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THE FAILURE TO CONVERGE: WHY GLOBALIZATION DOESN'T CAUSE DEREGULATION

ABSTRACT: *Conventional wisdom holds that the rigors of fiscal competition unleashed by globalization are forcing governments to roll back welfare programs, reduce or eliminate taxes on capital, and reduce regulation on mobile assets. In* Freer Markets, More Rules, *Steven Vogel attacks the latter contention, arguing that regulatory reform has been more often reregulatory than deregulatory, though it is generally undertaken with an eye to increasing market competition. He also maintains that governments have acted autonomously of social interests and market pressures in formulating regulatory reform. While Vogel is mistaken to contend that there has been no net reduction of government control worldwide, his revision of the conventional wisdom requires a fresh look at how susceptible states really are to the global competition for revenue.*

Steven K. Vogel's *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1996) challenges an important part of the received view about globalization: that it has forced governments to slash spending, balance budgets, and deregulate and privatize on a large scale.[1] He argues that states are not hostages of either market or interest-group pressures for economic liberalization in the name of international competitiveness. While global markets and domestic interest groups may provide the impetus for reform, he shows,

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the shape this reform takes depends a good deal on the particular nation's institutional legacy. Sometimes market demands are themselves the result of past policies that governments undertook with full knowledge of the results (12), and sometimes governments defy markets and powerful interest groups when they have other interests at stake (4–5).

Vogel makes a solid case for his central thesis, that governments worldwide have not converged on one neoliberal low-regulation regime. While case-study analysis of the sort Vogel provides cannot conclusively prove this as a universal rule, he persuasively shows that governments often act autonomously of social groups, especially when these groups are ill informed or ambivalent; and that we cannot expect governments to give up discretionary regulatory powers readily, even in an era of globalization and the alleged intellectual ascendancy of free-market economics.

What Is "Deregulation"?

To begin his analysis, Vogel presents a typology of regulatory reform along two dimensions (17). On one axis are reforms that either undermine discretionary bureaucratic control over industry or enhance it; on the other axis are reforms that emphasize either "liberalization" or "reregulation." Reforms that reduce discretionary control while mandating competition he calls "pro-competitive reregulation," which include measures designed to handicap market incumbents or strengthen antitrust enforcement. One might take issue with this description, since strong antitrust enforcement does not necessarily promote competition (for example, when it discourages a large firm's entry into a new product line dominated by another large firm), and it certainly does not usually undermine bureaucratic discretion.[2] Reform with a reregulatory emphasis that undermines bureaucratic control Vogel calls "juridical reregulation," by which he means reform that limits administrative discretion by codifying informal procedures or formalizing regulation into a judicial process. Administrative procedures limit government officials' discretion by forcing them to follow evidentiary rules, limiting the swiftness with which officials may act, or providing a formal mechanism for the regulated firm to provide feedback to the regulatory agency (see McCubbins, Noll, and Weingast 1987).

By labeling this sort of reform "reregulation" rather than "deregulation," Vogel makes it easier to prove his case against the prevalence of

globalization-driven deregulation, since such changes go on all the time. Most observers, however, would consider it an instance of deregulation—or at least would not label it as additional regulation—when bureaucratic discretion is replaced by formalized procedure. As Vogel's own typology recognizes, this sort of reform involves a net loss of government autonomy. Therefore this type of reform, to the extent it occurs, does not prove Vogel's thesis that there has been, worldwide, "little net loss of government control" (2). Vogel's case is better supported when he provides evidence of regulatory reform that actually enhances the authority of state bureaucracies.

Another problem with Vogel's analysis is that it appears to define any net increase in the number of rules that government promulgates as a move toward more regulation. But if we define regulation this way, then Vogel's object would have been easily achieved with a quantitative study: count up the number of pages of regulation published by the governments of a broad cross-section of countries and see whether the number has fallen; or whether more integration into the global economy correlates with fewer regulations. This approach would have been crude and unreliable not only because the codification of regulations that were previously implicit and vague may actually lessen government autonomy, but also for another reason: when a government privatizes a firm and then imposes regulations on it, the quantitative approach would indicate a net increase in government control, when perhaps the opposite has happened.[3] Falling into this trap, Vogel codes British regulation of telecommunications as an example of reregulation, even though it was preceded by privatization (60).

