

ECONOMIC INTEGRATION AND STATIST REACH - TOWARDS A HOLISTIC ASSESSMENT

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Abstract: *This paper assesses the relationship between public governance and economic competitiveness in a globalized world. The extent of statist reach is often seen as being reduced by the integrated world economy. The present article argues that this is not necessarily so: economic development is not mutually exclusive with good governance. Although international economic actors often tend to use the 'exit' strategy, by choosing those markets that are least regulated, as the globalization process homogenizes further on the world markets, inter-state synchronization of environmental, labour or fiscal regulation must be achieved. As this article argues, such accountability mechanisms will not thwart economic prosperity, but rather secure its further development in a predictable and secure environment for both citizens and firms.*

Keywords: *globalization, economic development, statist power, markets, accountability*

JEL classification: *H11, O10*

INTRODUCTION

The process of globalization has changed many aspects of our societies, from the macro level of national policies, to the micro level of our private lives and the way an individual conducts his daily practices. Therefore, one can only expect to see substantial changes in the relationship between states and markets in the globalized world of today. Many discussions have circled around the relationship between the economic sphere and the political. This paper, however, focuses this centuries' old debate on the specific impact of globalization forces on the balance of power between statist reach and the world markets. Although it makes use of empirical evidence, this is nevertheless a

theoretically oriented assessment, which tries to establish a holistic conceptualization of the relationship between states and markets.

The first part of this article will discuss the degree of economic integration worldwide. Borrowing data from the Global Economic Monitor, I will show how the economic flows have intensified substantially from year to year, thus constituting a tendency that must be reckoned with. The second part of this paper looks at what state power is constituted from and, based on Fukuyama's distinction between state's scope and state's strength, proposes a conceptualization of statist reach along the lines of intensive reach and extensive reach. Thirdly, this paper will tackle the impact of the global economic integration on the authority, autonomy and

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jurisdiction of the state, and the choices the latter is left with. Finally, the last two sections of this paper assess the level of accountability for transnational corporations—the actors of an economically integrated world, and the way governance is shaped by these new challenges.

“International Economic Integration”

Rodrik (2000) first used the expression ‘International Economic Integration’ to talk about economic globalization. Given that he saw globalization as a much more controversial, and too broad a term, he considered this phrasing much more suitable for the process of interconnectivity between world markets. Indeed, part of the process of globalization is this interconnectivity. As Kaldor (2007) defines it, globalization is ‘the intensification of global interconnectedness—political, economic, military and cultural—and the changing character of political authority’. Rodrik’s denomination of ‘international economic integration’ leaves out this latter political dimension that is captured by Kaldor’s definition. Indeed, there is a resilient tendency in the academia, as well as in the professional world, to see the political and economic dimensions of contemporary social life, as not only distinct from each other, which is an accurate assessment, but also as autonomous, independently occurring dynamics, which is an extreme, reductionist assessment of the contemporary political and economic nexus. Indeed, despite significant changes in the world morphology of power relations between politics and economics, these are much more intertwined than many studies admit. This article argues in favor of such an encompassing research approach

of the synergistic relationship between the economic and the political global environment.

The process of international economic integration has raised an intensive debate on the issue of its repercussions—some took it to have a positive impact, some saw it as a negative factor, while others claimed that its impact is limited. This essay will address all these different arguments. Understanding the repercussions of economic integration is essential as it grows exponentially. Considering the level of global trade to be an indicator of the intensity of economic integration, we can see a clearly growing trend (see Fig 1), and for the time period 1990-2009, we see a negatively skewed distribution, suggesting that the increase in recent years is more drastic than before.

Behind this discussion of the process of economic liberalization at a global scale, lies the question of choosing between economic benchmarks, and benchmarks of good governance. Essentially, there is a trade-off between having big governments (be they national or federal), and having capital inflows. The theory supporting economic integration suggests that trade openness, and economic prosperity more generally, can only be brought about by market liberalization and diminished governmental powers. In other words, the international economic integration is correlated with a diminished statist reach. But, before we can assess whether this is the case or not, we must firstly establish the expected contemporary level of statist reach, so that we can afterwards measure the actual variation of the level of statist reach, in an economically integrated world.

