The Demand for Global Governance

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Abstract

This paper develops a theory of the relationship between economic globalization and systems of market governance. Drawing on literatures in political science, economics, and sociology, it argues that the global system involves the co-evolution of market, state, and societal institutions. Contemporary economic globalization has outstripped the capacity of national-level governmental and societal institutions to regulate markets and to compensate for their impacts and eroded the compromise of "embedded liberalism." The resulting global governance deficit has triggered a social response and a demand for new forms of governance. Innovations in both the public realm, notably the linkage of labor and environmental issues to trade agreements, and in the private realm, notably codes of conduct and other forms of corporate social responsibility, are two faces of a common governance response to this demand. The paper predicts further thickening of governance capacity, but this may occur at either global or regional scales.

Key Words: development, globalization, governance, international trade

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The Demand for Global Governance[1]

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At the beginning of the 21st century a rising tide of protest threatens to engulf the global economic system. Workers in wealthy countries denounce unfair competition from their poorer counterparts, while developing countries balk at neo-liberal prescriptions for development and vie for power in global economic forums. Every meeting of the World Trade Organization (WTO), the International Monetary Fund (IMF), and the World Bank is challenged in the streets by a global protest movement.

For nearly half a century, the liberal economic institutions established at the end of the Second World War served as a cornerstone of international economic cooperation and growth. The regime embodied by the WTO, the IMF, and the World Bank was largely a success on its own terms, bringing more and more of the world's economies under its free market disciplines and knitting a collection of national economies into an increasingly interlocked global economy. But what was once the basis for global stability now appears to be a source of instability.

In some ways, the current situation parallels that faced by industrializing nations in the first half of the 20th century. Writing in the early 1940s, Karl Polanyi argued that the rise of the modern industrial economy had created a relatively autonomous market no longer "embedded" in traditional institutions of government or community, which constituted a threat to workers, to nature, and even to the stability of markets themselves (Polanyi 1944). The movement towards market, however, was everywhere countered by a social response. In the United States, the New Deal's strong regulatory and social welfare policies represented a partially successful attempt by society to reassert control over the market. Elsewhere, however, the response took a darker shape, including fascism. Ultimately, the collapse of the international economy in the 1930s stemmed in large measure from the extent to which the market, particularly the international financial system, had become disembedded from systems of national control.

Polanyi predicted in 1944 that there would be a retrenchment from international capitalism as a means of restoring social control over markets. Reviewing the first three decades of the post-war economy nearly 40 years later, however, John Ruggie judged that while Polanyi had been wrong in his prediction of the end of capitalist internationalism, he was essentially right in concluding that governments would need to assume a much greater role in providing social protection (Ruggie 1982). In Ruggie's view, a system of "embedded liberalism" had enabled an

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increasingly open international economy by tying it to strong interventionist policies domestically and by retaining a measure of protection from international financial markets.

Much has changed since Ruggie's insightful essay. Most notably, a process of economic globalization, different both in magnitude and kind from the economic integration of the immediate post-war years, has upset the precarious balance between international openness and domestic intervention. In the first decades after the war, international commerce was dominated by arm's-length trade among developed country economies, direct foreign investment constituted a relatively small portion of production, and financial markets were still largely national. This economy could be depicted as embedded in strong national social welfare and regulatory systems. In today's "partially globalized" economy (Keohane 2002), however, markets and market actors transcend national boundaries, international trade is increasingly organized through interfirm networks and global supply chains, and capital flows freely around the world. The global market has become dis-embedded from the national regulatory and social insurance institutions on which the liberal international system was predicated.

Moreover, the aggressive extension of the system to the developing economies, where markets were never embedded in domestic governance, poses precisely the same issues for these societies as those faced a century ago by the now developed nations. As Ruggie prophetically noted in speculating about how enduring the system of embedded liberalism would be, "the compromise of embedded liberalism has never been fully extended to the developing countries," who as "regime takers" bore many of the adjustment costs of the system (Ruggie 1982: 413). It is one thing to maintain the balance of international openness and domestic intervention among nations of roughly similar levels of economic prosperity and patterns of political and social organization, and it is quite another to do so among nations that differ dramatically on these dimensions.

What we are witnessing today, we argue, is a crisis of governance – that is, of the inadequacy of institutions not only to *facilitate* market growth and stability, but also to *regulate* markets and market actors, and to *compensate* for undesirable effects of market transactions. The rise of an increasingly global economy no longer firmly rooted in nation-states, and one that encompasses a large portion of the developing world, is challenging the regulatory and compensatory capacities of both developed and developing countries. Northern governments find it increasingly difficult to maintain their capacities in the face of competition from less regulated, lower cost economies. Developing nations lack both governmental and societal capacities to cope with the domestic challenges imposed by international openness. And at the international level, little regulatory or compensatory capacity has evolved to take up the slack. Taken together, these developments have led to a *governance deficit* of considerable magnitude.

Governance deficits provoke social responses. The clamor over globalization represents a social response to the perceived threat posed by the global market to workers, the environment, and, particularly in the developing countries, to the stability of the productive system itself. In part, the movement can be seen as a protest against economic globalization. Indeed, many of the loudest voices in the social movement are merely obstructionist, and deserve to be labeled as anti-globalizers. But in important ways the movement is better seen as a response to the governance deficit created by economic globalization, and as a demand for greater governance.

Social responses create a demand for governance. Just as in the early part of the 20th century, when the rise of the welfare state in the public arena and patterns of collective bargaining in the private realm represented institutional innovations to meet the demand for new forms of governance at the national level, at the beginning of the 21st century we are witnessing the invention of global governance mechanisms. We discuss two of these below: the attempt to link labor and environmental standards to trade agreements (a public governance mechanism), and the trend towards corporate social responsibility in the form of codes of conduct and monitoring (a private governance mechanism). Neither is likely to be sufficient, yet each constitutes an important innovation and points the way towards other governance responses.

The paper is organized as follows. Section I assesses how five different theoretical traditions have conceptualized globalization and what each suggests, explicitly or implicitly, about the nature of the governance challenge posed by it. Section II outlines our theoretical framework for analyzing the relationship between globalization and governance. We argue that as the international system has evolved during the past half century, developments in the economic realm have outstripped the capabilities of governance systems, both governmental and societal, and have created a global governance deficit. Section III argues that the governance deficit has triggered both a global social response and a demand for new governance institutions. We analyze two faces of this governance response, public and private, that illustrate the need for the kind of broad integrative framework that we propose. Finally, Section IV extends our model of the co-evolution of markets and governance into the future to discuss how the growing integration of the South, especially large economies like China, India, Brazil, Mexico, Turkey, and Indonesia, is pushing the international system toward a more fully globalized world, with major new challenges for all dimensions of global governance.

I. THEORIZING GLOBALIZATION AND GOVERNANCE

How does contemporary globalization differ from earlier episodes of economic integration? The decades leading up to 1913 were considered a golden age of international trade and investment, but this was ended by World War I and the Great Depression when most of the world's economies turned inward. Merchandise trade (imports and exports) as a share of world output did not recover its 1913 level until the mid-1970s (Krugman 1995: 330-331). Since the 1970s, trade has continued to grow faster than output at the world level, reaching historically high levels. Foreign direct investment enjoyed an even more rapid pace of expansion: between 1983 and 1990, it grew three times faster than trade flows and almost four times faster than output (Wade 1996: 63). The popularity in the 1980s and 1990s of new financial instruments such as international bonds, international equities, derivatives trading (futures, options, and swaps), and international money markets helped create a global financial marketplace as well (Held et al. 1999: 205-209).

We argue that both the degree and character of international economic integration is different from that of a century ago; "globalization" is indeed something new. As a process, we distinguish between *internationalization*, which involves the mere extension or geographic spread of economic activities across national boundaries, and *globalization*, which is qualitatively distinct from internationalization because it involves the functional integration of

internationally dispersed activities (Dicken 2003: 12). The globalizing economy of the late 20th century is characterized by a new international organization of production processes. Before 1913, the world economy was characterized by *shallow integration* manifested largely through *trade* in goods and services between independent firms and through international movements of portfolio capital. Today, we live in a world in which *deep integration*, organized primarily by transnational corporations (TNCs), is pervasive and involves the *production* of goods and services in cross-border value adding activities that redefine the kind of production processes contained within national boundaries (UNCTAD 1993: 113).[2]

Paralleling economic globalization have been related increases in the number of international institutions and transnational societal linkages. Flows of information on the Internet, transnational networks of activists, intergovernmental cooperation, the growth of international organizations, and other developments are all expressions of the increasingly complex interconnections of the modern era. Relative to the *thin globalization* of the earlier period in which the extensity (or spread) of global interconnectedness was not matched by an intensity (or multiplicity) of diverse relationships, we now have an increasingly *thick globalization* in which there are a plethora of relationships that are both extensive and intensive (Held et al. 1999: 21-22).