The other two categories in Vogel's typology are control-enhancing liberalization ("strategic reregulation," such as giving regulatory advantages to domestic firms) and control-enhancing reregulation ("expansionary reregulation," extending regulation to new areas). It is unclear how what the author terms "strategic reregulation" is an instance of liberalization at all; arguably expansionary reregulation is the only sort of reform Vogel has typed correctly. But the details of the typology are not crucial to his thesis. If governments have actually been engaging in expansionary, strategic, and procompetitive reregulation much more than in juridical "reregulation" or other forms of deregulation, then one would be forced to conclude that the deregulatory revolution never happened, and Vogel stands vindicated; if Vogel's case turns out to rely chiefly on instances of juridical "reregulation" it will be much weaker.

The Myth of Worldwide Deregulation

The thesis that deregulation has not been a secular tendency must immediately deal with the conventional wisdom to the contrary. Vogel argues that there was indeed widespread regulatory change over the last 20 years, precipitated by a crisis that produced a gap between states' goals and their regulatory capabilities (23–24). Technological developments made regulatory regimes outmoded in several ways: by creating new markets outside the scope of existing regulations, by blurring distinctions between lines of business, and by internationalizing markets (26). But, he contends, the resulting need for new regulation did not usually produce deregulation.

Vogel chooses to focus on two industries, finance and telecommunications, and two countries, the United Kingdom and Japan. One problem with this choice is that these countries have been privatizing their telecommunications systems, a step that in some instances, as I have already suggested, represents a retreat from government control even though it is accompanied by new regulations. Nor is finance the most appropriate sector from which to draw conclusions about regulatory reform worldwide, since in this industry what often looks like government regulation is either self-regulation undertaken by securities and commodities exchanges eager to preserve their reputations as honest markets,[4] or else is government regulation that is necessary only because of some other intervention. For instance, the regulation of the investment decisions of banks and savings and loans is necessary only because without it, government deposit insurance would create an intolerable "moral hazard": the temptation of insured institutions to invest wildly, secure in the knowledge that bad loans would be bailed out by government insurance. Vogel does note repeatedly that in finance, government regulation is often necessary because of previous intervention, but he fails to note that finance is almost unique in this regard.

Despite these flaws, *Freer Markets, More Rules* is valuable in pointing out—as its title suggests—how often new regulation takes place under the guise of deregulation. Worldwide, telecommunications privatization and the introduction of competition have been accompanied by regulation of the dominant service provider and, usually, by compulsory divestiture of certain parts of the company, as occurred in the United States. Most often service providers are forbidden from subsidizing their long-distance rates by raising rates on

local service, which everywhere remains a regulated monopoly (31). In Japan, the Ministry of Post and Telecommunications (MPT) actively limits entry into the telecommunications industry, while maintaining price and service regulation (161–66). In Britain, British Telecom was required to interconnect with a new telecommunications company, Mercury, in the interest of effective competition (76–77). Mercury also successfully lobbied for a seven-year ban on further competition on the grounds that it would undermine its competitive stance with regard to BT (70). The Office of Telecommunications still regulated BT's practices more than a decade after privatization, and the director general of the office, Bryan Carsberg, declared that deregulation probably would not be possible within his lifetime (65–66, 89).

In finance, Vogel shows that new regulation was often stimulated by innovations designed to thwart old regulations. In the United States, a unique regulatory barrier between banking and brokerage (and investment banking as well) prompted the development of new financial instruments to get around the distinction. As a result, the government reformed its financial regulations. On the other hand, regulation has often been designed to allow new financial instruments to develop, preventing capital flight to less-regulated markets. The oft-cited fiscal competition among governments induced by globalization has been at work in finance, since funds can move easily across borders. Deregulation of broker commissions occurred in New York first because investors were able to circumvent them, and once New York liberalized, other financial centers had to follow suit (32).