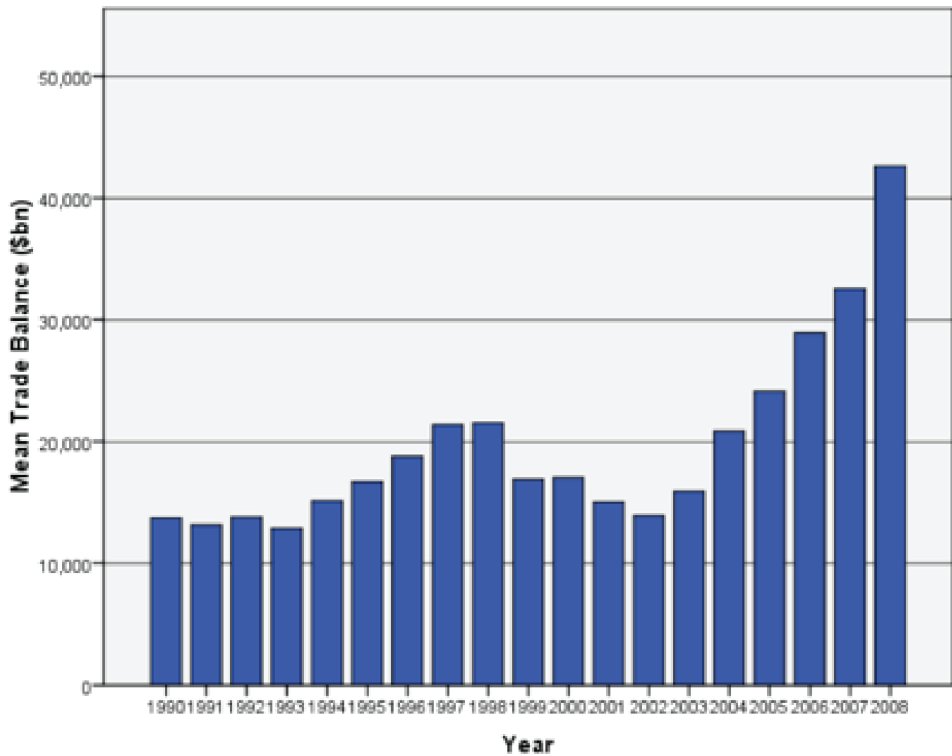


Fig. 1 Trade Balance Evolution World wide

Source: World Bank, Global Economic Monitor (GEM)

Statist Reach

Weber (2004) defined a state as 'a human community that (successfully) claims the monopoly of the legitimate use of force within a given territory'. Fukuyama (2004) agrees: 'the essence of stateness is enforcement'. One can easily see the usefulness of having coordinated statist capacity in such instances as security threats (e.g. global terrorist networks, transnational human trafficking networks), or for humanitarian purposes (e.g. AIDS epidemics in Africa). But within the national borders of a country, other definitions of the state may be more useful. Fukuyama (2004) thus expands the issue,

by defining a state's capacity along two dimensions: strength and scope. According to him, statist strength is 'the ability to plan and execute policies and to enforce laws cleanly and transparently', while statist scope is represented by the 'different functions and goals that a government takes on'. In this sense, one could see the strength of the state as its intensive reach, while the scope of the state would be its extensive reach (see Fig.1). The World Bank's 'World Development Report' of 2002 suggests that increasing statist strength, or otherwise put, the state's institutional capacity, is good for the markets, or the economic development of that country. The report claims that there is

a positive correlation between tax extraction and the level of development. Thus, reinforcing stateness—institutional capacity has a positive impact on a country's level of development.

being a nation-state, to being a transnational political community. Indeed such a transformation is only too clear in the case of the European continent, and its political organization in the European Union form.