Perspectives on Globalization and Governance

Not surprisingly, scholars in different disciplinary traditions vary considerably with regard to their beliefs about globalization and its implications for governance. These perspectives can be divided into at least five major paradigms of globalization: *international institutional*, which focuses on changing patterns of interdependence and authority between nation-states; *comparative institutional*, which focuses on national responses to increasing globalization; *international economic*, which highlights the distinctive features of the global economy resulting from the growing importance of the newly industrializing economies (NIEs) in international production and trade; *international industrial organization*, which emphasizes the creation of new forms of international production networks in the global economy; and *global civil society*, which explores the rise of non-governmental organizations (NGOs) and the growth of a global civil society, and the impact they have on international relations.[3]

International Institutional

International relations scholars focus on the question of how sovereign nations can cooperate in the international arena, and the extent to which international institutions can help solve this problem. Globalization, viewed from this perspective, increases the need for international cooperation and, therefore, the demand for international institutions.

In *Power and Interdependence,* first published in 1977, Keohane and Nye characterized the international system as one of complex interdependence, in which internationalization was leading to greater interaction at intergovernmental, interstate, and transnational levels. For them, globalization is largely an intensification of internationalization, which is leading to even

[2] By 1990, TNCs controlled one-third of the world's private sector productive assets (UNCTAD 1993: 1).
[3] There are other dimensions of globalization, such as cultural perspectives, that we don't discuss here.

more complex interdependence. In the third edition of their classic text, Keohane and Nye (2001: 229) argue that globalization is an increase of globalism, defined as "spatially extensive networks of interdependence." Compared to 1977, they see in globalization: (1) a greater density of networks, due to the increasing thickness of globalism; (2) greater "institutional velocity" because reduced communication costs lead a system and the units within it to change more rapidly; and (3) greater transnational participation, which increases the relevance of the manifold relationships associated with complex interdependence (Keohane and Nye 2001: 240-247).

Many other authors build on this interdependence perspective. Held et al. (1999) apply their notions of thin and thick globalization to multiple historical forms of globalization: political, military, trade, finance, business, migration, culture, and the environment. They identify two features of contemporary globalization as distinctive: unusually "thick" global flows and interaction networks; and complex overlapping political domains referred to as "multilayered governance" (Held et al. 1999: 431 & 444). Milner (1988) has demonstrated how increased internationalization of the economy fosters support for international institutions, such as the WTO, that facilitate greater economic openness, while Slaughter (1997, 2004) has explored how the growth in intergovernmental connections has created greater demand for the institutionalization of those relationships.

From the international institutionalist perspective, globalization poses twin governance challenges. On the one hand, there is the need to create more effective international institutions to facilitate cooperation in a world of sovereign states. As Keohane (2002: 325-326) argues, "effective governance of a partially – and increasingly – globalized world will require more extensive international institutions." On the other hand, effectiveness must be balanced with accountability, notwithstanding the fact that accountability at the global level is fragmented and disarticulated, especially in terms of rule making and rule implementation (Keohane 2002: 339).

Comparative Institutional

For scholars in the comparative institutional tradition, the main issue with economic globalization is its impact on the autonomy, stability, and performance of national institutions. Much of the literature is concerned with the governance of modern capitalist economies. There are diverse subfields, including: regulation theory (Aglietta 1980; Boyer 1989), national systems of innovation (Lundvall 1992; Nelson 1993), social systems of production (Campbell et al. 1991; Hollingsworth et al. 1994; Hollingsworth and Boyer 1997), and varieties of capitalism (Berger and Dore 1996; Kitschelt et al. 1999; Hall and Soskice 2001). Authors focus on the "institutional foundations of comparative advantage" in the advanced capitalist democracies, with an emphasis on topics like business-government relations, labor markets, collective bargaining, the welfare state, the internationalization of capital, and innovation systems (see Hall and Soskice 2001: 36-44).

The varieties of capitalism perspective, one of the most widely known comparative institutional literatures, is based on the idea that countries follow different institutional paths of insertion into the global economy. A key unifying concept is "institutional complementarity," which relies on "multilateral reinforcement mechanisms between institutional arrangements: each one, by its existence, permits or facilitates the existence of the others" (Amable 2000: 656). Complementary

institutions and other forms of path dependency lead most varieties of capitalism scholars to argue vociferously against convergence, given their belief that unique and valued institutions will sustain national diversities despite the withering pressures of international competition in an increasingly open global economy. However, there has been little effort to extend this paradigm to countries in the developing world.

Comparative institutionalists see the governance problem posed by globalization as situated within nations. In an environment where capital is increasingly mobile, TNCs have an incentive to seek the lowest cost and most productive international locations, thereby undercutting the effectiveness of government regulations, collective bargaining agreements, and social welfare institutions in the advanced industrial societies. Patterns of institutional complementarity that worked when most economic activities were encapsulated by the boundaries of nation-states are under pressure as imports garner ever larger shares of domestic consumption, "guest workers" and other forms of immigrant labor further diminish the role of unions, and global outsourcing becomes the norm for most goods and services provided in modern economies.[4] While the varieties of capitalism literature addresses governance issues in advanced industrial countries, it largely ignores the possibly more profound governance challenges posed by globalization for developing and transitional economies.

International Economics

For a generation or more, international economists more or less uniformly focused on the distorting effects of international protectionism and adopted a common position in favor of free trade. The central organizing concept of neo-liberal orthodoxy was comparative advantage, in which free trade creates maximum net welfare gains. This stance, translated into policy, undergirded the effort both to reduce levels of protectionism in advanced industrial economies and to pressure developing countries to adopt neo-liberal economic reforms.

A growing number of economists, especially in the international trade field, have begun to question conventional wisdom in light of contemporary globalization, particularly with regard to how growing participation by countries from the South raises fundamental questions about distribution and equity. When the focus was largely on commerce between advanced industrial economies, distributional issues tended to recede. But as Jeffrey Sachs (1998) puts it:

> The great novelty of the current era is the extent to which the poorer nations of the world have been incorporated in the global system of trade, finance, and production as partners and market participants rather than colonial dependencies. For globalization enthusiasts, this development promises increased gains from trade and faster growth for both sides of the worldwide income divide. For

[4] The boundary between international relations and comparative politics has been blurring in recent years, in part because globalization clearly affects both domestic and international institutions. For example, studies of international interdependence have evolved from a focus on the ways in which greater economic linkage among countries affects national interests to a more systematic analysis of how pressures created by interdependence are translated by national political institutions into policy choices and institutional change (Garrett and Lange 1995; Keohane and Milner 1996).

skeptics, the integration of rich and poor nations promises increasing inequality in the former and greater dislocation in the latter.

There is increased questioning of the relationship between free trade and economic growth, and a growing recognition that free trade itself is not a development strategy.

The new international economics literature, while generally not focused on issues of governance, implies several significant governance challenges. A first has to do with the problem of managing dislocations. Dani Rodrik's (1997) influential and aptly titled book, *Has Globalization Gone Too Far?*, demonstrates the distributional consequences of free trade between countries at different levels of development. Using a Stolper-Samuelson model, he shows that increasing free trade will tend to disadvantage workers in advanced industrial economies, who must now compete with an abundance of low-wage labor in developing countries. National institutions that bear the adjustment costs of economic openness (on plant closings, the outsourcing of jobs, worker skills, etc.) must be adequate to the task.[5]

Rodrik also identifies a second governance challenge, this for developing nations, which lack basic economic infrastructure (commercial law, educational systems, social safety nets, and the like) needed to engage effectively in the highly dynamic global economy.

A third challenge has to do with incorporating developing countries into international institutions and rebalancing the rules of the game. Economists such as Joseph Stiglitz (2002) have been sharply critical of the way in which wealthier countries of the North have pressured developing economies to open their markets to manufactured goods, while developed economies have retained extensive subsidies and protection in agriculture and textiles. Critics like Stiglitz (2002) argue that the major institutions that have buttressed globalization in the past, like the IMF, World Bank, and WTO, have failed to address the needs of the poorer countries in the international system.

International Industrial Organization

In contrast to the more aggregate flow analysis of most international economists, there is a long tradition of economic sociologists, economic geographers, and business strategy scholarship that focuses on the organization of production in the international economy and its implications for industrial upgrading, the status of workers, and firm-state relations. Authors in this tradition have been fundamentally concerned about issues of counter-balancing the power of transnational firms.

The first wave of this thinking, represented by Raymond Vernon's *Sovereignty at Bay*, focused on the rise of the TNC and its implications for the composition of trade and for the power relationships between states and firms (Vernon 1971). Work in this vein focused on the spread of TNC-led international production networks, and subsequently on the rise of manufactured exports from developing countries.

