

Economic Integration and Nationhood: An Extension

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Abstract

As national economies become more closely linked through the gradual evolution of informal interpenetration of markets (as well as through formal agreements), the ability of a nation to preserve its national identity or nationhood is reduced. This tendency applies to such vital areas of national identity as the target values for unemployment rates, sectoral net tax burdens, the level of social services provided and environmental concerns.

I. Introduction

An earlier paper [Gray, 1990.] identified the existence of *national character or identity* which can be formally said to consist of a set of collective values about the character of the national economy and would ordinarily be taken as including the acceptable degree of income inequality, the degree to which individual uncertainties are eliminated by state-initiated (though not necessarily state-run) programs, concern with the environment and the level of national health support.¹ These values enter

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1. These kinds of programs would ordinarily fall under the general heading of social-welfare programs but might also be extended to include any program which reduces the degree of *laissez-faire* in the economy (see below for the role of environmental concerns in this context). Often these values contradict the essential characteristic of *economic man* since they imply a measure of altruism towards others of the present and/or future generations. Such values are best allowed for by basing economic analysis on a construct such as Casson's [1988] *ethical man* which allows for the utility function to allow for events which generate *peace of mind* after some critical level of income has been attained.

as arguments in the national *general interest function* together with the more narrowly economic arguments emphasized by Tinbergen [1970, Ch.1]. The earlier paper suggested that the greater the degree of economic integration between two (or more) nation states, the smaller is the available degree of national identity (nationhood), *i.e.* the less the freedom of national policymakers to give weights to or to set numerical targets for the collective-value arguments different from those of the other nations.² That paper was couched in terms of a formalized integration process involving the creation of a free trade area (or a more closely-integrated relationship) and of the range of goods and services covered by the agreement. This short paper extends that argument to the effects of integration that comes about in an unofficial way as technological and other innovations (including reduced barriers to trade and the development of new financial instruments) merge national markets for goods and services.³ The paper distinguishes between formal integration processes negotiated between or among governments as *de jure* developments and informal evolutionary progress as *de facto*.

Addressing the problem of globalization (accelerating inter-dependence of flows of direct investment and technology), Ostry [1992] argues that convergence of economic policies is necessary because *a globalizing world has a low tolerance for system divergence* and she analyses the problems facing nations trying to achieve convergence of policies. By accepting convergence as inevitable, Ostry does not confront the possibility that nations are concerned with their national character and with the implications of convergence for the global set of policies imposed. Ostry's analysis is complementary to the argument of this paper.⁴

Section II introduces the concept of *de facto* integration and Section III examines the ways in which ongoing *de facto* integration of markets, as well as *de jure*

2. Standard target variables do not differ substantially among nations, *i.e.* all nations aim at high employment and price stability although there may differences among nations in the preferred trade-off.

Relative size affects the ability of the small country to enjoy nationhood because it will have to conform to the practices of the larger economy.

3. Multinational corporations are a medium of integration and their role in eroding nationhood was the focus of Servan-Schreiber [1968].

4. Recent expressions of concern with the Maastricht Agreement of a common currency and closer economic and political ties within the European Community, by the Danish people in a referendum and by large numbers of individual citizens in other members of the European Community suggest that nationhood considerations are still important.

developments, limit the freedom of policy options of a nation.⁵

II. Informal Integration

Traditional economists have approached questions of economic integration in terms of some formal agreement among nations to merge their economies to some predetermined degree. The European Community is the pre-eminent modern example of formal integration and, indeed, the continued viability of the Community could be said to depend upon the degree to which members are willing to accept and to legislate extensions of previously-negotiated agreements as developments require, *i.e.* to accept further limitations of nationhood. There is an implicit suggestion here that close unions need steady progress toward unification (up to some critical stage which precludes retrogression) if they are not to retreat under stress. A similar argument exists for multilateral trade negotiations and is termed the *bicycle theory* [Aho and Aronson, 1985]. This relationship explains both the perceived need for harmonization of conditions among the member states (so-called Europe 1992) [Yannopoulos, 1991]⁶ and the importance of some variation of the Maastricht Agreement on the need for a common currency (implying a common monetary policy) and of the ultimate ratification of that Agreement. The economic stresses involved give a basis for both the modern tendency of the Community to look inward in order to reduce some of interaction with non-European countries during the processes of adaptation and adjustment [Lorenz, 1992] and differences in values and a desire to retain identity cause nations to question the benefits of the Maastricht Agreement.