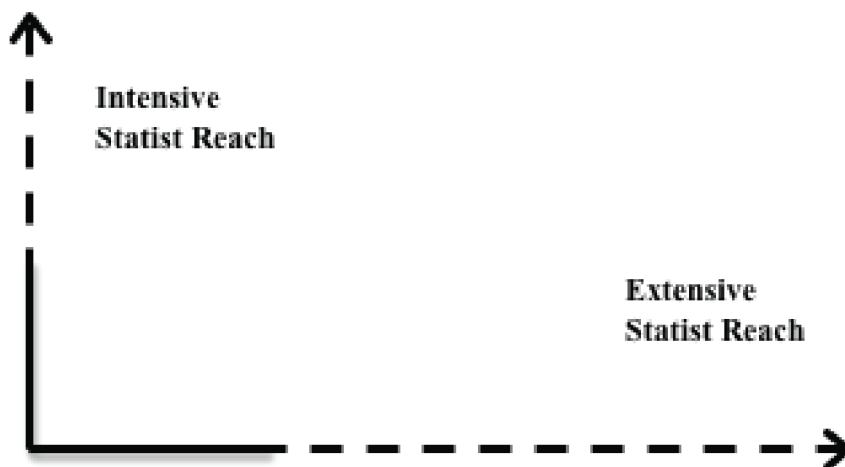


Fig. 2 Dimensions of Statist Reach

Source: the author

Still, reinforcing a state's strength is not only a matter of will nowadays. In the globalizing world, statist reach is not only diminished by the belief that reducing state's scope is good for business, but also by the state's own inability to control the economic and social forces within their territory, like they used to before. Dahl (1994) accurately observes this devolution of statist power: 'A country's economic life, physical environment, national security, and survival are highly and probably increasingly dependent on actors and actions that are outside the country's boundaries and not directly subject to its government'. He goes on to explain this trend, as being part of the democratic transformation of a polity from

Economic, political, or cultural integrative tendencies are found across all continents, and amongst them. No state can stand by its own in the interconnected world of today, and as Dahl warns, 'governments of countries are becoming local governments' (1994). In other words, there is an unavoidable decrease in the state's autonomy. Held (2009) defines a state's autonomy, as 'the actual power the nation-state possesses to articulate and achieve policy goals independently'. The interdependence of states, which is an effect of the globalization process, leaves the statist reach in the contemporary world with inherent limitations, which are not necessarily linked to the increase in economic integration worldwide, but rather

independently occurring processes. Still, as mentioned before, the political sphere is not independent from the economic sphere, and the following sections will assess the extent to which these two dimensions affect each other.

The Trilemma

In the 90s, there was an international wave of enthusiasm for the liberalization of markets. Some believed that the dominance of the economic sphere would open the door to prosperity and wealth, while others went as far as to claim it was a counterbalance to authoritarian governments everywhere. Generally, the trend was supposed to be a decreasing political decision-making capacity in favor of the increasing economic rule. These premises led Friedman to propose the term “Golden Straitjacket”, meaning that although the markets dictate much of what the governments should do, this is a positive thing in the end, as wealth and prosperity follow the open-economy. Much ink has been spilled on this subject, but it nevertheless remains central to the contemporary financial crises. As with many ideologies, the theory is enchanting, while the practice not so much. The dominance of the markets, of Smith’s *invisible hand* has proven over and over again to be a source of great inequality both within countries, and across countries.

