

How Domestic-Global Interaction Help Global Economy

Ritisha Mishra

Summary

Globalisation isn't just limited to goods and services but also ideas, particularly those pertaining to economic policy making. While international trends (pressures) might be responsible for policy implementation, it is the domestic factors that influence its form and diffusion.

Introduction

The globalization of the world economy has not only provided a conduit for importing international trends in policy making, but also for exporting domestic policies and influencing global trends. In such a dynamic feedback system, it becomes necessary to examine exactly what kind of factors affect policy making in any economy. To that end, this essay explores the case for domestic factors, the case for global pressures, as well as domestic-global policy interactions.

The argument of this essay is that although both domestic factors and global trends play a crucial role, their roles are quite different. I argue that while international policy diffusion determines the overall course of economic policy in any economy, it is the domestic factors that

limit the *extent* to which international trends can influence policy. The exact

nature and shape of policy is ultimately contingent on domestic interests, ideas and institutions.

This essay will proceed in the following steps. First, on the basis of existing literature in the field of International Political Economy, I will lay out the case for international trends affecting economic policy and the role of policy diffusion.

Second, I will study the role of domestic factors in shaping economic policy. Finally, I will summarise the salient features of the argument and briefly mention its implications.

The case for policy diffusion

No industrialized or industrializing nation can insulate its economy from global economic pressures. (Dolowitz and Marsh, 2000, p.6) Policy diffusion is the process by which policy decisions in an economy are systematically conditioned by policy choices made elsewhere. Four mechanisms of interdependent policy-making are usually recognised: coercion, competition, learning and emulation (Simmons, Dobbin and Garrett, 2006). I will now delve into the role these mechanisms have had to play in the six areas of economic policy.

In the case of privatisation in OECD and Latin American countries, Meseguer (2004) has found that *learning* and *emulation* played an important role in the privatisation wave of the of the 1990s. She finds that economic rationales alone are

insufficient in explaining why so many countries privatised together, and why then. Purely economic rationales cannot explain why countries where public enterprises were working well—such as France, South Korea, Austria, Taiwan—decided to divest. Efficiency considerations are also inadequate as “it may well be the case that privatisation merely transforms a state monopoly into a private one.” (Meseguer, 2004, p.302) Ideology, too, cannot explain why countries such as France and Britain saw both right-wing and left-wing governments supporting privatisation. In fact, it is learning from the experiences of countries which benefited from privatization or even emulating their “best practices” that played a major role in the incremental rise in privatization that was witnessed in the 1990s.

Closely related to the diffusion of privatisation has been the rise of regulatory capitalism. In an era where the logic of neoliberalism has gained eminence, it might seem paradoxical that regulation of the private sector should increase. However, this regulation does not come in the form of old-fashioned state command and control. Privatisation, it is argued, is accompanied by a new division of labour between state and society, which has resulted in an increase in delegation and new technologies of regulation. The following table (Majone, 1997, p.149) is useful in understanding the differences between the traditional Keynesian state and the modern regulatory state.

In fact, studies suggest that the rationale for regulation might be stronger than the rationale for privatisation. Regulatory solutions to market failure were initially

shaped in North America and Europe and are increasingly internationalized and projected globally as models of good governance. Coercion (through non-governmental and inter-governmental organizations) and the spread of the ideas of “best practices” have contributed to this diffusion. (Levi-Faur, 2005)

Even transitions to economic liberalisation, it has been found, cluster in time and space. The most influential factor in this instance of policy diffusion has been found to be *competition* for global capital, i.e., governments tend to liberalise when their competitors do. If country A’s foreign competitor B chooses to liberalise, B becomes a relatively more attractive venue for investment. Fearing that investors will be drawn away from it, country A will feel a pressure to liberalise as well. (Simmons and Elkins, 2004) In an era when developed countries are struggling to maintain positive growth rates and developing countries are racing to grow as quickly as possible, the significance of these pressures cannot be overstated.

Interesting policy convergence is also seen in the area of central bank independence, which has been on a radical rise since the 1990s. (See Figure 1) A central bank is said to be independent once it has gone through institutional reform whose explicit purpose is to grant it more autonomy from the government. Generally, functionalist explanations are provided by governments to justify such a reform: to tackle high inflation, increase credibility, acquire more expertise, et al. However, these demand-side explanations fail to explain rise of central bank independence in countries without high inflation. Moreover, studies

have failed to prove a significant relationship between central bank independence and low inflation rates. Therefore, the waves of convergence in such policies are explained by policy diffusion – in particular, though *coercion* and *emulation*. (Marcussen, 2005) Further, scholars like McNamara (2002) have critiqued this “one size fits all” type of governance that claims to result in better economic outcomes, even though no conclusive evidence is found to justify such rationales. ‘Normative isomorphism’, McNamara (2002, p.64) writes, plays a significant role in the spread of central bank independence.