Reductions in impediments to the movements of goods, services and factors can also derive from technological innovations in information flows, communications, management techniques and financial practices as well as from long-run tendencies towards free trade and unimpeded foreign direct investment (the right-to-establish and guaranteed national treatment for foreign subsidiaries). These evolutionary

5. Multilateral trade negotiations under the sponsorship of the General Agreement of Tariffs and Trade (the GATT) are identified as a *de facto* phenomenon because explicit analytic attention is not given to nationhood variables during negotiations (although negotiators may well have some sense of national values).

6. Harmonization of taxes is a particularly good example of the sacrifice of nationhood for the benefits of integration.

factors generate higher degrees of economic integration albeit on an informal (*de facto*) basis. The implications of these more gradual developments for national identity have attracted less attention than *de jure* integration, but the effects are similar. Any renunciation of nationhood should be counted as a cost of *de facto* integration to be set against economic benefits, because of the policy limitations which it imposes on the affected countries. Traditionally, the argument for the free exchange of goods and services has been made in terms of a static neoclassical model from which features of national identity are excluded. Arguments in favor of the free movement of direct investment, financial capital and technology are also usually made by extending the free-trade model.

Acceptance of a perfectly integrated world economy with free trade (and possibly free movements of some or all factors of production) implies a passivity on the part of trading nations which belies the concept of nationalism. If all participating nations are better off as a result of the integration, then there is a tangible reward for the loss of nationhood, but each nation must be willing passively to accept, for example, the inequality of income-distribution which falls out of the general equilibrium solution. This inequality will be determined by the tolerances of the (electorates of the) larger nations for income inequality.⁷

In contrast, voters in many modern nations are deeply concerned with considerations other than the simple maximization of gross domestic product. The inequality of income distribution and the related issue of the rate of unemployment are major concerns in industrialized democracies; the nation's international competitiveness⁸ is the focus of significant attention in the United States as well as in Europe; and the question of environmental protection takes on major importance in the eyes of influential voting blocs so that the effects of free trade (*de facto* integration) on a broad range of problems is placed into public debate. All of these issues have come into prominence as a result of the *de facto* interpenetration of markets to the point at which considerations of loss of national identity which

7. There is an asymmetry here: a nation desiring a more equal distribution of income than the dominant pattern will probably have to obey the dictates of the other nations but a small nation willing to tolerate a larger inequality will be able to indulge that taste: see the reference to social welfare measures in the following section.

8. This concept is difficult to define. It is used here in the sense of gains or losses of market shares in advanced, technology-intensive goods by a nation's firms competing in global markets.

might once have been negligible, have now become quite sensitive to increases in informal integration.⁹ Governments can no longer expect to be able to argue for greater informal integration simply in terms of national and global benefit through greater allocative efficiency without generating counterarguments at home.¹⁰

III. Three Policy Limitations

This section examines the limitations likely to be imposed on the collective-value arguments in the general interest function (nationhood) by greater *de facto* integration: restrictions on the social or welfare state role of government by the need to retain the international competitiveness of home industries in global markets; unemployment and income distributional problems; and environmental concerns (broadly defined).

(1) For a nation to use income-redistribution policies as social-welfare enhancing programs will run counter to the needs of its technology-intensive industries competing in international markets at home and abroad.¹¹ Maintaining or increasing international competitiveness has become a major concern of some governments and the need for special emphasis on this aspect of economic policy derives predominantly from the degree to which a nation's firms are subjected to competition from foreign firms. In this area, positive measures are required and simple protection is not a solution to the problem because few technology-intensive or advanced industries can compete on global markets if they are not continuously exposed to the cold winds of international competition [Porter, 1990]. The desire to

9. Gray [1990] argues that the potential loss of nationhood increases exponentially as ever-greater integration takes places.

