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LIMITS OF CONVERGENCE AND GLOBALIZATION[1]

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Historically, convergence has not been a smooth process. Though worldwide interdependence has increased, its outcome is neither homogenous nor foreseeable. Even in so called developed countries, with similar production facilities and access to technology, policy styles and economic policy outcomes vary. This chapter first gives an overview of the convergence debate in different disciplines, in order to show that institutional and policy aspects should not be ignored by economists. It then analyzes policy differences among countries of the European Union and why they persist. Market forces and competition work in favor of convergence, but institutions outside the market work against it. The latter are more important than the current debate admits. Channels of convergence such as imitation, competition, state competition and enforcement can be clogged due to institutional factors.

"In the long run, of course, it is hoped that the poorer Member States will become richer...as a result of a combination of continued efforts to promote cohesion and convergence.."

James Mc Kenna, EU-Commission, in 1993

Countries have different policy styles and policy outcomes. Per capita income and the development of the Welfare State differ substantially, even among so-called Developed Countries. Also unemployment and inflation rates, crime rates, average life expectancies, traffic death rates, statutory minimum wages, and literacy and education rates can vary significantly. There are many reasons for this rich diversity; geographic and demographic differences, culinary traditions, consumer preferences, culture, political ideas, social movements, voting systems, executive decision making structures, authority of the courts and extent of state regulation. In

general, policies and policy outcomes are the result of successive combinations of ideas, interests, and institutions, whereby each combination pre-structures new combinations at a later point of this nation's history in a path dependent way. This is what makes each nation's specific history. Because much of policy substance, form, and outcome is linked to national cultures and institutions which are strongly rooted in history, they have been surprisingly persistent over time.

But will this diversity in policy goals, instruments, and outcomes decline or even vanish as history unfolds? Will there be an eventual convergence of policy styles and outcomes? One is tempted to think so, in an age of increasing economic, social, cultural, political, and legal interdependence. Technological innovations allow for much easier communication and travel across the globe, thus facilitating information exchanges and shared cultural experiences. Television connects worldwide audiences. Shared information and stimuli may provide for similar consumer tastes, and multinational companies will try to enhance this through world-wide advertising. More than one billion people from all over the world watch the Super Bowl game at one point in time. In between they are confronted with the same commercials, and a large percentage of them will munch Italian pizza during the game and flush it down with American coke. Is there a new species emerging? The "global man", identical and faceless, living in Sassen's (1991) "global city" ? Do we approach Fukuyama's (1992) *End of History* with identical patterns of production, behavior, taste and ideology across countries ?

In the following, I will first give a short overview of the convergence debate in sociology, economics, and political science. Then, I shall explore some econometric problems. Even a short glance at this discussion reveals that in none of the disciplines is convergence an uncontested theoretical construct. Sociologists have controversies about the end of ideology, economists have them about the end of income disparities and political scientists about the end of policies. Even so called precise sciences such as mathematics and econometrics struggle with the choice and operationalization of convergence measures.

The first part of this essay emphasizes that convergence is an interdisciplinary issue and has come and gone in historical waves of optimism and pessimism regarding its success. The second part of the paper emphasizes the channels through which convergence will occur. Limits to convergence and globalization will be identified as "clogged channels" of which I distinguish four; imitation, market competition, state competition and enforcement. While the first two channels are quite familiar to economists and can be placed in the economic convergence debate, state competition and enforcement problems are more often

found under the heading of policy convergence. Yet, political factors have important impacts on economic convergence as a recent empirical study on policy convergence within the European Union for fourteen policy fields shows (Unger/Van Waarden 1995). The last sections on non-market conforming responses of political actors and on problems of enforcement provide an overview of some of the empirical results of this study. Main factors for convergence and divergence will be identified in the conclusion. If we include institutional and political factors into our analysis, we have to face new uncertainties concerning the outcome, because some of these factors work, at least partially, against convergence.

