challenges for governments are both generic and idiosyncratic. Maintaining social peace and making the country more attractive as an investment destination are obvious generic challenges.[6] Ignoring MNEs implies losing opportunities for acquiring capital and technology, exporting goods, and expanding the tax base. Governments try to attract MNEs in various ways. In portraying their country as an ideal location for global businesses, they try to emphasize resources that are cheap and plentiful. It is not unusual to see advertisements for countries in business newspapers and magazines that stress abundant natural resources, new infrastructure, vibrant capital markets, and inexpensive but high quality workers. Much of this is hype, but each country has to find out for itself what attracts the attention of potential foreign investors and what claims are credible to them.

It is incorrectly believed that governments always dilute their labor, environmental, and health and safety laws to attract foreign investors, which result in so-called "races to the bottom" (Spar and Yoffie, 2000). Such considerations were perhaps important when MNEs invested primarily in extractive or labor-intensive industries. Now, MNEs increasingly focus on high-technology sectors because this is where their

"ownership-based" (Dunning, 1993) advantages lie. Not surprisingly, more that 60 percent of FDI now flows between industrialized countries with comparable levels of labor and environmental laws (UNCTAD, 1997). Since the "traditional" advantages of countries (cheap labor, poorly enforced environmental laws, etc.) are not always highly valued by MNEs, a generic challenge for governments is to devise effective policies to attract this new form of knowledge- and technology-intensive FDI.

The ability of governments to attract new FDI flows will vary across countries and across industries. For example, although both China and Russia have huge untapped markets that MNEs covet, the former is the favored destination for FDI. An explanation offered by the United Nations Commission on Trade and Development (UNCTAD) is that MNEs are attracted to countries with well-functioning market systems, transparent policy-making, and policy stability (UNCTAD, 1996). Since Russia has none of these attributes, it remains unattractive for MNEs. Though China has had stable policies, as Yang and Su described in Chapter 1, its policy-making processes are certainly not transparent, but MNEs are still attracted. There are also other reasons to believe that firms may actually desire direct government interventions – the literature on business "capture" of regulators is well established (Bernstein, 1955; Kolko, 1963; Stigler, 1971). The recent antitrust cases in the United States, especially the case against Microsoft, also suggest that firms (e.g. competitors of Microsoft) eagerly embrace governmental intervention when it benefits them directly.

A more glaring example of opaque decision-making that benefitted MNEs is Indonesia prior to the 1997 meltdown. Indonesia was the second-most popular FDI destination among developing countries during this period. In 1996, it attracted almost $8 billion of FDI (UNCTAD, 1997). MNEs greatly profited from the privileged access to policymakers in Indonesia. Crony capitalism, now a favorite whipping boy of reformers, constituted an institutional device for reducing the transaction costs associated with managing host–MNE relationships.[7] Thus, one of the important lessons we learned from Chapter 1 is that MNEs may not always desire transparent policy-making.

However, Russia also seems to be experiencing crony capitalism but has not attracted significant FDI. As Solnick described in Chapter 7, Russia tried to impose a market economy on a non-market society in a fractured political space. Two salient features of Russia's transition were the overly rapid selling off of state enterprises to MNEs and reckless levels of external borrowing. The "reformers" portrayed privatizing state enterprises and acquiring foreign debt as a quick and effective means of injecting new capital and managerial and technical know-how into the Russian economy. Because many state enterprises were sold to private investors at bargain-basement prices, there was a nationalist backlash. This contrasts directly with the Chinese government's cautious supervision of the privatization

process and its reluctance to sell off state enterprises in sectors such as telecommunications and energy to foreign investors.

Clearly, domestic political constraints in Russia, coupled with the inept leadership of Boris Yeltsin, led to ineffective policy responses. To gain the support of the subnational constituencies, Yeltsin rapidly dismantled the economic and political power of the federal government. The state shrank just at the time when Russia needed the state to create confidence in newly adopted market institutions. Some observers refer to what happened as "spontaneous privatization" (Boycko, Shleifer and Vishny, 1995). By rapidly shrinking the state, Yeltsin made it impossible for his government to sustain the original coalition that supported domestic economic reforms and the leaders that followed Yeltsin were likely to abandon some of the earlier reforms. It is not surprising, therefore, that foreign investors preferred China to Russia as a site for new investments. Both systems lacked transparency, but the Chinese market and political environment appeared to be more stable and predictable. Thus, additional lessons learned from this volume are that: (1) governments should not let themselves be used as pawns in global interfirm warfare; (2) policymakers need to carefully scrutinize claims that everyone wins or loses when foreign investment flows into a country (a case-by-case approach is preferable); and (3) governments need to retain policy autonomy to maximize the benefits of FDI flows and to safeguard the interests of non-business societal actors even in the thinnest of regulatory states.