Fiscal policy, too, is not insulated from global pressures. Swank and Steinmo (2002) conducted a study that suggests that internationalization has required a change in tax regimes across the world. Tax impacts of internationalization are more complex than globalization theory suggests, but it cannot be denied that there has been significant policy convergence in this area of economic policy as well. Figure 2 illustrates how the top income tax rates have fallen systematically across various economies.

Although the argument for policy diffusion in the case of industrial policy is a weak one, modern industrial policy remains an important aspect of economic policy. This is especially true in a globalized economy—where domestic groups are favoured over foreign players because of their territorial status. (Clift and Woll, 2012, p.308) Industrial policy as a terminology has largely disappeared from modern economic discourse; however, it is aimed at protecting the interests of domestic groups, which is something

governments are indeed interested in doing, particularly in light of increased foreign participation in domestic markets. Thus, the impact of international factors on such policies cannot be disregarded.

The practicalities of the domestic economy

As discussed in the previous section, the impact of international factors on domestic policies is tremendous. However, this is not to say that policy diffusion implies that all nations will eventually have identical policies. On the contrary, it has been observed that more often than not nations tailor internationalized policies to suit domestic interests. These interests may be of powerful producer groups, or of politicians, or even (in an ideal scenario) of the citizens at large. These interests are aggregated through institutions, i.e., how interests are translated into outcomes depends on the strategic domestic environment, especially institutions and information. (Frieden and Martin, 2002, p.120)

Let us consider, first, the case of privatisation. The decision to privatise in most economies might have been a result of learning by experience; however, policy diffusion proves to be inadequate in explaining regional variations in privatisation. In some countries, privatisation was undertaken for pragmatic reasons (for instance, in Southern Europe and India); in others, it reflected a shift in ideology to roll back the state (examples are Mexico and several Latin American countries). Thus, it is local economic and political conditions that dictate how privatisation is carried out, what is privatised and how much is privatised.

(Murillo, 2002 and Schamis, 2002 cited in Meseguer, 2004) Moreover, since privatisation implies a change in ownership structure, it is the environment in which firms operate that determines the outcome of the new ownership structure. (Meseguer, 2004)

As in the case of privatisation, the timing of the rise in regulatory authorities can be attributed to policy diffusion. This does not imply, however, that the nature of regulation was the same in all countries. The increase in regulation in capitalist countries implies a growth in newer and more sophisticated instruments of regulation. The nature of these instruments, in turn, depends on the nature of the division of labour between state and society, which is contingent upon the policy goals and interest groups in the economy. This gives rise to national diversity in regulatory innovations and practices. (Levi-Faur, 2005) Regulation also sees diversity across sectors within an economy. For instance, financial regulation in a country like the United States faces more veto points and deadlocks than most other sectors in the economy. (Carpenter, 2010)

The case of liberalisation is an interesting one. Although all globalised economies face competitive pressures to liberalise, they do not do away with protectionist institutions altogether fearing political backlash. There continues to be a need to protect vulnerable groups, especially in underdeveloped countries. Moreover, studies on the diffusion of liberalisation do not predict a universal convergence towards liberalisation; rather, they predict convergence among competitors only. (Simmons and Elkins, 2004, p.173) This

can perhaps be seen in the fact that world trade liberalisation has hardly affected the continent of Africa, where trade-distorting support measures prevent access to international markets as late as 2004, and even afterwards. (Amoako, 2004)

Liberalisation in several economies is generally attributed to the coercive influence of the International Monetary Fund (IMF). However, some scholars (Mukherjee and Singer, 2010) have found that IMF loans have a positive effect on capital account liberalisation of an economy *conditional upon* the amount of welfare spending in that economy, and the ability of the government to compensate domestic groups that are harmed by liberalisation.

Some studies have found that liberalisation has been a result of democratisation, which can be viewed from an interest-based perspective. (Milner and Kubota, 2005; Hall, 1997) “Democratic leaders”, Milner and Kubota (2005) write, “...chose trade liberalisation as a means to garner political support”. Liberalisation can therefore be viewed as an interest-based political move. Financial sector liberalisation, in particular, is heavily dependent on the state of technology in the economy, especially the economy’s ability to fully exploit the advantages of telecommunications.