[5] Insights from economics have not been confined to economists. Indeed, political scientist Ronald Rogowski's *Commerce and Coalitions* (1989) anticipated much of the later thinking about the distributional implications of increasing openness.

More recently, Paul Krugman (1995) has argued, like Sachs and Rodrik, that the rapid growth of large volumes of manufactured exports from low-wage to high-wage nations is something new and important. The biggest change at the structural level is the rise of intra-industry trade in parts and components, especially those that are used as inputs for final assembly in other countries.[6] What has made the international trade of inputs possible is the "ability of producers to *slice up the value chain*, breaking a production process into many geographically separated steps" (Krugman 1995: 332). Feenstra (1998) takes this idea one step further, and explicitly connects the "integration of trade" with the "disintegration of production" in the global economy. The rising integration of world markets through trade has brought with it a disintegration of the production process of multinational firms, since companies are finding it profitable to "outsource" (domestically or abroad) an increasing share of their non-core manufacturing and service activities.

Development theorists also highlighted novel patterns of international industrial organization. The global commodity chains (GCC) framework tied the concept of the value-added chain directly to the global organization of industries (see Gereffi and Korzeniewicz 1994; Gereffi 1999; 2001). The insight that emerged from this work was the growing importance of global buyers (mainly retailers and brand marketers, or "manufacturers without factories") as key drivers in the formation of globally dispersed production and distribution networks. Gereffi (1994) contrasted these "buyer-driven" chains to what he termed "producer-driven" chains.[7]

A closely related approach, global value chain (GVC) analysis, accepts many of the observations made above on geographical fragmentation and focuses primarily on the issues of industry (re)organization, coordination, governance, and power in the chain (Gereffi and Kaplinsky 2001; Humphrey and Schmitz 2001). It analyzes cycles of organizational fragmentation and consolidation in global industries and their consequences. The GVC approach looks at how firms are linked in the global economy, but also acknowledges the broader institutional context of these linkages, including trade policy, regulation and standards.[8]

There are several governance challenges implicit in international industrial organization literature. One, going back to Vernon's early work in the field, has to do with the firm-state relationship. The highly flexible and mobile production networks of today, however, pose an even greater problem for national regulators than the vertically integrated TNCs that Vernon was describing. The second challenge has to do with firm-worker relations, or more generally firm-society relations, and the ability of societal actors, including unions, to make demands of global production networks on issues such as compensation, workplace conditions, and environmental protection. Finally, like the current international economists, a unifying theme of the international industrial organization literature is that global production is increasingly centered in

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[6] Yeats (2001), analyzing detailed trade data for the machinery and transport equipment group (SITC 7), finds that trade in components made up 30 percent of total OECD exports in SITC 7 in 1995, and that trade in these goods was growing at a faster pace than the overall SITC 7 total.

[7] The GCC approach adopts what Dicken et al. (2001: 93) call "a network methodology for understanding the global economy."

[8] A GVC research network has formed around these issues (see www.globalvaluechains.org).

the South, and firm-state and firm-worker relationships will need to be redefined in accordance with these realities.

Global Civil Society

New thinking about the global organization of the private sector has been paralleled by a reconceptualization of the relationship between globalization and society, and in particular on the emergence of a global civil society. Most of this work comes from political sociologists and political scientists with an interest in the relationship between societies and states.

The rise of an international network of NGOs has been characterized as a global social movement or global civil society. In political sociology, the emerging transnational society is cast in terms of contemporary social movement theory, as exemplified by Tarrow (1998), Snow and Benford (1988), and Smith et al. (1997). In political science, key figures are John Ruggie, whose early work on epistemic communities anticipated the rise of transnational communities and who more recently has focused on the possibilities for global civil society (Ruggie 2002a, 2002b), and Keck and Sikkink (1998), whose analysis of transnational advocacy networks also draws on contemporary social movement theory. The goal of this research is to describe and explain the thickening of transnational networks of NGOs, as well as to assess their impact both on domestic and international policymaking. The literature has been particularly attuned to the social implications of globalization, notably its impacts on workers and the environment, and on the ways in which those concerns have taken institutional shape in the society.

Some of this thinking has also influenced scholars primarily associated with other traditions, most notably Keohane and Nye (2001), whose concept of the thickening of transnational networks has been taken up Slaughter (1997, 2004), among others, and Rosenau (1999), who adopts perhaps the strongest position on the significance of global civil society.

The key governance issue for scholars of civil society is whether it is possible to reconstitute, at a global level, those societal institutions (labor unions, civic groups, political parties, professional associations, interest groups, etc.) that long served important governance functions at the national level. Global campaigns by NGOs and transnational advocacy networks have been remarkably effective in focusing attention on a broad range of social issues, especially in developing countries, such as human rights, labor conditions, wages, and environmental degradation.

The governance challenge is whether the highly heterogeneous collection of institutions and individuals that constitutes global civil society can sustain interest in and institutionalize remedies for these problems. In addition, the legitimacy of many NGOs has been called into question because the largest and best-known organizations are headquartered in developed countries, and tend to reflect Northern perspectives and priorities rather than an agenda defined by and in the South.

Summary

Each scholarly discipline approaches globalization from a different perspective; each emphasizes, therefore, different aspects of globalization and its implications for global governance (see Table 1). International relations scholars have demonstrated how globalization increases the need for international institutions that facilitate cooperation, but pay little attention to the distributional implications of globalization or governance institutions within developed countries. Comparative institutionalists call attention to the ways in which national governance institutions, both governmental and societal, resist as well as adapt to the challenges of globalization, but have little to say about the implications of globalization for developing countries with less well-developed systems of governance.

[Table 1 about here]

The new international economic and international industrial organization literatures, while primarily focused on markets, have important implications for global governance. International economics, by going beyond comparative advantage to consider the distributional implications of economic openness and the potential costs of economic integration, suggests the importance of institutions that enable developing countries to make globalization work for them, and of reforming international institutions to give greater consideration to the needs of developing countries. The recent literature in international industrial organization, by examining in greater detail the way in which production is now organized in the global economy, has deep implications for power relationships between markets and both governmental and non-governmental institutions of governance. Finally, scholarship on global civil society has largely been focused on describing and explaining transnational forms of social organization. But the literature also has important implications for our understanding of the social response to markets and of the demand for governance. None of these literatures, however, has been adequately incorporated into a unified theory of global governance.

What is needed, therefore, is a more comprehensive framework that can encompass all of these perspectives and allow for systematic exploration of the relationship between markets and public and private systems of governance at both national and international levels. The framework needs to be able to capture the interaction among key features of economic globalization, such as TNCs and global production networks; governmental regulatory capacity in advanced industrial and developing countries; and international organizations, NGOs, and other actors in national and global civil society, all of which interact in a complex system. Such a framework, we maintain, not only can provide a richer explanation for globalization and its impacts on governance and a better predictions of the future direction of the international system, but also suggest what international institutions might most effectively address the problems associated with globalization.

Table 1: Perspectives on Globalization and Governance

Academic Tradition	*Primary Focus of Analysis*	*Organizing Concepts*	*Core Issues with Globalization*	*Governance Challenges*	*Representative Authors*
International institutional	International institutions	International cooperation as a public good; complex (or thick) interdependence	Impact of globalization on demand for international organizations and cooperation	Building effective international institutions, accountability of international institutions	Keohane & Nye, Milner, Held et al.
Comparative institutional	National institutions	Relative performance of national political systems; varieties of capitalism; institutional complementarities	Impact of globalization on national institutions	Strengthening national systems to cope with globalization	Garrett & Lange, Hall & Soskice, Kitschelt, Evans, Fligstein
International economics	Aggregate economic performance, returns to labor and capital, growth of manufactured exports by the NIEs	National comparative advantage; vertical specialization; intra-industry trade in intermediates	Implications of integration of southern economies into international economy, particularly distributional concerns within and among countries.	Dismantling remaining protectionist barriers in North, providing effective adjustment and redistributive mechanisms, providing market infrastructure	Krugman, Sachs, Stiglitz, Rodrik, Rogowski
International industrial organization	Firm strategies, sectoral patterns of ownership and contracting, geographic location of production	Global value (or commodity) chains; international production networks; global outsourcing; industrial upgrading.	Implications of changing market structure on power relationships between firms and workers, firms and states	Rebalancing firm-state and firm-worker relationships	Feenstra, Gereffi, Kaplinsky, Dicken
Global civil society	International NGOs, advocacy networks, epistemic communities	Transnational social movements; codes of conduct; corporate social responsibility	Implications of globalization for social issues, worker rights, environment, etc.	Building effective, sustainable, and accountable civil society at the global level	Keck & Sikkink, Ruggie

II. THE GLOBAL GOVERNANCE DEFICIT: MARKET, STATE, AND SOCIETY AFTER GLOBALIZATION

The Nature of Governance

Before turning to the question of how globalization has created a governance deficit, it is useful to be clear about what we mean by market governance and how governance systems relate to markets. By governance we mean those institutions, governmental and non-governmental, that both encourage and constrain the behavior of markets and market actors.