10. The purpose of this paper is not to advocate either free trade and integration or the imposition of limits.

Electoralates were probably more easily persuaded by governments of the benefits to be derived from greater freedom of trade in the years after World War II when nations were still operating grossly inefficiently behind tariffs and other impediments to integration which were erected during the depression and consolidated during the war and its immediate aftermath. These conditions no longer hold to the same degree.

11. There are definitional problems here: not all measures which fall under social-welfare enhancing policies necessarily affect the efficiency of high-technology firms adversely: some, such as greater allocations to education, are compatible with a policy supporting national efficiency and the international competitiveness of home-country firms in global markets.

maintain or enhance international competitiveness of national firms reduces the degree to which governments may impose tax burdens on the relevant corporate sectors to benefit the non-business sector. Anything which limits the scope of government to levy taxes on the corporate sector can inhibit nationhood: redistributive policies consist either of transfer payments or the provision of services directly to the beneficiary: when their purpose is to limit the hardship of the low-income segments of the population, they are frequently funded by taxes levied on corporations. The mechanism by which the net tax burden for technology-intensive industries affects the international competitiveness of national industries exceeds the scope of the moneyless static neoclassical trade model on which the free trade argument is based. Firms in technology-intensive industries need to be able to spend on research and development, maintaining the technological-modernity of their physical plant, increasing their productive capacity to maintain global market share and upgrading their marketing and distribution systems at the rates imposed by the competition [Milberg and Gray, 1992]. In a closed economy, the net tax burden imposed on technology-intensive industries is of little concern since all firms face the same conditions and the only cost will be a reduced rate of economic growth, but there is scope for substantial slanting of the playing field in international competition as one country provides its high-tech firms with lower tax burdens and better infrastructural support.¹² Any *relative* diversion of funds away from high-tech firms weakens those firms in international competition.

(2) One of the features of modern industrialized societies is the growing numbers of low-skilled people who cannot adapt to the skill-requirements of a modern economy. To understand this problem, it is necessary to define structural unemployment as those people of working age who, under conditions of full utilization of the stock of physical capital, would be employed at a wage rate which would not yield a subsistence income.¹³ One long-run trend contributes to the steady growth in the numbers of structurally unemployed: the integration of the industrialized and

12. Infrastructural support is broadly interpreted here to encompass anything which will enhance the efficiency of the home industry and/or enable it to require higher rates of competitiveness-enhancing expenditures by its foreign competitors. Such measures can easily escape the GATT.

13. There are obvious difficulties in defining subsistence income and the value of subsistence income will vary not only with the number of dependents per income-earner but also internationally according to the standards of the nation. These problems are not confronted in this paper.

the third world (labor-surplus) nations through lower barrier to trade and through the transfer of technology and capital by multinational corporations (MNCs). This process is reinforced by the introduction of new robotic technologies and numerically controlled machine tools [Gray, 1987] [Aharoni, 1991, p.80] which reduce the number of production workers needed per unit of (manufacturing) output. However, with the improved access of production carried out in low-wage countries to markets in the industrialized countries, the problem of surplus low-skilled labor in the industrialized world has increased substantially to the point that it could begin to impinge on North-South economic relations.¹⁴ The problem would be less acute if MNCs were not able to distribute their value-adding capacity around the world according to local costs of immobile inputs. In other words, the *de facto* integration of the world economy (globalization) affects the production capabilities of labor-surplus nations as well as the pattern of international trade with given national endowments. What is particularly important here is the ability of MNCs to link and productive capacity in a labor-surplus country with internationally-mobile technology an extant and sophisticated marketing-and-distribution system in the industrialized country [Gray and Lundan, 1993]. Informal integration has exacerbated the problem of the new technologies by speeding up the rate of change in the skill-mix of workers demanded and has reduced the ability of governments to enact policies to reduce the severity of the problem.¹⁵

When formal integration takes place between industrialized and developing countries, the problem of a change in the skill-mix of labor demanded could be more severe because of the speed of integration of product and factor markets although formal negotiations have always shown a good sense of the need for phase-in arrangements. Crucial in formal integration is the difference in the proportionate numbers of structurally unemployed. Integration between France and Germany, for example, would have relatively little impact but a North-South

14. The concept of inevitable structural unemployment is not a part of the formal free trade model although development economics countenances the existence of surplus population in developing countries.