The responses to financial crises are usually not less extreme, and protectionism risks leaving a country just as impoverished as an unregulated open-economy. Essentially, the choice is not one between the liberalization of markets, and protectionism. It is rather, a choice of two out of three options: International Capital Mobility—meaning wealth, National Monetary Autonomy—meaning governmental market regulation, and Fixed Exchange Rates—

meaning market self-regulation (Rodrik 2000, Giplin 2001) (see Fig.2) Obstfel and Taylor (1998) coined this decision as the “open-economy trilemma”. Considering that all countries desire capital inflows, the choice then remains to be made between the National Monetary Autonomy and having Fixed Exchange Rates. Choosing the first would lead to an inter-state synchronization of economic policies, but the influence of the national political will would be preserved to some extent. Rodrik sees this combination (of capital mobility and national autonomy) as leading to a global federal political order between states. The latter choice—the fixed exchange rates, coupled with the capital inflow, would render a state subject to serious constrain in terms of policy rulings. Friedman (2000) explains how the economic “golden straitjacket” actually impacts on the political sphere: *‘political choices get reduced to Pepsi or Coke—to slight nuances of tastes, slight nuances of policy, slight alterations in design to account for local traditions, some loosening here and there, but never any major deviation from the core’*

Thus, overall, whatever the two out of three choices might be, countries are still seen as being involved in an inescapable “race to the bottom”—a competition of who is offering the lowest taxation, the lowest regulation in such fields as labour, environment, or health, and, finally, the least commitment to social protection or public welfare. These are the fields in which a downward pressure from the global economy is most present. At the country level, many consider the economic and the public sphere, as being placed in an inverse relationship, that is the least involved the government is, the greater the number of big business will come in. This is the convergence theory, claiming that ‘governments become more accountable to external economic agents than to citizens of the polity’ (Mosely 2007).

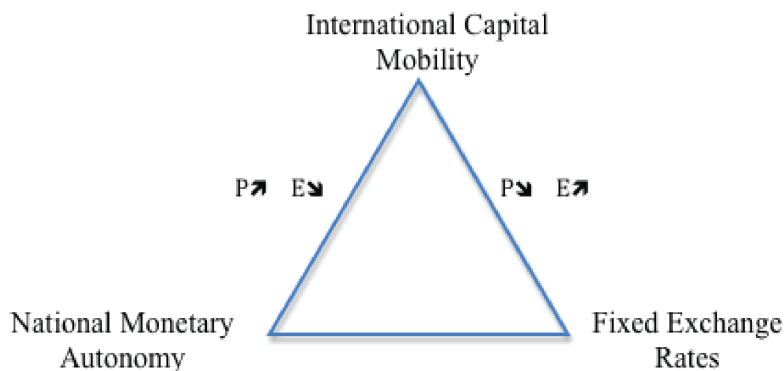


Fig. 3 "Open-economy Trilemma"

Source: adapted by the author after Obstfeld and Taylor 1998, Rodrik 2000/2007, and Giplin 2001

Still, there are many reasons that others take into account, when disagreeing with the inevitability of a global "race to the bottom" between states. Firstly, there are many ways to cope with the demands of the markets, many ways in which to remain competitive, while not completely forsaking regulation in essential areas like labour rights, and environmental standards. This world wide institutional diversity is one source of "room to move", thus escaping the predictions of the convergence theory. Rogowski (2003) calls this the "varieties of capitalism", acknowledging himself that different countries have different strategies in the face of market capitalism.

Secondly, several studies have concluded that there is a positive association between trade openness and the size of public spending (Rodrik 1997/1998, Adsera and Boix 2001, Garrett and Mitchell 2001, Mosely 2007). This statistically significant finding suggests that the citizens of a state, the ones that delegate power to their elected representatives—the government, still have sufficient leverage to counterbalance the reductionist tendencies in public spending imposed by the forces of economic

integration.

Thirdly, because certain governmental interventions may in fact yield greater competitiveness on the world markets, there is a symbiotic relationship between the state and the capitalist economy (Scharpf 1999, Brune and Garrett 2005, Giplin 2001). Examples of such business enabling governmental interventions would include: securing property rights, reducing corruption and bureaucracy, developing infrastructure, research and development, or professional training and education.