In the area of central bank independence, cross-national variations are quite clear. To begin with, the definition of ‘central bank’ and its functions varies from state to state. Independence of a central bank can be functional, legal, financial, or any combination of these. Moreover, the degree of autonomy and legal independence is a continuum—and no two

central banks have the same combination of functions and powers. (Marcussen, 2005) The following excerpt explains such variations well:

“...central bank independence also hinges on a broad series of factors and customary practices, which are partly determined by historical developments in the different countries. In particular, the way in which certain conflicts with other bodies of government have been resolved influences the extent to which a central bank is effectively protected against external interferences and marks the boundaries of independence.” (Bini Smaghi, 2008, p.447)

Taxation is another area where variations are evident. Although neoliberalism has required a change in the content of tax policy almost everywhere, these changes themselves are specific to each country. This is, in part, owing to the degree of dependence on fiscal policy in the economy. More importantly, the design of tax policy is significantly affected by the number and nature of actors in the tax-design process. This number is far lower in developing countries than in developed countries, and results in important variations. (Gould and Baker, 2002)

In the case of industrial policy, domestic interests play a vital role. An important point to keep in mind is that economic liberalism does not imply the disappearance of the state—in fact, most governments engage in some sort of industrial policy for domestic prerogatives. This phenomenon is referred to as ‘economic patriotism’ and can be either liberal or protectionist in nature depending

on the government’s policy targets. (Clift and Woll, 2012) In recent times, we have seen governments engaging in industrial policy in subtle and creative ways to avoid international criticism. Some economists find the recent rise in protectionism quite worrying and have found that countries as varied as India, Russia and USA are the “leading culprits”. (Johnson, 2016)

Summing Up

In this essay, I have attempted to demonstrate how the course of economic policy is affected by international factors and policy diffusion, while domestic factors determine the objectives of policies and their final forms. I have done so by looking at six areas of economic policy. In the case of privatisation, learning and emulation contribute towards international convergence, even though the nature of privatisation can be pragmatic, tactical or systemic depending on domestic policy objectives. (Feigenbaum and Henig, 1994) Privatisation is closely associated with re-regulation, rather than widespread deregulation; however, the regulatory authorities and institutions vary immensely across countries and the extent of regulation varies across sectors. While liberalisation is propagated by neoliberalism, its limits are determined by powerful societal groups, government welfare objectives and the extent of democratisation. Central bank independence for monetary policy saw a drastic rise in the 1990s, despite the fact that the nature of such independence and the powers of central banks are as varied as they are numerous. Fiscal policy, while facing pressures to be less stringent, depends on government ideology and the nature and number of actors in the policy

design stage. Finally, industrial policy, although frowned upon by champions of neoliberal ideology, continues to be an important part of economic policies for the logic of prioritising domestic interests.

These observations lead to some pertinent questions about economic policy in the international context. First, why is it that global factors influence some countries more than others? What determines the extent to which a country can resist outside pressures? For instance, a country like France has a more active industrial policy than that of most other developed countries. Perhaps it is possible that the more developed a country is, the more it can afford to resist global pressures. On the other hand, it is also possible that

policy diffusion plays a role in the rapid development of a country, making it difficult for the country to oppose international trends. Second, given that certain policies are propagated as “best practices” and enforced by the hegemony of certain countries and organizations, there arise important implications about the sovereignty of countries. The 20th century has been a century of decolonisation, but is any country truly free in a globalised scenario where there is hegemony of a few powerful nations? Interactions between domestic and international forces are evidently complex—hence, these are some interesting areas where further research may be undertaken.

Table: 1

	Positive State	Regulatory State
<i>Main Functions</i>	Redistribution, macroeconomic stabilisation	Correcting market failures
<i>Instruments</i>	Taxing (or borrowing) and spending	Rule making
<i>Main Arena of Political Conflict</i>	Budgetary allocations	Review and control of rule making
<i>Characteristic Institutions</i>	Parliament, ministerial departments, nationalised firms, welfare services	Parliamentary committees, independent agencies and commissions, tribunals
<i>Key Actors</i>	Political parties, civil servants, corporate groups	Single issue movements, regulators, experts, judges
<i>Policy Style</i>	Discretionary	Rule-bound, legalistic
<i>Policy Culture</i>	Corporatist	Pluralist
<i>Political Accountability</i>	Direct	Indirect

Figure 1 - Proportion of central banks with legal independence, 1870–2003 (Source: Marcussen, 2005, p.906)