15. Article XIX of the General Agreement of Tariffs and Trade (the GATT escape clause) allows countries to impose temporary protection to ease the problems of adjustment, but this policy seems now to be viewed as less legitimate than it once was. The existing problems may explain the less generous terms offered now by countries under the Generalized System of Preferences.

process might have severe repercussions for labor markets in the industrialized country.¹⁶

(3) In the context of this paper, the term *environmental issues* is used to describe not only the traditional concerns with pollution and any competitive advantage which a willingness to pollute might afford a national industry but also includes questions of consumer safety and consumer conscience when production methods in trading-partner nations might contravene national values as well as legislation enacted in the importing country.¹⁷ Health concerns over the use of chemicals in the production of fruit and vegetables, the safety of animal species in the processes of harvesting and production,¹⁸ as well as the destruction of rainforests are examples of national values which may be sacrificed in both formal and *de facto* integration. The essence of the concerns is that foreign legal suits lodged with the GATT will be able to allow higher (national) U.S. standards to be circumvented by foreign suppliers (whether under the *aegis* of an MNC or through arm's-length sales). The pressure groups involved are concerned that hard-won legislation in the United States (nationhood variables) can be nullified by so-called *faceless bureaucrats in the GATT* whose horizons do not extend beyond the narrow boundaries of the free-trade model.

In an open system, the global standard is likely to be set by the *low bidder* in terms of concern for social nationhood variables. The growing interdependence of the world economy means that a nation, which does not choose to opt out of the process and which wants to maintain a leadership position in advanced industries, must either design its policies in terms of the dominant set of policies of the trading-

16. Shelburne [1991] shows that the gap between Greece, Spain and Portugal and the industrialized nine members of the European Economic Community is far smaller than (about half) the gap between Canada and the United States and Mexico suggesting that the North American Free Trade Area requires protracted period of phase-in.

17. Opposition to the Uruguay Round has been sponsored in the United States by a union of such diverse groups as the National Consumers League, Rainforest Action Network, the Humane Society of the United States, National Toxics Campaign, Friends of the Earth, International Fund for Animal Welfare, American Society for the Prevention of Cruelty to Animals and other similar groups. *The New York Times*, [20 April, 1992, p. B5]

18. In the United States the focus is the Marine Mammal Protection Act whose best known purpose is saving dolphins from drowning in the nets of tuna fishermen. While the problem arises for tuna to be exported to the United States, the productivity-reducing restrictions imposed on U.S.-based tuna boats must be imposed abroad and apply to catches designed for the home market.

partner nations or lose ground in the race for international competitiveness. Given the close interconnection between the ability to finance competitiveness-enhancing measures by a nation's firms and the willingness of governments to provide high-technology industries with negative net tax burdens (*i.e.* to transfer resources net to and not from firms in these industries), the standard on which national policies must converge in an integrated world, will be those instituted by the (large) nation most willing or most able to sacrifice current household consumption and government-initiated income-equalizing, social-welfare measures for leadership in high technology industries. Kreinin [1988] suggests that because of stresses among the major blocs within the GATT and marked differences in national codes of conduct and in the willingness to be the *low-bidder*, the open trading system under the GATT is in danger of breaking down – possibly into regional blocs with quite high barriers to trade among the blocs.¹⁹

IV. Conclusion

An exclusive emphasis on *de jure* integration can lead scholars to overlook and neglect the economic side-effects of informal integration. The effects of informal integration on nationhood can be important and this analysis reinforces the prior concern for *national characteristics* under *de jure* integration [Gray, 1990]. One difference between the two types of integration is that in formal integration the benefits and the costs are exhaustively debated prior to the conclusion of the proposal: in cases of informal integration, the nationhood costs are usually bypassed unless groups with sufficient political prestige and power become involved and force the terms of analysis to be widened to include nationhood variables.

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19. For example, the very high rate of saving in Japan makes governmental support for high-tech industries feasible but this does not detract from the managerial skills – both strategic and operational – with which the firms have managed to achieve global supremacy in many industries.

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