Governance is not the same thing as government. Governance systems may be public, i.e. governmental, but private governance can be equally or more important. Public governance is the familiar stuff of governmental policy: laws, regulations, enforcement capacities, and the like. Private governance includes social mores that determine acceptable market behavior, professional standards and codes of conduct, collective bargaining agreements that define the obligations of firms towards workers, and other non-governmental institutions.

Governance systems play at least three roles with respect to markets:

> *Facilitation*—Governance institutions play a crucial role in facilitating the operation of markets by establishing property rights, enforcing contracts, establishing rules of fair competition, providing information, and much more. No market, even the most primitive, can operate outside of some institutional context.
>
> *Regulation*—Governance institutions are necessary to regulate the negative externalities of private market transactions. Without constraints (or incentives), markets would exploit and endanger workers, pollute the environment and over-harvest natural resources, and generate other negative externalities.
>
> *Compensation*—Governance institutions play a crucial role in limiting and mitigating the unequal impacts of markets. Social insurance, health care, public education and retraining, progressive tax systems, and other welfare policies all serve to temper the tendency of markets towards highly unequal outcomes.

Table 2, below, provides a typology of market governance and examples that fit each of these categories.

[Table 2 about here]

Table 2: A Typology of Market Governance

	Realms of Governance	
Modes of Governance	*Public*	*Private*
Facilitative	Property rights Banking and commercial policy Competition policy	Market ideology Professional norms and codes
Regulatory	Labor law Environmental regulations Health and safety regulations	Voluntary codes of conduct Corporate social responsibility Pressure and consumer boycotts
Compensatory	Social insurance Education/retraining programs Public health policies	Collective bargaining Philanthropy

Market, State and Society in the Pre-Globalization Era

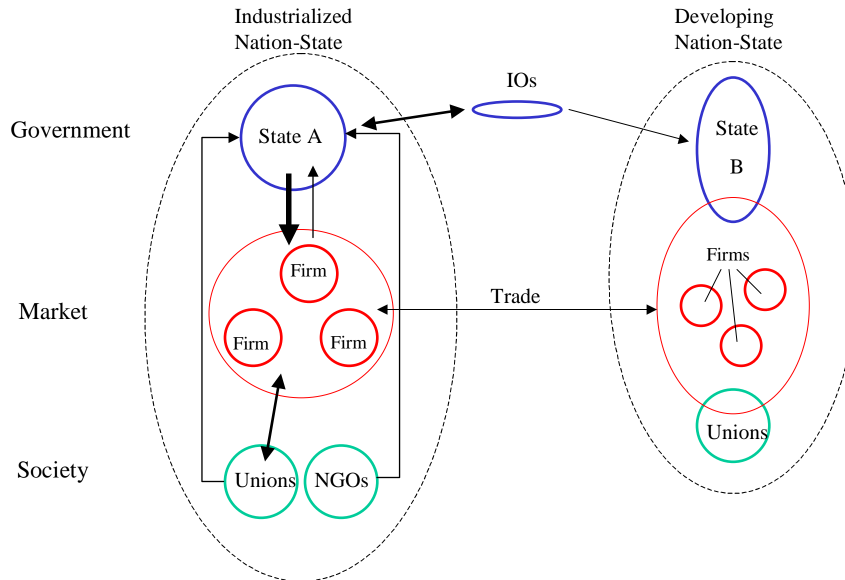
In the era before globalization, the mature industrialized nations had developed thick systems of governance to facilitate the operation of markets, to regulate market actors, and to compensate for market effects. As Polanyi argued with respect to an earlier era, markets demand systems of governance; indeed, they require them. This co-existence of markets and governance, often contested, was crucial to the success of the modern industrial state. Without strong governance systems to facilitate economic transactions, markets could not have prospered. Without strong governance systems to regulate and compensate, societies would not long have tolerated free markets.

Historically, governance capacity existed almost exclusively at the national level, which is one reason why the international economy of the early 20th century proved impossible to sustain. After World War II, the Bretton Woods institutions, most notably the IMF and the General Agreement on Tariffs and Trade (GATT), helped to facilitate the growth of international commerce by providing greater stability, but markets and market governance remained predominantly national in scope, and regulatory and compensatory functions of governance could be accomplished by national governance systems. From the pre-globalization era to the partially globalized world of the early 1990s, however, international governance institutions designed to facilitate the operation of global markets grew in strength, as the GATT evolved into the WTO, and the IMF became an important force in the spread of neo-liberal economic policy. The global market took off. But there was no similar development of regulatory and redistributive capacity at the global level. In short, while the facilitative governance capacities that are the essence of the neo-liberal regime are exceptionally robust and well developed, the regulatory and redistributive aspects of global governance have remained relatively weak.

The Emergence of Globalization

To understand the implications of globalization, it is useful to illustrate the evolution in the relationship among the three realms of governments, markets, and societies. Figure 1 presents a highly stylized picture of the pre-globalization world, roughly circa the 1950s through the 1970s. In this simplified world, there are essentially two kinds of nation-states: advanced industrial nations and developing nations.

Figure 1. The World Before Globalization: A Stylized View



At the governmental level, states are the pre-eminent actors. International economic organizations, notably the GATT, are relatively weak and focused on international market facilitation rather than market regulation, and deal primarily with commerce among developed nations. Markets and firms are largely national in scale. International trade tends to be arm's length, mainly between the advanced industrial nations, and international investment is limited. At the societal level, labor unions, NGOs and other groups are national in scope and have little international interaction.

In this stylized view, the governance of markets takes place within the nation-state, although it takes different forms in industrialized countries than it does in the developing world.[9] In advanced industrial countries, free markets are constrained by both public governance, in the form of elaborate regulatory institutions dealing with minimum wage, workplace conditions, environmental performance, and the like (the arrow from state to market within the industrialized nation oval), and to a somewhat lesser extent by private governance, largely in the form of collective bargaining agreements between unions and firms (the arrow from unions to market).

The relationship among state, market and society in the developing country is more corporatist, with high levels of public ownership and other forms of market intervention and less independence for labor unions. The domain of the market is less prominent, and is largely disconnected from the world economy. There are few of the regulatory and compensatory mechanisms present in the advanced industrial countries. These intertwined systems are illustrated here by overlapping circles of state, market, and society.

[9] We recognize that we are ignoring importance differences among developed nations, as explored extensively in the varieties of capitalism literature (see, for example, Hall and Soskice 2001; Kitschelt et al. 1999).

Globalization and the Governance Deficit

In the ensuing three decades, processes of internationalization altered the global landscape. Facilitated by the market opening of successive rounds of the GATT, market actors responded by becoming increasingly international, both in the form of TNCs and a growing reliance on the outsourcing of production to firms in the developing world. The large, vertically integrated TNCs that predominated in the 1950s and 1960s began to spread their global reach, initially through international subsidiaries fostered by the import-substitution policies of many developing economies. In the 1980s, the shift to export-oriented development models in much of the developing world, coupled with the growth in the industrial capabilities of offshore suppliers, contributed to the vertical disintegration of TNCs, especially in consumer goods industries, and the rise of international production networks in which TNCs emphasized coordination and control over relatively high-value activities, rather than ownership (Dicken 2003). As Milner (1988) has shown, the increasingly international outlook of corporations made them supportive of further market opening.

Figure 2 depicts a highly stylized view of the "partially globalized" world (to borrow Keohane's phrase) of the late 1980s and early 1990s. Globalization is most advanced in the economic realm. In the new global economy, TNCs, production and supply networks, and international financial markets operate on continental, hemispheric or global scales. A large proportion of international trade is now intra-firm or via inter-firm networks (Gereffi et al. forthcoming).

At the governmental level, globalization is much less advanced. States remain pre-eminent. Although international organizations that facilitate international trade are stronger (the reach of the GATT is expanded, negotiations to create the WTO have been launched, and there is talk of a North America Free Trade Agreement), there remain only the thinnest of international regulatory and redistributive institutions. Societies remain largely national in scope, although there are the beginnings of linkages between environmental and other NGOs and, to a lesser extent, labor unions.