In the United Kingdom, however, financial reregulation followed on the heels of deregulation. Traditionally, the Bank of England had informally regulated the City (Britain's financial sector) with an eye to its interests, but the regulatory regime placed British traders at a competitive disadvantage. British traders faced fixed commissions and a "single-capacity" system, whereby a firm could be either a "jobber" (a wholesaler) or a "broker" (an intermediary between investors and jobbers) but not both (97, 100). The October 27, 1986 "Big Bang" abolished fixed commissions and single-capacity requirements (107). But these reforms opened the door to foreign financial institutions, whose new presence in London made informal regulation less practicable. This prompted the imposition of a judicialized antifraud regulatory regime, accomplished through the Financial Services Act. It

created a private organization, the Securities and Investment Board, which was empowered to govern City financial practices. In 1987, the SIB promulgated an "enormous rule book," provoking a revolt among City practitioners (111–12). In creating the new regulatory board, the Department of Trade and Industry seems to have been more concerned with preventing scandals (several had erupted in the early 1980s) than with cutting costs (116).[5]

In financial services, deregulation and reregulation shared a common cause: the growing complexity and internationalization of financial services. In other industries, the British government privatized and allowed competition while sometimes tightening safety regulations or creating new agencies to regulate privatized monopolies. Vogel calls the aggressive promotion of competition without managing market entry and exit "the British pattern" (an exception would be telecommunications) (129).

By contrast, in Japan close government control survived financial deregulation. The Ministry of Finance (MoF) heavily regulates entry and exit in banking, securities, and insurance, with the aim of preventing bank failures and stock-market volatility (167–70). The impetus for regulatory reform was similar to that in the United States: the traditional distinction between banking and securities was breaking down. The MoF responded by incrementally liberalizing deposit interest rates and partly deregulating the financial system. At the same time, the MoF upgraded its supervisory capacities, tightened disclosure regulations, and promoted mergers between banks (174–75). The MoF was able to take advantage of divisions within the financial industry to enact a "separate subsidiaries" approach to the regulation and integration of banking and securities firms (182–85). And the ministry has retained the right to permit new financial instruments on a case-by-case basis rather than issuing a general permission for certain classes of instruments (192).

Vogel's book demonstrates that certain sectors of the British economy are somewhat less regulated than previously. I would add that American industries such as air travel, telecommunications, electricity, and natural gas have also been deregulated more than they have been reregulated, although electricity and natural gas providers are forced to serve all comers through open-access regulations, and cable television, never freed from local regulations that conferred monopolies on certain carriers, was federally reregulated in the early 1990s. Overall, however, Vogel shows that governments have truly deregu-

lated surprisingly little. Governments have responded to technological change that made existing regulatory regimes less efficient in various ways: sometimes by eliminating the restrictions on private profit-seeking behavior, but more often by merely restructuring them. Most government power over the economy has remained intact or expanded.

Has Globalization Caused Regulatory Reform?

Nonetheless, regulatory reform of whatever content or direction has been substantial of late, and at least some deregulation has occurred in most countries. At the same time, the internationalization of trade and capital has increased. Has globalization caused regulatory reform, if not deregulation, by exerting competitive pressure to allow (or mandate) more competitive markets?

One might expect that such pressure would come from domestic firms disadvantaged by relatively tight regulation. But Vogel shows that government ministries have been able to determine the character of reform according to their historical interests and orientations, without (and even in the face of) pressure from distributive coalitions in society. Vogel supports his case with a staggering array of interview evidence; rather than theorize a priori about the deregulators' motives, he obtained his information directly from the important players. In Britain, for example, the nationalized telecommunications provider, British Telecom, was particularly inefficient (relative to countries like Japan and France),[6] and provided an obvious target for the neoliberal Tory government that took office in 1979, which proceeded with privatization and plans for regulatory liberalization although no group had ever lobbied for it (74). Privatization was not even initially on the Tory agenda; although it clearly accorded with Margaret Thatcher's ideas for reform, it was the brainchild of Secretary of State Sir Keith Joseph, an ardent liberalizer (74–75). Radical regulatory reform was pushed through by a committed set of policy makers, without pressure from social interests.

Perhaps cultural factors, then—the traditions of different countries and the ideas of those in power—have been responsible for regulatory reform. Maybe—and in some cases, certainly—public officials, under the normative sway of market economics, have implemented deregulatory policies they thought would improve social welfare.

They might have been able to do so in spite of the indifference, and sometimes the opposition, of special interests because of widespread public ignorance of what they were doing.[7] A special interest that cannot mobilize public pressure to get its way (usually in the name of the public interest) will be powerless in the face of a determined government.