The end of the developmental state?

In the early stages of development, economic growth depends on resource mobilization – the intensive use of resources (Krugman, 1995). China is still at this stage. Different challenges emerge as countries enter the next phase of development in which growth in total factor productivity (TFP) is required. Korea, Japan and Australia, are at this stage. TFP growth requires structural changes in the domestic economy. Achieving internationally competitive high-volume production of industrial goods and consumer durables requires a new set of supportive practices and institutions. It is possible to catch up with the industrialized countries if the resources of the state are combined with those of large private enterprises to reduce the risk of introducing new technologies, transfer the necessary knowledge and skills to the workforce, and maintain social peace during the difficult transition from earlier institutional arrangements.

The South Korean and Japanese developmental states were successful in fostering the growth of internationally competitive businesses in many important industries, including high-tech electronics, until the beginning of the 1990s. Then they began to stumble. In the last two years, domestic political actors in the two countries began to seriously propose reforming the system to deal with the following developments: (1) the weakness of domestic

financial institutions in the face of a sharp increase in non-performing loans; (2) overcapacity in mainstay industries like shipbuilding, textiles, steel, autos, and semiconductors (especially DRAMs), (3) the relative uncompetitiveness of the larger firms in new markets for software and Internet-related products and services, and (4) the tendency of large US and European MNEs to establish international alliances with smaller Asian countries to compete with Japan and South Korea in manufacturing industries.

Chung-In Moon suggested in Chapter 2 that Korea was unable to undergo a transformation toward a regulatory state quickly enough to effectively respond to globalization. Marie Anchordoguy reached a similar conclusion in her examination of the Japanese software industry in Chapter 3. Though Australia scaled back "protection all around" and liberalized, fiscal and current account deficits grew rapidly. As John Ravenhill noted in Chapter 4, the electorate was unwilling to live with further liberalization that lead to structural changes. With the social bargain weakening due to the dilution in "protection all around," there was a growing support for extremist, anti-immigrant, and anti-trade liberalization sentiment. Domestic interest groups favoring changes in markets and corporate governance were not sufficiently mobilized, organized, or powerful in those countries. International pressures can empower such groups only up to a point. As the continuing stalemate in the three countries suggests, domestic politics becomes a key variable in shaping the nature, pace and sequencing of responses to globalization.

The recent reforms in South Korea indicate that governments can still force significant changes in their domestic economies. The Korean economy is dominated by *chaebols* whose close alliance with politicians and bureaucrats brought them easy access to cheap bank credit and a protected home market. The recent crises generated demands that the Korean government restructure the *chaebols*, and it is doing so through forced divestitures, mergers and asset swaps, and even closures of firms. The objectives are to reduce excess capacity and to force the *chaebols* to focus on core activities where they can be competitive internationally. Further, President Kim Dae Jung – who represents the political interests of small and medium industries, the mid and western region of the country, and the workers – took over in 1998. The previous ruling coalition represented the *chaebols*, the eastern region, and conservative forces. President Kim Dae Jung would obviously like to reduce the power of the constituencies that oppose him.

Many *chaebols* oppose President Kim Dae Jung's policies. The government has threatened that banks, several of them now nationalized, will cut off funding to *chaebols* unless the restructuring goes through. The threat is credible because historically the government has employed its control over credit to channel investment into critical areas. The restructured automobile industry now has two players (previously five); Hyundai alone holding 64 percent of the market. Daewoo, the other remaining player, has

swapped its electronic business with Samsung's automobile business. Consequently, Samsung now holds 60 percent of the domestic consumer electronic market and internationally it controls the production of 30 percent of microwave ovens, 18 percent of videocassette recorders and 10 percent of televisions (*Wall Street Journal*, 1998a).[8] It is therefore clear that the Korean government retains the abilities, and has the political incentives, to reconfigure market and corporate governance at the macro level and business strategy at the micro level. Though it does not directly manage firms, it does play the role of an "orchestrator of resources" (Stopford, 1997).