Figure 2. A Partially Globalized World

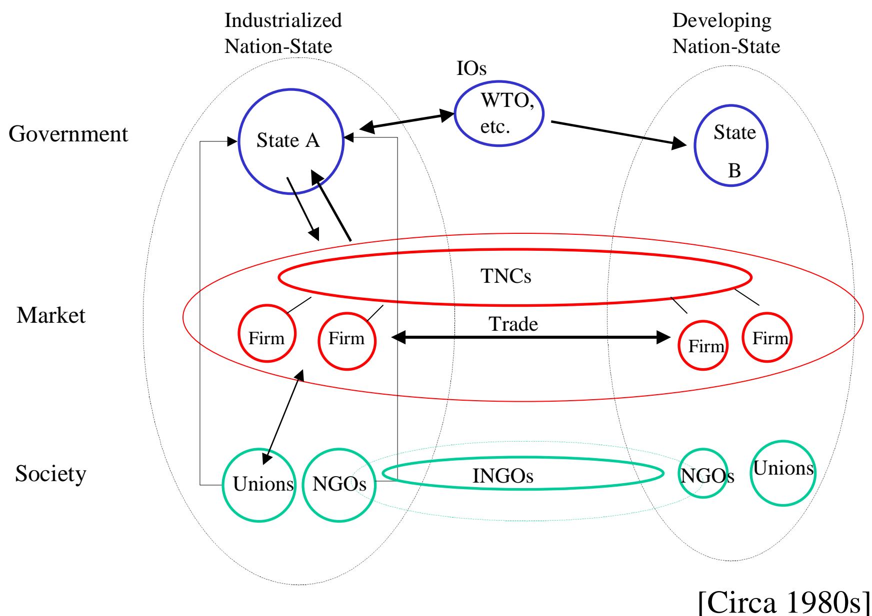


Figure 2 illustrates the partial breakdown of old, national systems of governance, and the governance deficit that results. As national borders became increasingly porous in the global economy, the old governance structures, organized on the unit of the nation-state, lose some of their capacity to govern the market.

In advanced industrialized countries, competition from developing markets and competition for investment began to hollow out both regulatory and social safety net institutions. Although there were few dramatic regulatory rollbacks, outsourcing provided opportunities to avoid some forms of regulation and a credible threat that chilled others. Social insurance, welfare, and other societal programs are insufficient to compensate those who lose out in the international marketplace. In the private governance realm, the ability of unions to demand wage and other concessions from firms has diminished greatly.[10]

In the developing countries the impact of economic globalization on governance was even more dramatic. The neo-liberal prescription of privatization and open markets eroded the old corporatist model and strengthened the role of the market in national societies. In fairness, that model had often been co-opted by privileged elites, but it had at the same time provided some mechanism to involve firms in the provision of certain social goods. In the new system, since governments lacked the governance apparatus of the advanced industrial countries, there was little effective public governance of markets at all. Given the intensely competitive international environment, unions had very limited ability to constrain corporate behavior, and other societal

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[10] In this regard, as in others, the European Union is an exception to the general trend, but it also is an illustration of the broader point about the need to develop stronger international institutions. Europe has responded to the governance challenge posed by globalization by establishing a vast internal market and by simultaneously developing thick governance institutions at the European level that have enabled it, so far, to maintain much of its regulatory and compensatory apparatus.

interests were largely unorganized. Previously sheltered nations found themselves unable to adjust rapidly enough to intense international competition and volatile financial markets.

In the international arena, little new capacity had arisen to replace the old. Intergovernmental organizations dealing with labor, the environment, and other social issues remained largely ineffective, and in the private realm there were few transnational institutions capable of pressuring global market actors. In summary, the new global economy had created a global governance deficit.

III. GOVERNANCE RESPONSES: PUBLIC AND PRIVATE

In response to the governance deficit, manifested in social costs and domestic inequality, forces in society have mobilized to demand greater governance. In this section, we explore the nature of the societal pressures arising from economic globalization. We argue that two seemingly unrelated developments—the push to link social issues to trade liberalizing negotiations, and the attempt to force corporations to behave in more socially responsible ways—constitute two faces of the same effort to strengthen governance of the global economy.

Social pressures and the demand for governance

The contemporary social backlash against globalization could be traced to many moments, but the controversy surrounding the North American Free Trade Agreement (NAFTA) was seminal. From the announcement in 1990 that the United States intended to seek a free trade agreement with Mexico, its less developed neighbor to the South, to the eventual passage in 1993 of NAFTA's implementing legislation by the U.S. Congress, there arose a remarkably broad and intense opposition that almost scuttled the agreement (Mayer 1998).

In the last decade, a broad anti-globalization movement has emerged in developed countries that mirrors many of the concerns expressed in the NAFTA debate. As markets have gone global, many people sense that globalization paradoxically means both greater vulnerability to unfamiliar and unpredictable forces that can bring economic instability and social dislocation, as well as a flattening of culture in the face of well-financed global marketing machines and "brand bullies" (Rodrik 1997; Klein 1999; Ritzer 2000). The massive protests against WTO trade talks in late 1999, against the IMF and the World Bank in 2000, and of every major economic summit since, were triggered by perceptions of a lack of accountability and transparency in the deliberations of dominant global economic institutions like the WTO and the IMF. There was also a sense of outrage that corporate-sponsored international liberalization was moving full steam ahead, while the regulatory concerns, social safety nets and adjustment assistance traditionally provided by national governments were endangered. The historic compromise of embedded liberalism, characterized by the New Deal in the United States and social democracy in Europe, whereby economic liberalization was rooted in social community, was being undone (Ruggie 2002a; 2002b).

The Public Governance Response: "Trade Plus"

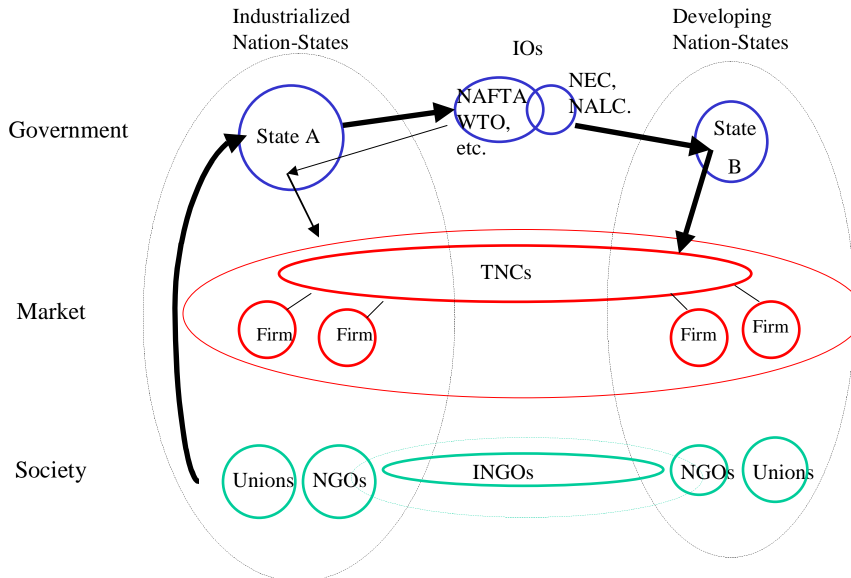
One form that societal pressures have taken is a push to link social concerns to the trade agenda, particularly labor and environmental regulatory issues. This push is most advanced at the regional level, especially in Europe, where continental economic integration has been accompanied by the creation of strong regulatory, social, and development institutions. Europe appears to have found a way to address governance issues by creating deep (or thick) institutional structures at the regional level that are difficult for other parts of the world to emulate.

In North America, NAFTA, unlike the European Union, was initially envisioned as purely a free trade (and investment) agreement, with few provisions to deal with the governance implications of integrating a developing economy (Mexico) with two advanced industrial ones (the United States and Canada). From the outset, NAFTA was a highly contentious issue in U.S. politics. Organized labor immediately saw it as one more step down the path of corporate outsourcing, in which U.S. workers were increasingly forced to compete with low-wage labor in other countries. Environmentalists saw free trade with Mexico as opening the door for polluting companies to move to Mexico. Both groups also saw NAFTA as a force for deregulation at the national level. If companies could move to Mexico to avoid higher labor and environmental standards, even the threat of such movement would weaken the hand of labor and environmentalists in domestic debates.

In 1993, to obtain sufficient Congressional support to pass the NAFTA implementing bill in the face of this societal resistance in the United States, the Clinton Administration compelled Mexico to negotiate separate labor and environmental "side agreements," intended to ensure that there would be no "race to the bottom" with Mexico (Mayer 1998). The side agreements established an international process to which claims that a country was failing to enforce its environmental or labor laws could be brought, and potentially result in fines or trade sanctions.

The basic logic of this public governance response is illustrated in Figure 3. Pressure from societal forces in the developed economy (the United States) compelled supplemental negotiations to establish new international institutions, intended to pressure the developing country (Mexico) to enforce labor and environmental standards governing private market actors.

Figure 3. Public Governance Response: "Trade Plus"



Few social activists were satisfied with what was accomplished in the context of NAFTA, but labor and environmental groups have pursued this logic of linkage in subsequent U.S. free trade negotiations. In both the U.S.-Jordan and U.S.-Cambodian Free Trade Agreements, which entered into effect in December 2001, as well as the U.S. free trade agreements subsequently negotiated with Chile and Singapore, labor and environmental provisions were moved from side agreements into the main text of the trade accords. The U.S.-Cambodian agreement is considered particularly important because the International Labor Organization has agreed to undertake a monitoring program in the textile and apparel sector, to report its results in a credible, efficient and transparent manner, and to make quota levels contingent on adequate performance (ILO, 2002).

