Global Neoliberalism, Policy Autonomy, and International Competitive Dynamics
Author(s): George DeMartino
Source: *Journal of Economic Issues*, Vol. 33, No. 2 (Jun., 1999), pp. 343-349
Published by: Association for Evolutionary Economics
Stable URL: http://www.jstor.org/stable/4227445
Accessed: 12/12/2010 21:07

JOURNAL OF ECONOMIC ISSUES
Vol. XXXIII No. 2 June 1999

Global Neoliberalism, Policy Autonomy, and International Competitive Dynamics

George DeMartino

How has global economic integration affected the ability of national governments to sustain social democratic regimes in order to ensure economic security and some measure of equality? This question is particularly important today because of the apparent economic difficulties facing many European countries that have historically pursued social democratic policies. But it has become even more immediately relevant over the past year or so, as national elections have returned social democratic and/or labor parties to power in most Western European countries. What possibilities lie before social democrats in the new global economy?

To explore this matter, we first need to be clear about the nature of contemporary international economic integration. While many nations have had close economic ties for centuries, the present period is unique in the degree to which international economic relations are *market-based*. The linkages that bound the economies of Britain and India during Britain's colonial empire, or that bound Eastern Europe under the aegis of the Soviet Union, are very different from the linkages that increasingly bind nations today. In place of state-directed flows of goods, services, and capital, we find dramatic shifts toward what I will call *global neoliberalism*, or market-directed flows and outcomes. Today the decisions of private economic actors—particularly multinational corporations (MNCs)—increasingly determine the flow of goods and services and capital across national borders and thereby affect employment levels and income. As just one indicator of this trend, we should take note of capital flows from the North to the South: today, private flows

The author is Assistant Professor of International Economics, University of Denver. This paper was presented at the annual meeting of the Association for Evolutionary Economics, New York City, New York, January 3-5, 1999.

between these regions in the form of foreign direct investment (FDI) and portfolio investment (PI) are many times larger than North-South public aid flows.[1]

The question before us, then, is how does the shift toward neoliberalism at the *international* level affect the state's ability to sustain social democratic institutions and policies at the *domestic* level? To answer this, we need to distinguish between three distinct concepts that tend to be conflated in the literature on the impact of globalization on the state. By "state capacity," I refer to the ability of a state to achieve some objective that it sets for itself, such as economic growth, equality, or security. By "policy autonomy," I refer to a state's ability to implement and sustain a policy of its own choosing, independent of the policy choices of other nations, in order to achieve its objectives. Finally, by "sovereignty" I refer to the state's formal *right* to pursue and sustain a certain policy, separate from its ability to do so.

Let me demonstrate the importance of this distinction by way of a simple example. Let us assume that a country intends to address the problem of high unemployment through expansionary monetary policy. If it has the formal right to pursue this policy, then we say that it has sovereignty in this policy area. If it also has the ability to sustain this policy, independent of the policy choices of other nations, then we also say that it has policy autonomy in this area. And if it can indeed improve its employment performance via this policy choice, then we also say that it has state capacity in this area.

But now consider the following cases. First, the state may very well have the right to pursue expansionary monetary policy but not be able to sustain it. In the absence of coordination with other countries, it may find its expansionary policy sabotaged by capital flight and a collapsing currency, which together induce a political crisis and force the government to reverse its policy. In this case, we say that the state enjoys sovereignty but lacks policy autonomy. Alternatively and less dramatically, the state may be able to sustain the policy but find that it generates a trade deficit and inflation, rather than improved employment. In this case, we can conclude that it enjoys sovereignty and policy autonomy but lacks state capacity in this policy domain.

To say that these three variables are distinct is not to say that they are independent in their effects. Instead, the distinction allows us to see that state capacity is a direct function of the other two. A diminution in either sovereignty or policy autonomy might be expected to translate into a loss of state capacity. The distinction is therefore useful because it allows us to explore the distinct pathways by which global integration affects the state—and to consider alternative means by which the erosion in state capacity (if and when we find it) can be reversed.

For the sake of brevity, I will focus in what follows on policy autonomy. I will argue that global neoliberalism undermines policy autonomy and thereby threatens the ability of domestic social democratic regimes to ensure economic security and equality. I will conclude the paper with a brief discussion of just how social democratic regimes might seek to respond to this loss of policy autonomy in order to secure traditional social democratic goals.

Systems of Economic Governance

During the inter- and postwar periods, a variety of distinct approaches to economic governance emerged across capitalist countries. Though broadly committed to the institutions of private property and market organization, these countries diverged on the fundamental question of the role of the state in managing economic affairs. We can identify two "ideal types" of market capitalism, distinguishable by their degrees and types of state involvement.

The first ideal type I will call "domestic neoliberalism." Under this regime, the market is taken to be the optimal means for deciding what will be produced, where and how it will be produced, and, within broad parameters, how income will be divided among society's members. The state's primary economic roles under this kind of regime are to support the market and to correct isolated market failure. For instance, the state is to delineate and protect property rights while regulating monopolies. Economic policy is to remain restricted to these areas so as to avoid disrupting the proper functioning of the market.