Domestic politics remains important

Globalization processes by themselves cannot solve domestic problems, structural or institutional. They can create "demands" for policy changes but cannot fully supply them. Domestic institutions can also block the signals from the international system, thereby moderating the perceived demands for change (Evangelista, 1996). The "supply" is critically dependent on domestic politics, the incentives for governments to act, and their abilities to do so. The latter is influenced by the character of the state–societal relationships, and their abilities to rally a winning coalition.

In the early 1990s, South Korea partially deregulated the domestic economy ostensibly for responding to globalization. In reality, the commitment to domestic reforms was superficial: the globalization platform merely replaced the previously popular democratization platform. Haphazard and incomplete globalization sowed the seeds of the current crisis. Due to easier access to foreign funds, Korean banks and manufacturing firms accumulated short-term debt, unhedged. The government failed to supervise the debt binge; when the crisis struck, it could not even quantify the level of country's indebtedness. The use of globalization as a political slogan, and embracing market processes without an institutional framework to govern them, proved disastrous.

Why did the Korean political economy not permit such changes? Perhaps Korea was entrenched in protectionism. It was difficult to discard the *chaebol*-based system that propelled it to impressive prosperity. Success was its own enemy. It required enormous foresight and political will to abandon the developmental state in favor of untried institutions. Future research could examine why the Schumpeterian gales succeed in creatively destroying only in some cases. How can "creative destruction" be differentiated from destructive destruction, *ex ante*? Or, should this be left to be determined by the market, *ex post*? Do markets differentiate creative destruction from destructive destruction? If market processes succeed best in democracies, how can democracies resist populist pressures to avoid creative destruction? Governments, therefore, need to carefully select aspects of globalization processes that they wish to adopt for the domestic

economy. Changes should be ushered only when institutional structures are in place.[9]

From country-level to regional-level responses to globalization

Globalization processes are undoubtedly redefining the essence and the purpose of national boundaries and the roles of governments. This volume suggests that governments continue to play a major role in shaping countries' responses to globalization but differ in their abilities to choose policy instruments, their sequencing, and the pace of implementation. Governmental responses show significant variations: partially or completely withdrawing from direct (privatizing government-owned firms) or indirect (downsizing welfare) participation in economic activity; outsourcing the production of public services (for example, privatizing prisons); deregulating or liberalizing but retaining regulatory and rule-making powers; transferring decision-making and regulatory powers to supranational or subnational authorities where national governments only indirectly play a role (creation of regional blocs such as the NAFTA).

Fratianni (Chapter 5) argued that the euro signifies a transfer of sovereignty: eleven countries of the European Monetary Union (EMU) have voluntarily ceded control over an important arena of state sovereignty – the power to issue currency. The euro is predicted to enable them to better face the challenges of globalization by catalyzing structural changes in the systems of industrial organization. With only one currency, European companies will not be able to hide their substandard performance behind national currencies. Since cross-border acquisitions within the euro zone will no longer be subjected to currency risk, such firms may be more vulnerable to being taken over and, as a result, managers will focus on maximizing shareholder value. This could redefine the relationship between labor, capital and other stakeholders of firms. The European system of industrial organization may then adopt some aspects of Anglo-Saxon capitalism.

Of course, the euro project has political dimensions as well. Externally, an economically integrated Europe (the euro being one dimension of it) is a stronger political actor in world affairs, and internally it binds Germany closer to its European neighbors. Both of these serve political and security objectives of national governments: giving up sovereignty in one issue area could have payoffs in others. The euro project clearly illustrates that governments matter, even when they are strategically retreating from some areas.

International system and policy responses

The 1990s are different from the previous decades since the end of World War II, not just in witnessing the end of central planning but also in

experiencing a major increase in flows of short-term capital. Increased flows of short-term capital to the Third World and the formerly Communist countries are a mixed blessing. On the one hand, these capital flows can add to the overall level of investment and thus can contribute positively to economic growth. On the other hand, nervous investors holding short-term assets are prone to extract their funds when anything appears to be going wrong. Long-term investors, in contrast, will liquidate their investments only when economic crises are deep and prolonged.