Nevertheless, the prospects for further progress on the trade-plus front currently seem limited. Advocates for worker rights had hoped for strong linkage in the context of the U.S.-Central American Free Trade Agreement (CAFTA). In one ambitious proposal, "CAFTA must include a specific provision that the benefits of the agreement can be accelerated—or delayed—for each Central American country and for each sector within those countries on the basis of whether the country and sector have met the agreement's obligations with respect to workers' rights" (Polaski, 2003: 3). Since current trade preference programs already passed by U.S. Congress (such as the Generalized System of Preferences, the Caribbean Basin Economic Recovery Act of 1983, and the Caribbean Basin Trade Partnership Act of 2000) all extend unilateral market access benefits to the Central American countries on the condition that they respect workers' rights, the Polaski proposal hoped to "succeed where Central American governments alone have not" by aligning "private sector incentives with public interests regarding good governance and the rule of law" (Polaski, 2003: 7). Thus far, CAFTA has fallen short of this proposal.

The limits of the trade-plus strategy in the CAFTA context illustrate just how difficult it will be to go much further with the trade-plus agenda. It is highly unlikely that the Free Trade Agreement of the Americas (FTAA), if concluded, will include significant new institutions for dealing with labor, environmental, or other social impacts of free trade. In part this reflects a strong resistance from developing countries, who perhaps rightly view the strategy as a Northern one, and who fear that making free trade conditional on regulatory performance leaves them vulnerable to political forces they can't control. In addition, there is a structural difficulty with the approach that may limit its usefulness. The threat of withholding trade benefits to a nation because of the behavior of a private market actor seems to many in developing countries to put them in an untenable position as they lack the capacity to effectively regulate multinational corporations.

The Private Governance Response: Corporate Social Responsibility, Codes of Conduct and Certification

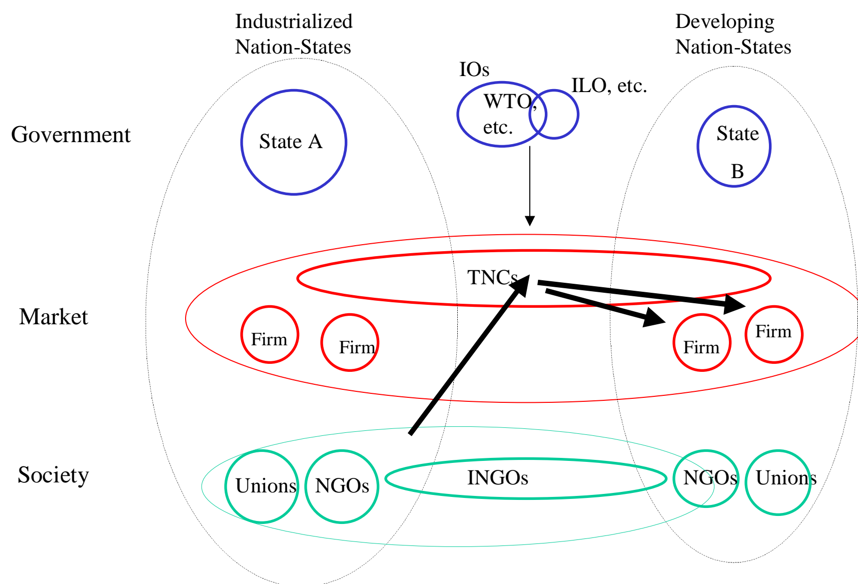
A different approach to addressing labor and environmental issues has emerged in the private governance arena from the confluence of interests among civil society and government actors. In the textile and apparel sector, aggressive campaigns by labor groups, NGOs, and student activists compelled apparel manufacturers to adopt stringent codes of conduct and establish independent monitoring. The revelation in 1995 of the virtual enslavement of Thai workers in a garment factory in El Monte, California, prompted the Clinton Administration to form a task force called the Apparel Industry Partnership (AIP). Composed of manufacturers, NGOs, unions, and U.S. Labor Department representatives, the AIP forged a code of conduct for apparel firms, stipulating the payment of the local minimum or prevailing wage, that workers be at least 14 years old, and that workers not be required to work more than 60 hours per week (although they could work unlimited voluntary hours). In November 1998, the AIP created the Fair Labor Association (FLA) as the monitoring organization that would implement this code of conduct. Subsequently, there has been a proliferation of different codes of conduct and factory monitoring systems in the apparel industry (Maquila Solidarity Network 2002; Esbenshade 2004).

More generally, a variety of new "private governance" responses or certification institutions are emerging (Gereffi et al. 2001). These include: individual corporate codes of conduct; sectoral certification schemes involving NGOs, firms, labor, and other industry stakeholders; and third-party auditing systems, such as SA8000 for labor standards or the Forest Stewardship Council (FSC) certification for sustainable forestry practices. The United Nations' Global Compact is an initiative that encourages the private sector to work with the United Nations, in partnership with international labor and civil society organizations, to move toward "good practices" in human rights, labor standards, and environmental sustainability in the global public domain. While skeptics claim there is little evidence to show that these codes have significant impact on corporate behavior (Hilowitz, 1996; Seidman, 2003), proponents generally argue that new systems of certification, enforced either by global consumers or by institutional actors such as the United Nations, could provide the basis for improved regulatory frameworks (Fung et al, 2001; Williams, 2000).

Figure 4 illustrates the main dynamics of the private governance model. The goal of private governance campaigns is to force the peak or lead firms in global supply chains to set higher

standards of corporate conduct that lesser known suppliers would be forced to adopt (hence the arrows from TNCs to other developing country suppliers in the figure). Brand-named multinational manufacturers (Levi Strauss, Nestle), retailers (Gap, Benetton), and marketers (companies like Nike, Liz Claiborne, and Disney) are the targets for campaigns by transnational NGO activists and labor groups usually based in developed countries that are intended to improve labor, environmental, and development conditions in Third World production locations. The logic of the private governance model is to identify the most profitable and visible branded companies at the apex of global supply chains, not because the conditions of their suppliers are the worst in the world (actually, they are often quite good in relative terms), but rather because these companies have a to protect their reputation with consumers. Their global brand names become a double-edged sword: they are a source of great market power, but they also make branded companies vulnerable to charges of exploitation that could harm their image among consumers.

Figure 4. Private Governance Response:
Codes of Conduct, Monitoring, etc.



Despite considerable progress, various challenges confront the codes of conduct regime. First, it is clear that government policy alone is inadequate to handle these grievances: they are transnational in scope, and they deal with social demands on which regulations are weak, ill defined, or simply absent. Second, there is a "free rider" problem in the sense that only a handful of the most visible branded companies (such as Nike, Reebok, The Gap, Phillips-Van Heusen, and Liz Claiborne) currently have codes, and they are receiving the brunt of the criticism from NGOs and unions even though their standards tend to be well above the industry norm. Thus, efforts to defend the collective reputation of apparel brands are concentrated among the most visible branded firms,[11] and the large retailers and unbranded manufacturers who

[11] The Gap, the largest U.S. clothing chain with more than 3,000 stores and an estimated 3,000 factories in 50 countries, promoted its corporate responsibility campaign with the publication of its 2003 "Social Responsibility

account for most of the global outsourcing in the apparel industry are not held accountable by the public for the labor violations of their offshore contractors. Third, there is much discussion regarding the possibility of consolidating codes of conduct, many of whose provisions are virtually identical, in order to avoid the time and expense of carrying out repetitive factory audits for similar codes.

Private governance in multi-stakeholder arrangements seeks to strengthen oversight in global supply chains by charting a course that goes beyond conventional top-down regulation based on uniform standards, on the one hand, and reliance on voluntary initiatives taken by corporations in response to social protest, on the other. Some argue that a continuous improvement model based on "ratcheting labor standards" upward would work well in a highly competitive, brand-driven industry such as apparel (Fung et al. 2001). Others propose a "compliance plus" model that pushes beyond the basic floor of minimum standards set by most codes, and seeks an "inside-out" approach to ethical sourcing based on training and empowerment initiatives that address the needs and interests of factory-based stakeholders (Allen 2002). Still others contend that because of the power relationships and conflicts of interest within the monitoring paradigm, greater involvement by workers themselves is essential in order for private monitoring to effectively address the sweatshop problem (Esbenshade 2004). In any case, private governance responses probably need to be integrated wherever possible with public efforts and legal institutions before sustainable social change is possible.