However, if state officials are so autonomous that they can translate their ideal policy preferences into law, we should see ideal types of various policy regimes all around us. We should have pure laissez-faire regimes, completely controlled fundamentalist religious regimes, and pure communist states. In reality, though, even Hong Kong and nineteenth-century Britain and America were very far from pure laissez faire, even Iran is far from a completely controlled Islamic society, and the Soviet Union in retrospect looks like a fairly typical bureaucratic-authoritarian regime. If states were completely autonomous, we would expect them to vary much more than they do.

A Theory of State Interests

The relative homogeneity of modern states may be explained by drawing on Theda Skocpol's concept of the state as being "fundamentally Janus-faced," in that it has to deal with international pressures while maintaining effective control over, and legitimacy with, the domestic population (1979, 32). While public ignorance may afford states a large degree of autonomy on the domestic front, international pressures act as a selection mechanism to weed out "weak" states.[8] One such pressure is war. Weak states will succumb to stronger states in battle. Over time, we would expect to see states that are resilient in the face of external military threats. Indeed, even a state's need for democratic legitimacy—and thus the effectiveness of an ignorant *demos* in creating state autonomy—can be attributed to selection pressures. States that were viewed as illegitimate by significant sectors of the public and lacked the resources to suppress these sectors would be subject to coups d'état, revolutions, and partitions. Thus, they would tend to disappear.[9]

In general, if states are to survive, they must be able to extract enough resources from the domestic population to equip a military force sufficiently powerful to resist external aggression, while maintaining a domestic mix of legitimization and repression that prevents revolutions and coups from within. Thus, a domestic bureaucracy is neces-

sary not only to extract resources for military use, but to provide goods and services that are perceived as desirable by domestic interests. Military and bureaucratic establishments, in turn, need discretionary authority so as to meet domestically perceived needs, mobilize production for war, crush threatening dissent, maintain patronage networks (even strong states must do this to some extent), and, in general, to react to threatening situations with speed and effectiveness.

The two broad requirements of a militarily sustainable state—fiscal stability and domestic control—are usually in tension. To achieve fiscal stability, the state needs a healthy private sector from which to extract funds (the partial structural dependence of the state on capital);[10] overuse of discretionary powers will discourage investment through high tax rates and oppressive levels of regulation, and it will generate domestic discontent over economic interventions and curtailments of civil liberties, particularly if they are applied inconsistently or arbitrarily. Fiscal ill health may also require paring back those state institutions involved in domestic resource extraction, political legitimation, and civil repression.

The relationship between fiscal health and discretionary power can be seen as a sort of generalized Laffer curve. The Laffer curve posits an upside-down U-shaped relationship between tax rates and revenues. Low tax rates mean low tax revenue; high tax rates mean low growth and therefore, again low tax revenue. The revenue-maximizing tax rate lies somewhere in between. We can imagine a similarly shaped relationship between discretionary power and fiscal health. States that are able to limit their discretionary powers, particularly through a credible commitment to maintain this limitation, would in turn be able to maximize not only tax revenues but access to loanable funds through bond markets.[11]

We might say that successful states are highly "institutionalized," in that they have developed institutions that limit their own ability to pursue unsustainable fiscal policies while allowing them to act quickly when their survival is at stake.[12] Therefore, we would expect to see budget-conscious treasury departments checking the discretion of social-service and regulatory departments, and even different regulatory departments checking each other, while supreme military control is concentrated and relatively more autonomous. Another way a state would limit both its discretionary powers and its fiscal instability would be by insulating itself from radical change that might otherwise be im-

posed by an ideologue (such as Keith Joseph). Bureaucratization (in the sense of "red tape") and departmentalization would achieve this end.