The fluctuations in the international economy in the 1990s connected with the growing importance of short-term capital flows have created some ironic situations. The Peso Crisis in Mexico in 1994 posed major problems for the international system and particularly for the United States. The devaluation of the peso caused short-term investors to extract a great deal of capital from Mexico and from several other countries in Latin America. The United States had to assemble a very expensive bailout package to prevent political and economic chaos in Mexico. The Asian Crisis of 1997 left South Korea and several other East Asian countries nearly bankrupt, while promoting China (à much poorer country) to the role of regional stabilizer.

There remains a high degree of interdependence among the major industrialized economies even though the fragility and volatility of the global economic system is increasing. In this unstable environment, international organizations, especially the IMF, have become more important than ever before in shaping country-level policies.[10] In his testimony to the US House of Representatives on the world financial crisis, Alan Greenspan noted:

> This *burgeoning global system* has been demonstrated to be a highly efficient structure that has significantly facilitated cross-border trade in goods and services and, accordingly has made substantial contributions to standards of living worldwide. Its efficiency exposes and punishes underlying economic weaknesses swiftly and decisively. Regrettably, it also appears to have *facilitated the transmission of financial disturbances far more effectively than ever before.*
>
> As I testified before this committee three years ago, the then emerging *Mexican crisis was the first such episode* associated with our new high-tech international financial system. *The current Asian crisis is the second.* . . . Once the web of confidence which supports the financial system is breached, *it is difficult to restore quickly.* . . . Moreover, investor concerns that weaknesses revealed in one economy may be present in others that are similarly situated means that the *loss of confidence can quickly spread to other countries.* . . . At one point the economic system appears stable, the next it behaves as though a dam has reached a breaking point and water (read confidence) evacuates its reservoir. . . . *The abrupt onset of such implosions suggests the possibility that there is a marked dividing line for confidence.* When crossed, prices slip into free fall

> – perhaps overshooting the long-term equilibrium – before markets will stabilize.
>
> (1998: 1–4; emphasis added)

How does the international system empower or enfeeble government in responding to globalization? Korea makes an interesting study. The waning of the Cold War in the 1980s and the burgeoning trade deficit led the United States to pressure Korea for trade and FDI liberalization. Not surprisingly, the *chaebols*, the beneficiaries of the protectionist system, opposed it. However, South Korea wanted OECD membership and liberalization was required for it. Due to the pressures from the *chaebols*, financial and trade liberalization preceded FDI liberalization – FDI liberalization threatened them on their home turf while financial liberalization gave them resources to build manufacturing capacities. Easy access to foreign funds created highly leveraged (high ratio of debt to equity) banks and manufacturing firms.

The recession in Japan and the lackluster economic growth in Europe made international fund-managers keen to invest. But debt eventually has to be paid back. The short-term debt, unhedged, was either diverted to real estate (that does not earn foreign exchange) or to industries with global excess capacities (hence low potential for generating export earnings). Thus, some fundamentals of the Korean system were weak. Thailand was first to crumble in July 1997. The bhat's depreciation threatened the competitiveness of its neighbors, especially Korea and Indonesia. The speculators reasoned that neighboring countries with similar fundamentals would soon be forced to depreciate. The run on various currencies began, forcing their depreciation.

Why did the international system not force the yen's depreciation or a free fall of the Japanese economy? For one, Japan has had a consistent trade surplus since the 1980s. Second, Japan does not compete with most Asian countries (Korea and Taiwan being exceptions) because it has moved up in the value-chain. The wave of currency depreciation in East Asia did not make its imports uncompetitive. They did impact Japan, however, by shrinking the market for its exports to East Asia. Further, since Japanese banks were major lenders to these countries, the crisis further undermined the financial health of the Japanese financial sector.

Japan was more successful than Korea in resisting US pressures to open up the domestic economy for trade and investment for may reasons. Unlike Korea, its economy is more at par with the US economy. It was a major investor in US treasury bills that financed the budgetary deficits of pre-Clinton days. It is relatively less dependent than Korea on the US for its national security. It was also the major engine of growth in East Asia, an import economic and military region for the US. The US could, therefore, not dictate the pace of liberalization to Japan to the extent it could do for Korea.

China did not competitively devalue its currency, the *renminbi*, although its exports competed with those of its Asian neighbors. How did the international system empower China to achieve this glory? China has many advantages over Korea in determining the pace of economic liberalization. It is a large market coveted by US firms. Due to significant FDI inflows of US MNEs such as Boeing and Motorola, it influences US domestic political processes (see the debates on the renewal of the Most Favored Nation status). Militarily, it significantly impacts US interests in East Asia (especially North Korea and Taiwan), Iran (missile sales), and the Middle East. Thus, the US is not able to force its vision of globalization onto China. Also, China does not have full convertibility on its capital account. This, coupled with its substantial foreign exchange reserve, empowered it to assume the role of a stabilizer.