The Convergence Debate

Convergence has been defined in social sciences as "the tendency of societies to grow more alike, to develop similarities in structures, processes, and performances" (Kerr 1983: 3). The topic has recently gained in popularity, following the Maastricht Agreement among EU Member States that requires - for monetary union to occur - that several of their macroeconomic indicators should converge beforehand. This has no doubt stimulated the scholarly interest in convergence in the economic literature; at the same time that it has kept econometricians busy searching for ways to measure it.

However, the question of convergence of nations and their structures, policies and performances is an old one. It keeps reappearing, as if following some invisible cycle. The issue has been central to theory formation in most of the social sciences, in sociology, in economics, and in political science. As Boyer (1993) showed, the convergence debate seems to go in waves or swing like a pendulum: the strong belief in convergence in the Postwar period of the 1950s and 1960s was criticized and followed by a conviction in divergence in the 1970s and 1980s. In the 1990s, belief in harmonization and convergence seems to be back in vogue.

System Convergence - The End of Ideology?

The term "convergence" has been used often to refer to system convergence, the growing together of whole societies from initial points of extreme, if not polar, difference: the developed and developing, the industrialized and industrializing, the democratic and totalitarian, the capitalist and socialist. The classics of sociology, writing at a time when most European societies experienced common processes of

industrialization, urbanization, secularization, state formation, and imperialism, all had implicit or explicit theories of convergence as part of their theories of modernization. Durkheim saw an increase in the societal division of labor and feared the replacement of organic by mechanical solidarity, resulting in a common situation of anomia. Marx predicted increasing tensions between the forces and relations of production, a gradual lowering in profit rates and eventually the end of capitalism.

In the Postwar period authors such as Tinbergen (1959) and Bell (1960) predicted the "end of ideology", as Fukuyama prophesies now the "end of history". The former two authors argued that the ideological and structural distinctions between communism and capitalism would gradually disappear. Countries in East and West would develop into more or less similar industrial societies. The global spread of technology, industrialization and economic growth would confront all countries with similar imperatives. The uniform imperatives of growth and technology would make ideological distinctions irrelevant and class differences would disappear. The convergence proponents strongly believed in technological determinism and a harmonious outcome from the diffusion of technology and growth.

However, such perspectives have been more popular in certain periods than in others. The 1960s were followed by the 1970s and 1980s with more attention focused on international differences and divergence. Kern and Schumann (1976) demonstrated empirically that technology did not have the unifying effect it has often been presumed to have. First of all, technological development tended to increase the level of required skills for higher level jobs, but to decrease them for lower level ones, resulting in a divergence in skill requirements, working conditions, and workers' consciousness. Secondly, the effects of technology differed by sector. Implicit here was the further argument that, since different societies have different sectoral portfolios, technology would affect them differently, thus leading to divergence, rather than convergence at the macro-level. Several other studies in the volume edited by Goldthorpe (1984) pertain to the political organization of classes and emphasized the differences between corporatist and pluralist systems, which complicated the simple dichotomy between capitalism and socialism that prevailed in the earlier convergence theories. According to their findings the specific and diverse institutional arrangements in capitalist societies mattered for differences in performance. For example, corporatist countries with well organized employers' associations and strong trade unions performed better than more market driven and "disorganized" Western Capitalist Societies.

Economic Convergence: The End of Income Disparities?

Convergence in economics refers to convergence of economic variables such as growth rates, interest rates, inflation or unemployment, indicators, which can also be seen as economic policy outcomes. There has been considerable disagreement as to the likelihood of convergence in the various theories. For every convergence theory there has been an opposing divergence theory.

Neoclassical growth theory expects convergence of living standards and productivity between poor and rich countries through the diffusion of similar technology. International Trade Theory stresses the convergence of factor prices (wages, interest rates) and good prices as a result of trade and competition The latest newcomer in the convergence debate is "Maastricht convergence". The Maastricht Treaty sets criteria for inflation rates, nominal interest rates, budget deficits, and public debts, to which Member States are supposed to converge in order for them to be allowed to join the planned European Monetary Union. If convergence should take place, it will be partly the result of the political enforcement of this Treaty commitment.