IV. THE CO-EVOLUTION OF MARKETS AND GOVERNANCE

The relationship between markets and governance systems is dynamic, not static. Viewed over the long sweep of the last 50 years, the international system has undergone a dramatic transformation. The once sparsely populated international landscape is now teeming with new actors: intergovernmental organizations, TNCs, international NGOs, and broad issue networks and advocacy groups. Where once international economic interactions consisted mainly of arm's-length trade between one nation's producers and another's consumers, now global goods, services, capital markets, and production networks have broad transnational reach and complex structures of economic interdependence. Where once there was anarchy or at best thin globalization, an increasingly rich set of institutionalized rules, norms, customs, and laws now operate in the international arena with varying degrees of efficacy.

These changes in the international landscape reflect the co-evolution of market and governance institutions. In our theoretical framework market actors react to incentives and opportunities established by the governance environments in which they operate, societal groups respond to conditions created by markets, and governance institutions adapt to the pressures coming from society, which in turn establish a new context for markets, and so on. Thinking both comprehensively and dynamically helps connect the phenomena of economic globalization, the rise of global civil society, and the move towards stronger global governance. The approach also predicts future developments in all three realms: economy, society, and government.

Report" (Gap Inc., 2004). While Gap monitors found problems in many of its overseas suppliers, and revoked its stamp of approval from 136 factories in 2003, it took a big step toward making its anti-sweatshop policy more transparent, and thereby placed pressure on its branded and unbranded competitors alike to do the same thing.

The Deepening of Economic Globalization

Economic globalization has spread to include most regions of the developing world, and it has also deepened in terms of the complexity of international production networks that link developing and developed economies, and the range of industries it affects (Dicken 2003). The initial expansion of globalization in the 1960s and early 1970s occurred as vertically integrated TNCs went abroad in search of new markets for their products, prompted by the import-substitution policies of many developing countries that conditioned access to their domestic markets on capital investments and technology transfer by subsidiaries of multinational firms. The rise of the East Asian NIEs (Hong Kong, South Korea, Taiwan, and Singapore) in the 1970s and 1980s highlighted the importance of cheap labor and capable local suppliers as new drivers of the globalization process. By the mid-1980s, export-oriented industrialization had displaced import-substituting industrialization as the new orthodoxy for developing economies, following the neoliberal agenda of privatization, liberalization, and deregulation urged by the World Bank and the IMF in what became known as the Washington Consensus (Gore 2000).

With a facilitative international trade regime in place and minimal restrictions in developing economies, TNCs began to outsource more and more of their production to offshore suppliers in order to concentrate on the more profitable activities of product design, innovation, and marketing in their home countries. Global outsourcing seemingly had no bounds. What began as simple offshore assembly work in the 1960s and 1970s involving apparel, consumer electronics, and toys rapidly spread up and down the value chain into a wide range of goods and services. Virtually all consumer products sold by developed country retailers today are made entirely or to a significant extent in locally owned factories located in developing countries. Certain kinds of software programming and hardware design can now be done more cheaply in places like India, Taiwan, South Korea, and the Philippines than in the United States, Europe, or Japan, and a growing array of knowledge-intensive business services, such as engineering, design, accounting, legal and medical advice, financial analysis, and business consulting, are beginning to move offshore as well (Engardio et al. 2003; Huang and Khanna 2003).

The internationalization of the global economy shows no signs of slowing. Developing economies doubled their share of manufacturing value added between 1975 and 2000, with close to 25% of global value added in the latter year; and the manufactured exports of developing nations accounted for over 70% of their total merchandise exports in 2000 (UNIDO, forthcoming). If anything, as China, India, and other developing economies fully join the international economy, the trends towards economic globalization are likely to accelerate.

Investment in China has exploded. Today China, whose economic growth has averaged 8% a year since 1978, has established a critical mass of infrastructure and factory capacity that makes it the world's most important global outsourcing platform for manufacturing.[12] But China is not alone. The rapid growth of India as an offshore site for information technology services is considered another globalization success story. U.S. firms alone have created as many as

[12] For example, China produces 50% of the world's cameras, and 30% of its air conditioners and television sets (Asian Development Bank, 2004). It is the top supplier of most consumer goods imported into the United States, and it has become the major engine for intraregional trade in much of Asia.

100,000 information technology jobs in India (Pink 2004). The outsourcing of white-collar jobs to India parallels the earlier outsourcing of blue-collar factory work to places like Mexico and China. Paralleling the outsourcing of production from North to South is the even more rapid rise of South-South trade.

We cannot say just how far the trends will carry us, but almost certainly in the next decade we will see a more globalized economy, with more extensive transnational production networks, a growing proportion of world production in the developing economies, and deeper integration of much of the developing world into the global economy.

A Growing Governance Deficit

Although governance institutions that facilitate the expansion and operation of markets are likely to remain strong in the future, regulatory and compensatory governance capacity at both the international and domestic levels lag considerably, and will be dramatically inadequate as the economy continues to globalize. Thus, the governance deficit is likely to grow.

The governance deficit is really two deficits: the first is at the international level, where the thinness of international regulatory and compensatory institutions has become even more apparent in recent international economic summits. The second is within those developing countries now rapidly joining the global economy, which have strengthened the institutions designed to facilitate markets, but which will continue to lag badly in developing regulatory or compensatory institutions.

The growth in the global governance deficit, and the interplay between governance capacities at the international and domestic levels, should be seen in an historical perspective. In the pre-globalization era of the 1950s, the advanced industrial nations of North America and western Europe developed a social pact with strong facilitative, regulatory, and compensatory dimensions. In the private sector, large industrial corporations stabilized domestic class relations through the creation of a well-paid, secure organized working class (the protected "primary" sector) and a "secondary" fringe of workers that was more subject to the vagaries of the market. Oligopolistic control of these self-contained national economies allowed large corporations to transfer higher wages and other costs into prices.[13] In the public sector, welfare policy, social insurance, labor and environmental law, and other policies arose to govern markets. These social and political bargains constituted the foundation of embedded liberalism (Ruggie 1982), which took different forms in the United States (the New Deal) and in most of Europe (social democracy).[14]

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[13] There is an abundant literature on this period, which has been characterized by diverse authors as the new industrial state, Keynesianism, Fordism, segmented labor markets, and so on. For succinct overviews of some of these approaches, see Portes (1997) and Hall (1999).

[14] The varieties of capitalism literature further distinguishes between "liberal market economies" (the United States, Britain, Ireland, Canada, and Australia) and "coordinated market economies" (Germany, Austria, Switzerland, Sweden, Norway, and Japan), with the former having more facilitative (or thinner, in our terms) forms of governance than the latter, in which the regulatory and compensatory institutions are more developed. European countries like France and Italy are hybrid cases (Hall 1999: 143-145; Soskice 1999).

As markets globalized, the compromises of embedded liberalism began to erode. As early as the 1970s, foreign competition became an increasing threat to the national economic models that prevailed in the United States and Western Europe. Domestically, the principal loser in the developed countries was organized labor, but regulatory and welfare policies also came under increasing pressure in the 1980s. With the expansion of the neo-liberal regime to developing countries in the 1980s, with its emphasis market facilitating mechanisms such as the privatization of industry, reduced subsidies, stronger and more transparent legal protections for investments and intellectual property, and, of course, free trade, the pressure on the global governance system increased. In this partially globalized world, facilitative institutions such as the GATT, the IMF, and numerous other organizations, agreements, and practices remained strong at the international level, but regulatory and redistributive institutions lagged internationally, eroded in developed countries, and in developing countries were inadequate in the face of the new global market forces to which they were now exposed.

In the current transition toward "full" or "deep" globalization, the governance deficit will likely grow more acute. Deeper economic globalization will require greater governance capacity. The contrast between robust facilitative institutions of governance and the lagging regulatory and compensatory institutions is stark. At the international level, there has been only modest movement to establish stronger environmental, labor, or other regulatory institutions (in the form of the "trade plus" and private governance initiatives discussed earlier), and even less action to provide compensatory mechanisms for redressing unequal market impacts. In the domestic arenas, the need for regulatory and compensatory capacity will likely outpace the growth of that capacity, particularly in developing countries.