Australia also retains a degree of autonomy in shaping its policy responses since it is already an OECD country and not dependent on the US for exporting its products. Further, though it has a military alliance with the United States, and is protected by its nuclear umbrella, it faces no imminent military threats that would require US intervention on its behalf.

International organizations such as the IMF are increasingly establishing parameters (sometimes dictating specific policies as well) within which governments decide on policy responses. The role of international credit agencies, for-profit firms providing evaluations on the financial health of firms and countries, has also come under scrutiny, especially their role as the "eyes and ears of financial capital." Moon, for example, blames them on two counts: first, for failing to give warnings about the precarious financial health of the Korean banks and firms, and then for aggressively downgrading credit ratings after the start of the crisis. The market overaction and panic that resulted was out of proportion to the fundamentals. Moon attributes at least some of this overreaction to the raters' precipitous actions.[11]

A country's vulnerability to credit ratings is a function of many variables including the level and character of its external debt, especially the short-term debt. An important area of future research, therefore, would be to examine how such rating agencies can be made more accountable and to whom. International rating business is not perfectly competitive where the bad raters are punished by "consumers." If raters incorrectly rate financial instruments of a country or firm causing them significant financial loses, the "victims" cannot sue and recover damages. The new architecture of international financial governance must have mechanisms to ensure the accountability of credit rating firms. This means, for example, that international financial institutions may have to provide their own independent ratings services as a check on the arbitrariness of the private raters.

Ideas and norms

Market-based economies succeed only if transaction costs of securing property rights are low. Transaction costs are the costs of negotiating, monitoring, and enforcing contracts (Eggertsson, 1990; North, 1990). Transparent, simple and clearly laid out laws, however, cannot provide guidance for every contingency. Contracts therefore need to specify rights to residual control, that is control over contingencies that have not been written into contracts. Williamson (1985) argues that market failures due to unforseen contingencies, coupled with "asset-specificity" and opportunism, can be dealt with by vesting residual control with hierarchical superiors.[12] However, as Williamson's critics point out, this only replaces market failures with hierarchical failure (Miller, 1992). Dealing with uncertain contingencies requires that managers be vested with the residual power, but giving them such power could lead to hierarchical abuse. Thus, norms create a climate of trust that ensures that creating mechanisms that bestow authority and at the same time check its abuse, do not make transactions unviable.

This discussion suggests that markets are not impersonal arenas where anonymous actors transact. Markets are social institutions and the role of widely shared and legitimate norms is crucial in the evolution of rules of governance. Market economies, therefore, require sets of norms to reinforce and supplement formal rules.[13] Since norms cannot arise and gather legitimacy overnight, policymakers should not assume that well-functioning markets can be created merely by the decree of the IMF or any other international institution.

Ideas and norms impact how policymakers respond to globalization in three ways (Goldstein and Keohane, 1993). As "world views," they suggest economic and political models to policymakers for understanding the etiologies and implications of globalization and for thinking about generic responses to them. Many think the Anglo-Saxon model of capitalism (or the regulatory state) is the way to go, while others defend import substitution or the developmental state as models. Second, as "principled beliefs," ideas provide normative underpinnings to response strategies. For example, are the societal objectives of efficiency and economic growth that are prioritized in the Anglo-Saxon model of capitalism desirable? Or, are the societal objectives of developmentalism – a bias towards international competitiveness in manufacturing, cooperation between government and industry, and the subordination of consumer interests to the interests of "catching up" – superior to those of the regulatory state? Finally, as "causal beliefs," ideas explain why specific features of globalization are posing challenges, and the expected outcomes if certain policies were to be adopted to deal with them. For example, the Anglo-Saxon model requires flexible labor markets. Thus, ideas about labor market flexibility must inform policymakers how and why it will impact economic growth and wage rates, thereby influencing strategies to respond to globalization.