States' Interest in Regulatory Reform

While this theory can, with a little ingenuity, be tested statistically,[13] it also engenders predictions that fit well with the narrative evidence Vogel has marshalled. The theory is able to explain why states respond to external economic shocks, such as globalization and technological change, with reforms that point in a common direction. Vogel and many other researchers have argued that globalization and technological change have made old regulatory regimes more inefficient. In order to promote economic growth and, by extension, revenue growth, states have recently needed to restructure their regulatory regimes, largely in the direction of more competition. At the same time, states will not undertake their own destruction by abolishing all regulatory authority, which strengthens states in many ways. Regulation allows states to maintain political control over firms that might be essential to national defense. It also allows states to engage in constituent service, whether by imposing controls on poorly organized groups, such as small businesses, in order to benefit well-organized groups, such as large businesses; or by creating exceptions to the rules for particular clients.[14]

This view of state interest and regulatory reform captures the cross-national commonalities that Vogel has uncovered. It explains why different countries have converged toward competition-promoting regulatory reform but not toward laissez faire.[15] The theory does not explain divergence among national approaches, however, since it deals only with the ends of states (revenue and discretionary power) without addressing the means states use to accomplish those ends. The means depend on the situation of the country in the international economy (open economies may be more constrained than closed ones); the socioeconomic structure of the country (a powerful landowning class may thwart the growth of manufacturing, or voters in a highly unequal class system may strongly favor redistributionist policies); institutional design (for example, separation of powers may block sweeping policy initiatives or comprehensive planning); and "regime orientation" (a fuzzy variable describing how state actors view the consequences of their policies—for example, a regime orientation toward corporatist macroeconomic compromise is often attributed to Germany). Vogel himself

makes the case for this theoretical "division of labor" between factors explaining convergence and those explaining divergence.[16] Being more interested in divergence, Vogel focuses on the set of variables just mentioned, particularly regime orientation.

Regime orientation is malleable to changes in state actors' economic views. Thus, it might be fair to say that there has been a common shift in regime orientations toward the promotion of loosely defined "deregulation" and "liberalization" due to both the experience of regulation and the emergence of economic theories of regulation that emphasize the extent to which regulations are likely to serve special interests. However, regime orientations still differ among countries. Japan's approach to regulatory reform has obviously been more regulatory than Britain's and, arguably, has been less liberalizing (less effective in promoting competition). Both states are more-or-less consciously seeking the same ends—fiscal health and the ability to intervene when necessary—but the individual policy makers within each system have different ideas about how to achieve these ends. Apparently Britain's experience with labor-union militancy and widespread nationalization, combined with its old intellectual and political-economic heritage of market liberalism, caused Conservative (and New Labour) policy makers to see competition-promoting deregulation as the solution to long-standing economic problems, while Japan's apparent success with (relatively) state-led development gave Japanese policy makers reason not to want to scale back state authority.[17]

Vogel's claim that there has been no net loss of government control over industry worldwide, despite the perception of widespread deregulation, corresponds to the findings that capital mobility has not caused governments to cut taxes and spending, and that it has not provoked convergence in national tax and spending trends (Garrett 1998). But this does not mean that globalization has not been a source of regulatory reform (including some deregulation). If states make tradeoffs between fiscal stability and domestic control, then international economic competition, along with state officials' changing convictions about economic theory, may have made it seem necessary to reduce or restructure regulation—an element of domestic control—in the interest of fiscal health.

This would explain why, in a world of mobile capital, governments have not been forced to slash spending, taxes, and regulations. Even if by retaining taxes and regulations states lose some of their tax base, revenue maximization is not their sole goal. They will not abandon

the various tools of intervention that allow them to promote national self-sufficiency in industries thought vital to national security; to satisfy the demands of domestic constituencies; and to reward friends and punish enemies, both domestically and internationally. (In countries where the population is particularly ignorant of political goings-on, and states are particularly desperate for legitimacy, they may even use tools of domestic regulation covertly to *create* problems and then ostentatiously solve them.) Furthermore, governments can compete for mobile capital by offering subsidies, not just tax breaks—as a perusal of economic competition among local governments in the United States reveals.

Globalization may, therefore, have prompted a great deal of regulatory change; but only when it has been coupled with policy makers' perception of either the fiscal benefits of enhancing international competitiveness through deregulation (see Borchert 1996), or with their belief that deregulation would serve the public good independent of state interests, has globalization led to a contraction of state authority.