Finally, the extent to which economic globalization actually takes form may be to some extent exaggerated. One argument in favor of a more modest estimate of the force of economic integration is that there is persistent national bias in terms of investment. The majority of companies still invest in their country of origin. Rodrik (1997) illustrates this point by observing how 'trade between a Canadian province and a U.S. state is on average 20 times smaller than trade between two Canadian provinces'. Another argument suggesting a lesser degree of economic integration than many estimated is that there is a persistence

of price and wage differentials between countries (Rodrik 2007, Giplin 2001).

The Accountability Gap

In discussing the effects of economic integration on the form and performance of states, we must now disentangle the economic actors—transnational corporations (TNC's), from the public actors (citizens, governments, NGOs). The main beneficiaries of international economic integration and the decrease of national authority over the markets are the TNC's. Given the new borderless morphology of the world markets, it is more difficult for national governments to hold corporations accountable than it used to be. This is due to what Koenig-Archibugi (2004) calls 'opportunities to exit', meaning that if a government tries to restrict in any way a TNC's activity on its soil, the latter may choose to escape such inconvenience by moving to another market or country. Thus, governments are becoming increasingly drawn into a bidding game of low taxes and lax regulation. Koenig-Archibugi (2004) goes on to state that this situation 'turns the accountability relationship upside down, by making governments accountable to TNC's, or at least by increasing the bargaining power of TNC's vis-à-vis governments'. Sometimes, TNC's even acquire the status of political actors (not only economic actors), by attempting to influence formal political and administrative decisions on their behalf.

The reasons behind the rise in influence and power of the TNC's are multiple. The first and most effective favoring circumstance is the deepening of the economic integration. To this point, Kobrin (2001) observes how 'firms have become more involved with governments and governments have come to recognize their increased dependence on the scarce resources controlled by firms'. A second explanation for the power of

TNC's is the turn to economies of scale in order to remain competitive. Local, national companies can no longer keep up with large scale, multinational operational companies. This is supported by the economic premise of increasing returns to scale. Thus, a self-supporting circle is instituted: companies have the incentive to develop in size, acting on multiple markets, but once they do this, they are big enough to decide on which markets they prefer to enter, thus creating a jurisdictional gap between national governments and themselves. Finally, Reinert (2008) points out the necessary synergies involved in the process of technological change and innovation. This is another explanation of why companies not only want, but also need to be 'big'. Kobrin (2001) makes a valid observation on this point also: 'in sectors such as semiconductors, aerospace, pharmaceuticals, biotechnology, or telecommunications, a competitive R&D budget cannot be sustained by sales in even the largest national market'.

Given these different facets of today's world economy, it is obvious how an accountability gap is created, one through which many TNC's may do more harm than good. As Kehone once pointed out, one should firstly distinguish between internal accountability—to those who delegate power, from external accountability—to those who are affected. While mechanisms for self-enforcing internal accountability exist, given the relationships of mutual dependence between the participants (e.g. companies—clients, companies—stakeholder), the issue is much more delicate in what concerns external accountability. Thus, the general public doesn't usually have any means at its disposal to hold TNC's accountable for their action. Sensitive issues such as environmental regulation, labour rights, or taxation levels are far from the reach of the population. While the citizens

may hold their governments accountable for not dealing satisfactorily with these issues, this is nevertheless, a delayed effect that may leave serious infringements uncontrolled.

An accountability relationship is defined by Koenig-Archibugi (2004) as 'one in which an individual, group or other entity makes demands on an agent to report on his or her activities, and has the ability to impose costs on the agent'. Therefore, if we consider TNCs, they should be constrained to report on their activities and to be sanctioned if their actions are judged as faulty. The BP oil spill in the summer of 2010 is one example of an instance in which governmental sanctions must follow environmental misconduct. Human rights abuses in oil resource exploitation in Nigeria, in the 1990s, by Shell, constitute another example of how a TNC's activities must be checked and, if necessary, sanctioned.