Often there are multiple ideas about the efficacy of a given response strategy and about the desirability of its societal goals. How do policymakers choose from competing ideas? Do ideas impact policy only if they are championed by influential actors? If so, are ideas epiphenomenal? This volume suggests that neither ideas nor interests are epiphenomenal. Ideas about responding to globalization influence preferences of actors on policy alternatives, and vice versa. Thus, ideas and interests together shape responses to globalization (Goldstein and Keohane, 1993).

Though the acceleration of MNE-led market integration – globalization – predates the ending of the Cold War, globalization processes began receiving serious scrutiny only in the 1990s. Predictions about the arrival of the so-called "new world order," where economic issues take precedence over security issues, focused attention on the causes and the implications of economic integration. It should not be forgotten that in the 1980s, many scholars were writing epitaphs for Anglo-Saxon capitalism and proclaiming the virtues of Japanese "alliance-capitalism" (developmental state). Thus, popularity of various "world views" fluctuates. We are not suggesting that there is a "flavor of the decade" and we can expect a new version of capitalism to be on the ascendancy in the next decade. We only advise caution about jumping to conclusions quickly about the "end of history" (Fukuyama, 1992) regarding competing "world views" on market and corporate governance, even in a world devoid of central planning. It is much more likely that the debates on how to organize capitalist systems will continue and will shape the next generation of international economic institutions (Berger and Dore, 1996).

Like products, ideas have a life-cycle. New ideas, or repackaged old ideas, focus attention on pressing problems and force policymakers to confront them. New ideas may also arise to solve both existing problems or new problems. As we approach the end of the1990s, with the buoyant US economy, the crisis in East Asia and Japan, and the discrediting of centralized planning, the Anglo-Saxon version of capitalism and the regulatory state that is consistent with it are more popular today than they were prior to 1989. Not surprisingly, as the various chapters suggest, policymakers are attempting to create the correct conditions for the effective functioning of this type of capitalism. However, as the Australian experience demonstrates, the regulatory state cannot solve many of the economic problems created by the jettisoning of import substitution and is being discredited in that country (and possibly elsewhere). The Russian experience suggests that it is difficult to dismantle a system based on central planning and replace it with a regulatory state in societies that are accustomed to highly centralized forms of economic and political organization.

Identity and policy responses

Perceptions about and responses to globalization are also significantly

impacted by shared notions about identities. Though identities shape responses, they are in turn also influenced by them. Moon suggested that the South Korean identity reflects xenophobia and paranoia, both of which can be attributed to its proximity to two big powers – China and Japan. In part, Korea's protectionist developmental state model was predicated on the national desire to be self-reliant. The jettisoning of this model is, therefore, meeting with internal resistance. Crawford discussed the role of "identity politics" in shaping the Bulgarian and Yugoslav perceptions about globalization and responses to it.

The euro exemplifies the impact of identity politics on policies.[14] As Fratianni argued, it is a regional Western European response to currency globalization. The euro project has been made possible by a number of steps taken since World War II to foster a European identity by integrating Western European economies. The euro is a political project as well:

> Finland is a clear example of what the euro is really about: politics. Germans will rhapsodize about the benefits of economic harmonization, but former Chancellor Helmut Kohl pushed for the euro in the sincere belief that it was the way to avoid another war with France. In France, the euro is seen as a way to get a bigger voice on the world stage. For Ireland, the new currency gets it out from Britain's shadow. When Italy was threatened with exclusion from the initial wave of countries participating in the euro, it used a political argument to get in: "Europe without Italy is not Europe," Italian Prime minister Romano Prodi said.
>
> (*Wall Street Journal*, 1998a: A1)

The euro experiment is noteworthy because it tests the efficacy of regional response where national governments willingly surrender an important aspect of state sovereignty: control over currency. Since a common currency without a political union has not been successfully tried before, the EMU members have taken a significant risk. These risks stem from the insufficient economic integration of euro countries among themselves. Due to different structural compositions of the national economies, at any point in time they could experience different phases of the economic cycle and asymmetric external shocks (that is a function of the level and nature of their integration with the non-euro economies).[15] With monetary policymakers located in Frankfurt, national governments will not be able to employ monetary policy to pursue domestic objectives. For example, for Finland, the euro-zone accounts for only one-third of its exports. Unlike France and Germany, where manufacturing and high-technology industries dominate the economy, Finland relies on the primary sector, forestry alone accounting for 40 percent of its exports. Thus Finland's structural constraints differ from the euro partners'. Yet, it enthusiastically embraces the euro due to political reasons and its need to identify with Europe, and not

Russia which has traditionally dominated it. The euro is a fascinating institutional innovation to collectively respond to globalization. An important area of research is to what extent the euro contributes to the evolution of a European identity, and whether such an identity impacts the competitiveness of European companies in the world markets. As Robles argued in Chapter 6, an evolution of a "regiocentric" mind-set among the managers of Latin America firms could give them competitive advantage versus the MNEs that cannot fully appreciate the idiosyncratic demands of the market. It remains to be seen if such an argument holds in the European context as well.