NOTES

1. Other dissidents from the conventional wisdom are Geoffrey Garrett (1998) and Dani Rodrik (1998).
2. Vogel even goes so far as to say that "liberalization and deregulation contradict each other more than they complement each other" (65). This statement cries out for context; complete central planning of the economy would not be conducive to market-driven competition. Vogel's central paradox, evident from the title of the book, is that liberalization requires more regulation; but this is overstated. Immediately upon privatizing or removing monopoly privileges, governments often must actively promote competition with the firm that had been enjoying legal privileges for so long. On the other hand, when bureaucrats maintain their control over entry and price and production decisions indefinitely after the initial reform, regulation no longer assists liberalization but instead hinders it.
3. Privatization without deregulation does not necessarily decrease bureaucratic authority: in the limit case, regulation of privately owned firms can approximate straightforward state management. However, to code the replacement of state ownership with state regulation as an instance of "reregulation" is misleading.
4. See Abolafia 1985 for a detailed analysis of self-regulatory policy at the Chicago Board of Trade.
5. This is probably true of much regulation all over the world.

6. According to Vogel, "it was falling behind its Continental neighbors in labor productivity, and it was lagging in the all-important race toward digitalization" (70). Furthermore, it was undergoing financial problems.
7. See Somin 1998 and Friedman 1998 for compelling accounts of pervasive public ignorance.
8. State strength and state autonomy are often conflated in the literature, but it is useful to keep the concepts analytically distinct. Logically, a state may be strong (i.e., stable) and yet not autonomous (i.e., it is penetrated by social forces and coalitions). Empirically, perhaps, state strength and autonomy are correlated, though the monarchies of the Arabian crescent may be examples of nonautonomous strong states.
9. I have so far avoided defining the state. However, I believe the evolutionary argument would apply to any organization that attempts to maintain an exclusive privilege of exercising violence within a given territory (Weber's definition). Of course, no state has a monopoly on violence within its claimed borders. About the best a state can accomplish is to secure the right to be the ultimate arbiter of what constitutes legitimate violence within a given territory (thus, a state can decide whether private violence is legitimate or not). The part of Weber's definition that is crucial to my argument is exclusivity. It is the state's attempt to be the exclusive arbiter or employer of force that generates the competitive dynamic among states.
10. See Przeworski and Wallerstein 1988.
11. For a historical example, see North and Weingast 1979.
12. My use of the term "institutionalization" is not much different from Samuel Huntington's (e.g., 1968, 5). Unlike Huntington, however, I do not wish to equate the state's interest and the public interest.
13. One way to do so is to take a random point in time and run a regression predicting the future survival of polities against their past survival. I have done this for European and industrial countries after World War II. The Pearson correlation between years before 1945 under 1945 constitutional arrangements, on the one hand, and whether the polity undergoes a fundamental constitutional change between 1945 and the present (1=change, 0=no change), on the other, is –0.00513, with a standard error of 0.002093 (p-value=0.02), indicating strongly that governments that have existed longer are more likely to survive in the future. Of polities in the sample that had existed for at least 20 years prior to 1945, none had undergone a significant constitutional change between 1945 and today except one: the Soviet Union. Of polities that did not yet exist in 1945 or were just being (re-)created, only Italy, Japan, Austria, the Netherlands, Belgium, Denmark, and Luxembourg have not since had a major constitutional change—and the latter four countries had an only recently dismantled administrative apparatus to reinstate, while the former three maintained new institutions under the watchful eye of foreign military observers. Though the sample includes only 30 countries, the data provide striking evidence that past state survival predicts future survival. It would be difficult to account for this finding without an evolution-

ary theory of state strength, particularly since it directly contradicts the "rise-and-decline" theory, which holds that the longer a state exists, the more likely it is to become corrupt and to fall (e.g., Olson 1982).

14. See Olson 1982, 71, for an example of the latter phenomenon.
15. "Laissez faire" is, of course, a form of regulation aimed at establishing private property rights. But including laissez faire in the definition of "regulation" would make it impossible to speak coherently of "deregulation," which is a traditional usage in discussing the putative effects of globalization—as is the term "laissez faire."
16. Each of these forces for change—market shifts, the export of U.S. regulation, and macroeconomic changes—provides a partial explanation for the widespread movement toward regulatory reform in the advanced industrial countries. . . . These explanations account for the elements of convergence among the advanced industrial countries. . . . However, they cannot address the even more remarkable variance in how these countries have responded to these challenges. (41)
17. Borchert 1996 argues, in fact, that reform was a distinctly national and nationalist endeavor, undertaken to enhance the stature of the nation-state in global context.

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