There are 4 main sources of accountability gaps. According to Koenig-Archibugi (2004), the first source of an accountability gap is the collision between government officials and TNCs. A second source is the inevitable regulatory competition—'OECD countries are able to resist the downward pressure of competitive regulation. Yet, fiscal, social and environmental 'races to the bottom' are a serious risk in the developing world' (Koenig-Archibugi 2004). Finally, the third and fourth sources of accountability gaps target the diminishing of state reach—both in strength and scope, both intensively and extensively. On one hand, TNCs may be reactive, profiting from state weakness and breakdown, and thus pursue their own interest despite political fallout. On the other hand, TNCs may be proactive, and act towards political subversion themselves. Examples of the first instance include the trading of rough diamonds and minerals in such states as Congo, while examples of the latter instance include the United Fruit

Company's participation in the Guatemalan coup d'état of 1954, or the ITT's machinations against Salvador Allende's government in Chile.

Unfortunately, there aren't many efficient solutions for countering such accountability gaps. There are two lines of action for creating a sustainable economic environment world wide—one in the direction of improving the transparency of companies' practices, and the other one in the direction of enabling the imposition of sanctions when necessary. Macdonald and Macdonald (2006) call these two lines of action: public transparency and public disempowerment. They consider the latter to be efficient when it takes the form of non-state initiatives—mostly 'naming and shaming' strategies. Their examples of successful negative publicity campaigns against TNCs are taken from the garment industry, where indeed many such instances can be found. Just to name a few brands that have succumbed to public pressure in matters of labour rights: Nike, Reebok, Walmart, K-mart, JC Penny, Kathy Lee Gifford's clothing line, etc. Unfortunately, the state led efforts to sanction bad behaviour on the parts of TNCs have been much less successful. Such measures must be internationally coordinated, and the conflicts of interests between states have mostly thwarted such initiatives. Still, progress in narrowing the accountability gap has also been achieved by pursuing the strategy of improving the transparency of their activities. Koenig-Archibugi (2004) distinguishes between different standards and certifications: internal, sectoral, and external. The most effective is for obvious reasons the external development and imposition of standards and certification, being the less biased of them all. These external certifications are usually done by third parties, such as non-governmental organizations (NGOs) or intergovernmental

organizations (IGOs). Examples include the Global Reporting Initiative (GRI), the Social Accountability International (SAI), or the Global Compact.

From Accountability to Democratic Participation

Dahl (1994) underlines the fact that in a transnational polity structure there is an inescapable trade-off between system effectiveness and citizen participation, which he calls the 'democratic dilemma'. Indeed, the reduction of statist reach in the face of economic integration has pushed the balance of priorities on the side of achieving system effectiveness both politically and economically. Thus, political power in the face of growing economic integration can only be achieved at a supra-national level, through interstate cooperation. Even more so, the higher the political coordination, and policy synchronization, the better for the business sector, that thrives in a predictable legislative environment. A good example of this is constituted by the European Union and its common market. Although much has been said about the TNC's 'exit' options, and how this places them in a particularly favorable negotiation position, in the end, the regulatory homogenization of the world market is more beneficial for them. This way, what is lost in the opportunity to elude disadvantage regulation is gained in the ability to plan on the long term, thus reducing expenses with the unexpected circumstantial changes. Therefore, the higher the level of transnational political integration is, the greater the capacity to tackle the big issues affecting our lives today. Yet, this trend is diminishing the level of citizen participation in the decision-making process. Again, a good example of this is the way the European Union takes economic

and political decisions at the supra-state level, often disregarding local preferences or traditions.