To conclude, this volume suggests that globalization processes are recasting opportunities and threats faced by governments and firms. How policymakers comprehend the challenges and respond to them, cannot be understood by reductionist explanations. It can be understood only by engaging in the kind of research that typifies the chapters in this volume: careful examination by experts in specific countries and regions who are informed by a sophisticated conceptualization of globalization. Such research requires a careful examination of the interests and ideas of key actors, and how they are articulated within given institutional and historical contexts. We hope that this volume represents a start in the right direction.

Notes

1 We thank the anonymous reviewers for their input. Research and editorial assistance of Jun-ho Kim and Jennifer Baka is gratefully acknowledged.
2 Some argue that the Soviet system collapsed primarily because it could not cope with the pressures of globalization (Kort, 1992; Castells and Kiselyova, 1995; for a review see, Reuveny and Prakash, 1999). This chapter does not examine the merits of this argument.
3 The issue of the impact of political systems on economic growth is complex. For a review see, Diamond (1992) and Przeworski and Limongi (1993).
4 Mastanduno, Lake and Ikenberry (1989) classify states as "soft" and "hard" based on their relationship with domestic societal actors, and as "weak" and "powerful" in terms of their relationship with the international system. They criticize Wallerstein (1974) for the notion of "weak" and "strong" states since it does not distinguish between domestic and international dimensions of state strength.
5 On the relative advantage for governments to provide redistributive services that contribute to domestic peace, see McGinnis (1999).
6 FDI is often viewed to ease balance of payment (BOP) deficits. Anchordoguy (Chapter 3) and Moon (Chapter 2) have pointed out that Korea and Japan have resisted FDI inflows. Japan does not require FDI inflows because it has had a BOP surplus since the mid-1980s. Though Korea has had a BOP deficit since1990, it relied on short-term capital inflows to meet the deficit.
7 For example, US energy firms succeeded in securing huge contracts in Indonesia due to their alliance with the "crony capitalists" (*Wall Street Journal*, 1998b).
8 The restructuring program hit the first major roadblock when the LG Group refused to submit to the government-favored merger of LG Semicon Company

with Hyundai Electronics Industries. However, with the banks threatening to recall loans from the company, the LG Group relented and submitted to the government-sponsored restructuring plan. The merger will form the world's second-largest manufacturer of DRAM (dynamic random access memory) chips (*Wall Street Journal*, 1998c; *New York Times*, 1999).

9 There is a huge literature on the causes of the East Asian crisis and the responses to it. The IMF has been criticized for forcing governments to raise interest rates for stemming currency depreciation and to undertake budgetary cuts. However, all agree that high-leverage of banks and firms was a key structural weakness of these economies. For a review of the key issues, see Sachs (1997), Fisher (1998), IMF (1998), Greenspan (1998) and Prakash (1999).

10 Key IMF policies require support from 85 percent of its shareholders. Since the United States holds 18 percent of IMF's shares, it can veto such policies. Hence, the IMF is correctly viewed to toe the US line.

11 Sachs (1997) views the IMF as the other culprit since it coerced countries to sharply increase interest rates.

12 Williamson's argument has been extensively debated. For a critique, see Ghoshal and Moran (1996); Perrow (1981).

13 The literature on this subject is rather vast. Key works include Commons (1934); Coleman (1988); North (1990); Ostrom (1990); Putnam (1993); Taylor (1993).

14 Effective January 1, 1999, the euro replaced the European Currency Unit (ECU), a basket of currencies used for a long time in foreign exchange markets, as the unit of account. Though the currencies of the eleven European Monetary Union (EMU) members will continue to remain in use until end 2002, only the euro will be quoted in relation to non-EMU currencies.

15 In this context, see the literature on whether the EU qualifies as an optimum currency area (McKinnon, 1963; Cohen, 1998; Jacquet, 1998).

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