Practically speaking, no state has achieved this neoliberal ideal, of course. But it is certainly fair to say that some states have come far closer to this ideal than others. In particular, the United States and the Great Britain, especially since the late 1970s, are widely taken to approximate this neoliberal model.

The second ideal type is "social democracy." This model also features market-based economic organization. But in the social democratic regime, there is far less optimism about the adequacy of the market as a regulatory institution. Social democrats argue that the market is prone to instability and excessive inequality. Social democratic regimes therefore entail a far greater role for the state in structuring (and sometimes dictating) economic outcomes, usually with the goal of ensuring equitable distributions of national income. They do this through aggressive tax policy, promotion of social cooperation between capital and labor, and industrial policy that directs investment to regions and communities most in need. These regimes generally place far more restrictions on capital, constraining what it can do in pursuit of profitability [DeMartino 1996].

Many states introduced at least some of the features of social democracy listed here. Those most frequently cited are the Scandinavian countries (especially Sweden) and other countries across continental Europe (especially Germany).

The dichotomy between these two ideal types is emblematic of the choices facing all governments today about the proper role of the state in the market economy. The debate about the virtues of domestic social democracy has reemerged in the context of the series of recent political victories by the Left in Europe, of course. But it is also a choice before policymakers in the former socialist countries and in developing countries, especially in the wake of the Asian financial crisis.

Globalization and "International Competitive Dynamics"

We can now reformulate the central question of this paper, to wit: how has the trend toward global neoliberalism affected the viability of domestic social democratic policy regimes? The provisional answer that I would like to offer is that global neoliberalism places severe strains on those countries that pursue domestic social democratic governance. Social democratic regimes in Europe today face extraordinary rates of unemployment, reaching heights not seen since the economic crisis of the interwar period. In addition, many developing nations have largely abandoned the kinds of policies associated with social democracy. There are good reasons to suspect that some of the difficulties at least are the result of globalization. In what follows, let me identify one.

As others have rightly argued, global neoliberalism can create an "international competitive dynamic" in which institutional change in one or more countries induces similar changes in other countries. The most commonly cited example, which is also among the most important, entails the removal of capital controls. The Euromarket emerged during the 1950s and expanded substantially over the following three decades. This new capital market entailed the free flow of U.S. dollar-denominated assets without supervision or control by any national government. The British and U.S. governments propelled this market by refusing to take achievable steps to restrict these transactions. Each viewed the emerging Euromarket as serving its own domestic and international political and economic agendas, and so each acquiesced in the face of its expansion. These countries also rescinded capital controls on short-term capital flows in the early 1980s.

These policy decisions proved to be extremely influential. Other countries across Europe soon found that in an era of tightening economic integration, they too faced pressure to rescind their own capital controls. Capital controls became very difficult to sustain, especially in the context of the rapid growth of MNCs that could evade controls by borrowing and lending through foreign affiliates in the Euromarket. MNCs could also shift operations to other countries with looser restrictions to preserve their competitiveness. Countries that tried to retain tight controls therefore faced the threat of capital outflows and a loss of investment, employment, and income. In short, once several large and important economies permitted the free movement of short-term capital, other countries found it expedient to follow suit by liberalizing capital flows. An international competitive deregulatory dynamic led to the virtual elimination of capital controls across Europe (and Japan) by the end of the 1980s [Helleiner 1995; Goodman and Pauly 1993].

The international competitive dynamic that eliminated capital controls has had a profound effect on the viability of social democratic governance. As Stuart Wilks [1995] has argued in the case of Sweden, the liberalization of capital flows undermines the ability of individual governments to sustain the costly and restrictive policies that social democratic governance entails. Generalizing, let me offer the following proposition by way of a hypothesis:

> Social democracy in one or more countries can perform well when either of two conditions is met:
>
> 1. When national economies are largely "closed," that is, when they are separated explicitly by policy tools (such as tariffs or capital controls), or implicitly by economic constraints (such as high transportation costs).
>
> Or, absent this condition,
>
> 2. When most states are social democratic.

Either of these conditions spares a social democratic regime from corrosive international competitive pressures that erode its policy autonomy. Under the first condition, one country's domestic policy regime has few economic spillover effects on other countries. Moreover, absent the free international flow of goods and capital, each nation retains a substantial degree of policy autonomy because domestic actors cannot easily exit from domestic arrangements that run counter to their interests. Under the second condition (in the absence of the first), though nations are now open to international economic flows, the absence of a significant neoliberal presence affords security to existing social democratic regimes. Although social democracy may impose relatively high costs on firms in the form of high wages, taxes, and other regulations, firms do not have substantial opportunities to escape these burdens by shifting capital abroad.