For a long time, the modernization theory supported the belief that economic development, and the corollary transformations that go with it, will automatically lead to good democratic governance. This premise was disproved on several grounds. On one hand, the foundations of the theory were faulty, as the developed world was taken as an example for the rest of world, which, from the historical determinism's point of view, is unacceptable. This critique claimed that the Western European route to democracy was unique, and not to be repeated. On the other hand, the modernization theory implied that if certain circumstances are met, then the outcome of democratic governance will follow. This idea, of basing a system of governance on the mere incidence of conditions, was found faulty by the followers of the strategic interaction theory, who claimed that democratization is an outcome of actions, not just conditions. Thus, one must look forward at economic development to find the factors that incite the formation and survival of democracy. This essay is interested in seeing how democracy is related to economic development, as only within a democracy, can the level of statist reach impact positively on the economic sphere, and the public sphere alike.

Without citizen participation and representation of the popular will, the authoritarian rule surfaces from the extent of statist reach. On the long run, economic development threatens the 'political survival of repressive regimes as it raises the likelihood that effective political competitors will emerge' (de Mesquita and Downs 2005). But, if an authoritarian government limits the strategic coordination of the opposition, by suppressing "coordination goods", such as

political rights, human rights, freedom of the press, or access to higher education, then it reduces the chances of being removed from office, without jeopardizing the country's economic development (de Mesquita and Downs 2005). One example of such a strategy is China's market liberalization, while continuing political repressiveness. In such a case, the state's reach is undesirable, as it doesn't best serve the interest of the citizens, but rather those of the political elites. Bremmer (2010) observes China's situation as well: 'The Communist Party needed to embrace market capitalism while protecting its monopoly on power by ensuring that the state controlled the lion's share of the wealth that market generates.' He goes on to synthesize the predicament:

'Authoritarian governments everywhere have learned to compete by embracing capitalism. But they know that if they leave it entirely to market forces to decide winners and losers from economic growth, they risk enabling those who might use the new wealth to challenge their political power.'

Still, the incentive to achieve economic development may lead many countries on the path of good governance. Hafner-Burton (2005) observes how preferential trade agreements (PTA) that supply hard standards, tying material benefits of integration to compliance with human rights principles, are proven to be effective. Examples that support this hypothesis are such instances as the prosecution of the perpetrators of a massacre in Rwanda, in 1995, the political reforms to secure democracy and respect for human rights in Togo, in 1998, or in Fiji, in 2000, or the passing of national legislation outlawing child labour in Pakistan, in 1997—all measures taken as a response to conditional PTAs. Thus, the positive repercussions of trade openness,

at the socio-political level are felt only if they are channeled by statist guardianship, or better still, interstate guardianship of the economic sector. In this sense, Rudra (2005) underlies the fact that openness in both trade and capital markets has a robust, but indirect effect on democratization via social spending. Therefore, high levels of social spending are required to generate a positive, synergistic interaction between economic liberalization and the quality of governance within each country.

CONCLUSION

In a world struggling with financial crises and serious regulative challenges, many questions arise on the nature of the current relationship between states and markets. This paper has attempted to address some of these concerns, by developing an assessment of the interaction between the integrated world markets, and para-state economic actors, on one side, and the states, and public initiatives to resolve issues of accountability and regulation, on the other side. The first two parts of this article described the extent and significance of both sides of the subject: the economic integration and the statist reach. The third part of the essay has discussed the impact of economic integration on the state's ability to regulate the economic activity on its territory, and enact social policies. The fourth section has approached the issue from the reverse perspective, by assessing the ability of states, and non-state actors to hold TNC's accountable, in the face of this jurisdictional asymmetry between markets and national territories. Finally, the paper has looked at the influence of economic development on the quality of national governance.

In conclusion, this article supports that states are still powerful actors on the global scene, although they must be

ready to make certain concessions to the equally powerful economic forces. The state's resistance in the face of the growing influence of the economic sphere is due to the markets' reliance on legal protection and predictability, and the development of infrastructure, all being functions of states. There are as many examples of countries in which excessive statist reach has discouraged economic development, as there are of countries in which good governance, although extensive and intensive, has only encouraged economic development further. Thus, it is not the extent of statist reach that is in an inverse relationship with the degree of economic development, but rather the quality of governance. Good governance can harbor both social spending and competitiveness in an economically integrated world.

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