The Increasing Demand for Global Governance: Trends and Evolving Scenarios

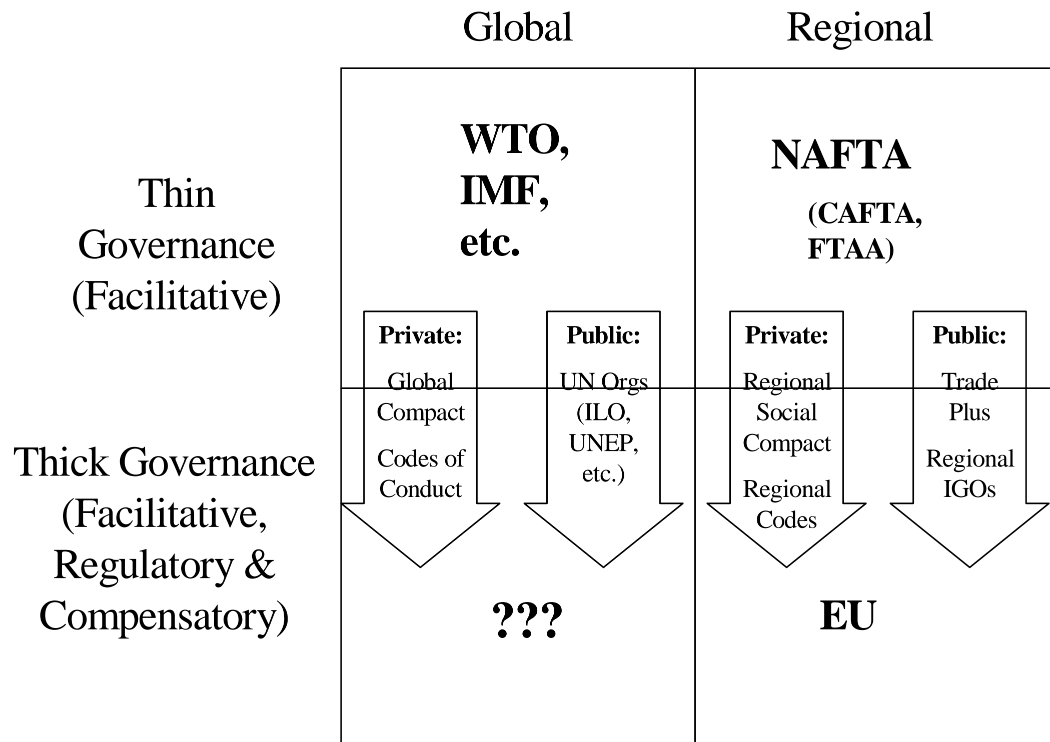
To the extent that the current anti-globalization sentiments constitute a social response to the inadequacy of governance institutions, the growing governance deficit will intensify societal demands for greater global governance. Global pressures in the form of protests at international meetings, of activism within developed countries, and of social movements within developing countries are likely to continue to build. This global demand for governance could take several forms.

Table 3 characterizes global governance along two dimensions. First, we distinguish between thin governance, which only facilitates markets, and thick governance, which includes the facilitative, regulatory, and compensatory dimensions. Second, we distinguish governance institutions in terms of their spatial reach – i.e., whether they are global or regional.

[Table 3 about here]

In terms of classification, one can identify "thin" or primarily facilitative forms of global governance, such as the WTO or its predecessor, GATT. Similarly, one can distinguish relatively "thin" regional governance agreements, such as NAFTA, from more comprehensive or "thick" regional arrangements like the European Union. However, we are more interested in the evolutionary patterns in these governance arrangements, not just a static portrait.

Table 3
The Thickening of Governance:
Global and Regional Scenarios



One trend we have identified is the shift from thin to thicker forms of governance, defined as the addition of regulatory and compensatory institutions. In the realm of public governance, for example, the "trade plus" agenda seeks to add some social conditionality to free trade agreements, requiring adherence to certain labor, environmental, or human rights norms. To date, these tend to operate at the regional level or through bilateral agreements, although the mechanism has the potential to become more generalized. Similarly, codes of conduct have also become thicker forms of global governance as a result of recent moves toward independent or third-party monitoring (Esbenshade 2004), as well as greater transparency by large firms in terms of the nature of the violations against their codes and action toward redressing problems or compensating losers in the process (Gap Inc. 2004; Gereffi et al. 2001). The Global Compact, a set of ten principles that corporate supporters of the compact voluntarily pledge to uphold, launched by U.N. Secretary General Kofi Annan at the World Economic Forum in Davos, Switzerland in 1999, is a promising initiative. Annan now seeks "to design a new governance structure that matches its widening scope" (Wurst 2004). Thus, we believe that the demand for greater global governance is likely to translate into new governance capacities.

What form those capacities will take, however, is less certain. On the spatial axis of Table 3, there is no clear trajectory or direction of change. We see, therefore, the possibility that the thickening of governance may occur at a global scale or it may be primarily accomplished within regions.

Global Scenario

One scenario is that economic globalization leads eventually to the thickening of governance institutions, both public and private, at the global scale. Notwithstanding protests against the WTO, the IMF, and other visible targets of neo-liberal policy, these facilitating institutions will define the context in which market actors operate, and indeed will spread their disciplines to a greater portion of the globe. With China already a member of the WTO, other developing and transition economies such as Russia and Vietnam clamoring to be included, clearly a much larger portion of global production will operate under rules designed to facilitate the globalization of markets. The end of the Multi-Fiber Arrangement (MFA) in 2005 will extend the free trade regime to textiles, which had previously been highly protected. And a successful conclusion of the Doha Round multilateral trade negotiations, a reasonable probability at this point, would further expand the facilitative capacity of the international governance system.

As the global economy deepens, demand for thicker governance at the global level who translate into greater governance capacity. Possibilities include a stronger ILO linked more effectively to the trade regime, stronger multilateral environmental agreements, also linked to the trade regime, and stronger international development institutions capable of more effectively providing support for social insurance, public education, and public health. Less formally, networks of bureaucrats in national governments and in international organizations may continue to develop cooperative mechanisms below the level of inter-national agreements, a trend Ann-Marie Slaughter has effectively documented. (Slaughter, 2004.) At the same time, we might see the maturation of a truly effective and global civil society, capable of not only putting pressure on governmental institutions, but also of providing effective private governance by pressuring corporations and influencing consumers.

There is logic to such a parallel development of governance capacity to match the scale of the market. On the other hand, there are significant obstacles. One is the continued jealousy of the nation-state to incursions on national sovereignty, which while not so pronounced in Europe, remains an important element in the rest of the international landscape. The other is the sheer difficulty of negotiating or otherwise coordinating cooperation on a global scale.

Regional Scenario

A second scenario is that the governance response to globalization largely takes place at the regional level. In this model, regions composed of relatively homogenous nations, and more capable for many reasons of intergovernmental cooperation as well as of the formation of effective regional cooperation in civil society, develop distinctive regional regulatory and compensatory mechanisms. Given that most manufacturing sectors tend to be regionally, and not globally, integrated (Rugman and D'Cruz 2000), regional economic integration could lead to the establishment of regional level governance institutions.

It is clear that a form of deep regionalization is occurring in Europe. The Single Market Initiative launched by the European Community in 1985, largely a market-facilitating move, has subsequently evolved into the European Union, with strong regulatory and compensatory capacity at the regional level.[15] NAFTA, in contrast, is a far more limited regional governance agreement covering only the United States, Mexico, and Canada in 1994. Whether similar deepening of governance capacities could happen in North America is less certain. There has been some modest deepening of governance capacities, in the context of the NAFTA, in increased intergovernmental cooperation among Mexico, Canada, and the United States, and in a thickening of societal linkages, but despite calls for the creation of a North American Community (Pastor, 2004), there are tremendous obstacles. In the rest of the Americas, the CAFTA and the proposed FTAA are both essentially facilitative governance instruments on a regional scale, lack any regulatory or compensatory capacity. In Asia, regional economic cooperation is occurring, but there is little immediate prospect of EU-like governance mechanisms. Africa, of course, lags even further behind.

The regional scenario, therefore, appears to be one of highly uneven thickening of governance, with the EU much more advanced in this regard than other regions. As a consequence, many of the tensions we have identified in the international system would remain, including differences in levels of development, tensions between different regulatory standards, and to the extent that there remains significant inter-regional commerce, incongruence between the scale of the market and the scope of governance institutions.

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[15] Interestingly, by transferring responsibility for a good deal of industrial policy from national governments to the European Community, regional integration in Europe actually increased governance capabilities at the supranational level, while weakening governance capacities nationally by promoting a retreat from interventionist policies (Hall 1999: 154).

V. CONCLUSION

This paper has been concerned with illuminating certain properties of the international system, in particular the relationship between economic globalization and institutions of market governance. It has deliberately cast a very wide net, addressing developments in markets, governments, and societies over nearly six decades. Such a broad perspective necessitates simplification, but there is considerable value in viewing matters comprehensively, both to see the relationships among developments in each realm and to demonstrate how market and governance institutions co-evolve over time. Viewed broadly and over a long time, one can see clearly the dynamism of economic change, social response, and institutional adaptation.

The approach taken here is interdisciplinary and draws on numerous strands of the literature on globalization. There is great value, we believe in crossing disciplinary boundaries, particularly in marrying the insights from the scholarship on the new global economy with the institutional perspectives of those who study international relations, comparative political institutions, and civil society. Only then, we believe, can one clearly see what is at stake in the next global transformation, as we move from a world dominated by the developed nations of the North, to a real partnership with the developing nations of the South.

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