But social democracy is less viable when neither of these conditions exists. In this case, the institution of a domestic neoliberal agenda by some countries threatens social democratic governance in all countries. The presence of domestic neoliberal regimes in an open (neoliberal) international economy provides firms in social democratic regimes with the opportunity to flee and the incentive to do so. The larger the share of global economic activity accounted for by domestic neoliberal regimes, the greater are these opportunities and threats.

Over the past several decades, we have witnessed the erosion of both of the conditions necessary to sustain social democracy. First, several large OECD countries have pursued the domestic neoliberal model aggressively. They have been joined by many developing countries that have embraced domestic neoliberal regimes in order to enhance their attractiveness as sites for investment and to improve their export performance. Second, the postwar period has been marked by dramatic reductions in all sorts of policy-based barriers between economies, from capital controls to tariffs. States are choosing (and have been induced) to promote, rather than inhibit, the free flow of capital and goods across national borders. Third, technological advances have substantially reduced the obstacles of time and space that have historically insulated national economies [Dicken 1998]. Today, physical distance matters far less in driving economic flows and outcomes.

In the context of these changes, the conditions have emerged for an international competitive dynamic that imperils social democratic governance. Firms operating in the high-cost and highly restrictive milieu of social democratic governance can shift operations to lower-cost sites available under neoliberal regimes. Firms facing severe constraints at home can credibly threaten to leave, given the freedom that global market-based economic integration provides to them. Were all or most other countries committed to the social democratic model, this threat of capital flight would be far less credible. In short, we might conclude that policy autonomy is substantially compromised in the context of a deeply integrated, global neoliberal economy. Indeed, many analysts have been led to conclude that we should expect increasing convergence of national policy regimes around the domestic neoliberal ideal summarized above.[2]

Conclusion

What can be done, if anything, to protect domestic social democratic policy regimes from the competitive dynamics associated with global neoliberalism? Let us take note of two options. First, a country can try to preserve policy autonomy by taking steps to insulate itself to some degree from the global economy, as through high tariffs and capital controls. This would mark an abrupt break with the trend of the past 40 years, to be sure. But in the wake of the Asian crisis, this strategy may not seem so far-fetched—at least to some developing country policymakers. The practicality of this course of action will depend on a host of factors relating to the size of the nation's economy, its dependence on multilateral agencies (such as the IMF and the World Bank), its resource endowments, etc. For many countries, this strategy may fail to restore state capacity. Alternatively, a country that seeks to maintain deep integration with other nations may seek to construct regional coordination in those policy domains where policy autonomy seems most threatened. Regional policy regimes, such as trade and investment pacts, may serve to restore the state capacity of social democratic regimes. For example, such a pact could specify rules that govern intra-regional capital mobility or the behavior of MNCs that operate within their borders. If effective, this harmonization would serve to subvert the international competitive dynamic among the regional partners. Cooperation of this sort might also strengthen the hand of the signatories when negotiating multilateral agreements with other countries, especially when there are multiple outsiders seeking market access and sites for investment within the region.

If the arguments advanced herein are correct, then the recent resurgence of social democratic parties across Europe is consequential. These governments might be able to achieve far more by acting in concert than could any one of them by acting alone. Together they might be able to reorient European economic integration toward the achievement of regional protections against the perils of global neoliberalism. Indeed, the recent decision by France to disrupt OECD negotiations over the thoroughly neoliberal Multilateral Agreement on Investment might indicate a willingness on its part to pursue a new course for Europe—one that re-establishes the conditions for the viability of domestic social democratic policy regimes across the continent.

Notes

1. This is not to say that the state has been a passive victim of these changes. To the contrary, as Panitch [1994] correctly argues, the state has been a chief actor in orchestrating the shift toward neoliberalism. Moreover, the state continues to serve the vitally important functions of establishing and enforcing the legal framework and of providing myriad institutional supports without which global markets could not function.
2. See the essays in Berger and Dore [1996] for a comprehensive treatment of the debate over globalization and convergence.

References

Berger, Suzanne, and Ronald Dore, eds. *National Diversity and Global Capitalism*. Ithaca, N.Y.: Cornell University Press, 1996.

DeMartino, George. "Industrial Policy versus Competitiveness Strategies: In Pursuit of Prosperity in the Global Economy." *International Papers in Political Economy* 3, no. 2 (1996).

Dicken, Peter. *Global Shift*. 3d ed. New York: Guilford Press, 1998.

Goodman, John, and Louis Pauly. "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets." *World Politics* 46 (1993): 50-82.

Helleiner, Eric. "Explaining the Globalization of Financial Markets: Bringing States Back In." *Review of International Political Economy* 2, no. 2 (Spring 1995): 315-41.

Panitch, Leo. "Globalisation and the State." In *The Socialist Register 1994*, edited by Ralph Miliband and Leo Panitch, 60-93. London: The Merlin Press, 1994.

Wilks, Stuart. "Class Compromise and the International Economy: The Rise and Fall of Swedish Social Democracy." *Capital and Class* 58 (1995): 89-111.