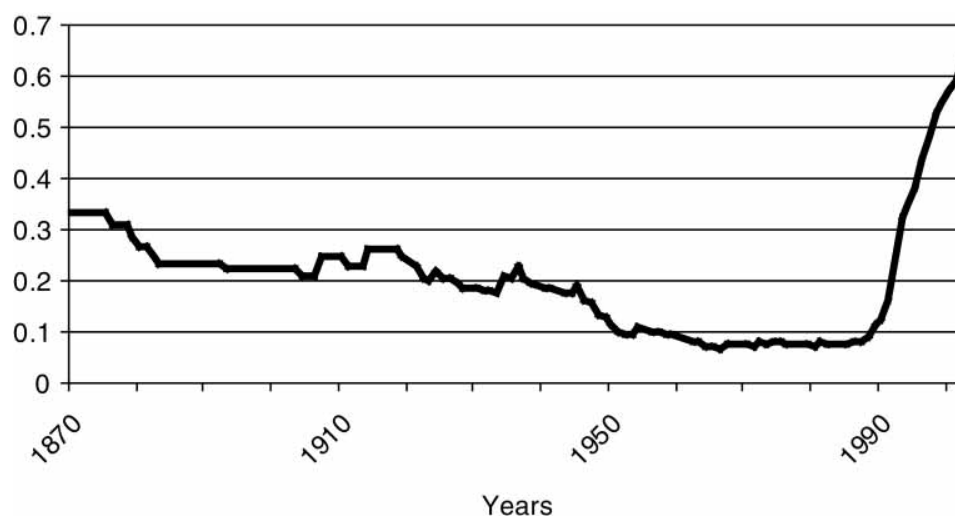


Figure 2 - Top (wage) income tax rates decreased (Source: Brys, Matthews and Owens, 2011, p.4)

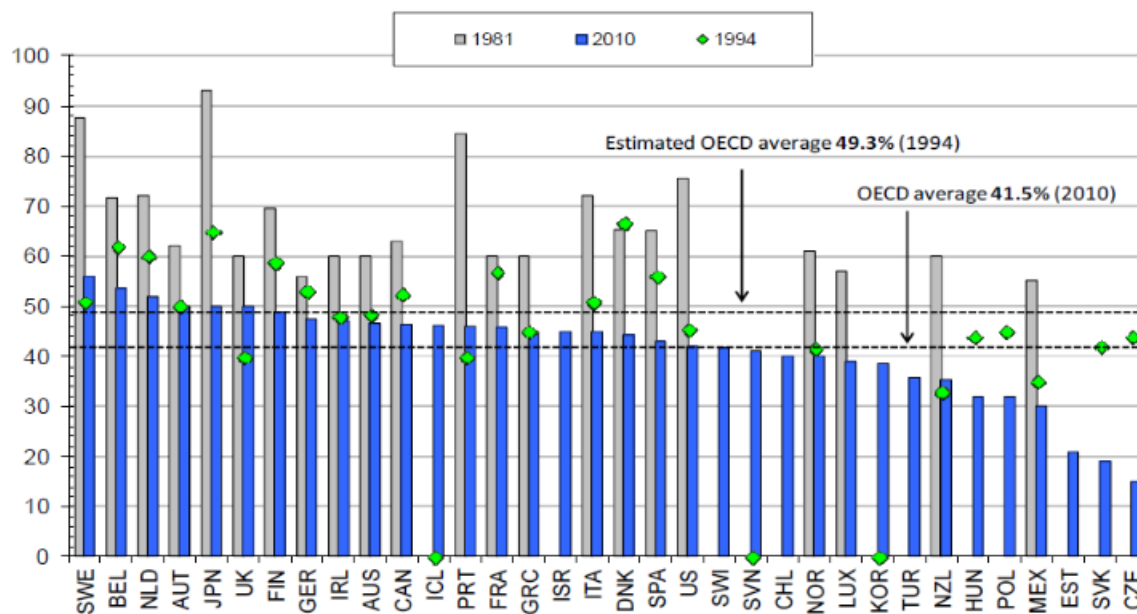
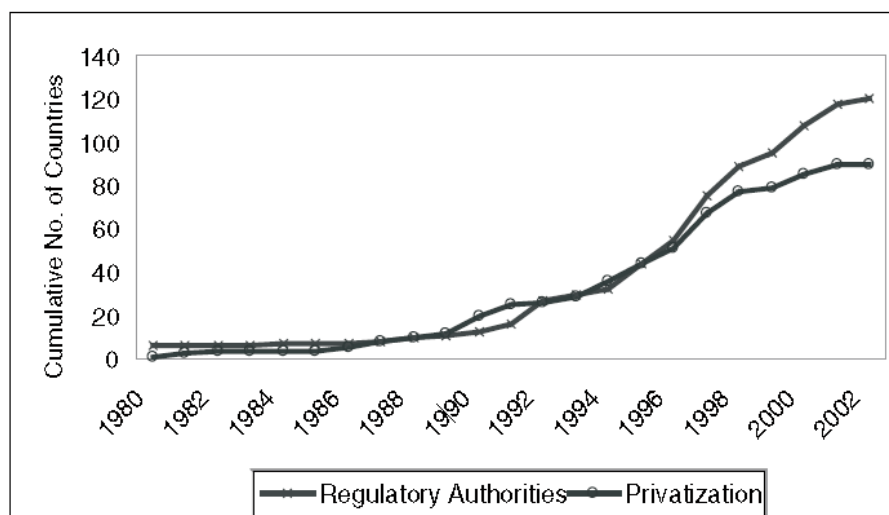


Figure 3 – The diffusion of privatisation and regulatory authority around the world
(Source: Levi-Faur, 2005)



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