Neoclassical growth theory expects convergence through the channel of imitation. Poor countries will imitate the technology and know how of rich countries. Modern technology will diffuse worldwide. By taking advantage of Kuznets' "transnationally available stock of useful knowledge" and by replacing their entire capital stock with the latest high tech capital stock of developed countries, poor countries should eventually "catch-up".

Abramovitz (1986) showed that "falling behind and forging ahead" instead of catching up of income and growth will occur, if poor countries are unable to use the foreign technology due to "social inabilities". Poor countries will *not* catch up, if they cannot implement the technology of the rich countries on a one to one basis, e.g. because labor skills differ. Kuznets' "stock of knowledge" can then simply not be drawn upon by the poor. Thus, the convergence theory of growth rates found its divergence counterpart.

While orthodox growth theory sees convergence by means of imitation of technological progress, International Trade Theory expects convergence through competition and trade. The neoclassical factor price equalization theorem states that interest rates, profit rates, wages, prices, and income will converge due to the mobility of factors of production and the mobility of goods and services. Instantaneous, perfectly flexible reactions of market participants will guarantee

arbitrage in all fields. Financial capital goes to the highest interest rate, i.e. to the poor countries, until interest rates are equal. Physical capital seeks the highest profit and thus results in a convergence of interest rates and profit rates. Labor goes to the highest wages and entrepreneurs to the lowest wages. Their claims meet at the international market clearing wage rate. If wages are below the equilibrium rate, labor would go abroad. If wages are above the equilibrium rate, capital would abandon the high-wage country. As a consequence, wages will converge due to market forces. If factors of production are somehow prohibited from smoothly flowing across borders, then the mobility of goods will bring about convergence. Consumers buy from the cheapest offer of goods. Prices of goods across countries should, therefore, converge. And since labor and technology are incorporated in goods, wages and profit rates will converge as a consequence of trade in goods.

A consequence of this overall mobility of factors and goods is that economic policies are constrained by exogenously, i.e. internationally, given prices, wages and interest rates. Policies are either impotent or forced to be the same across countries. They have to converge. The convergence hypothesis proclaims a smooth, automatic adjustment of economic outcomes and as a consequence also of economic policies.

As we have seen above, for every convergence hypothesis there is one of divergence. It usually stresses some imperfections and frictions. International trade theory of factor price equalization and income adjustment was criticized most prominently by Krugman (see e.g. Dehesa and Krugman 1992). He showed that convergence by means of trade depends on two crucial assumptions; the same efficiency in production among countries and constant returns to scale. Differences in efficiency may prevent physical capital from flowing from the rich to the poor countries. If capital flows to the rich, this would widen the gap of income differentials. Falling behind and forging ahead, instead of catching up, would be the outcome, due to differences in efficiency in production.

Economies of scale tend to promote agglomerations. Firms tend to cluster in order to be close to markets. Reduced barriers to trade make it also profitable for firms to concentrate production in a few locations to achieve economies of scale. It has been indicated that seen from an airplane, Europe at night looks like a "blue banana", with blue lights stretching from Milan to Copenhagen, rather than being evenly spread over Europe as in the shape of a grape (Dehesa and Krugman 1992). If so, regional disparities would become greater, rather than smaller, as trade theory would predict.

Financial capital does not behave well either. According to neoclassical theory, capital will go to the highest interest rates, provided that exchange rate risks are subtracted. Arbitrage will lead to a convergence of interest rates. Differences in interest rates only account for the risk. Due to diminishing returns, poor countries have higher returns than rich countries. Capital should flow from the rich to the poor. But capital also flows systematically from the poor to the rich countries. Financial capital follows expectations and primarily creates speculative waves instead of intertemporal smooth adjustment. Political risk and inefficient production in many poor countries make it unattractive for investors to place their capital there, even though interest rates are exorbitantly high and put poor countries in financial and economic crisis.

Labor mobility does not satisfy the assumption of international trade theory either. Convergence of wages is to be expected, only if labor mobility is high. But labor mobility can be very limited due to linguistic, cultural, and social barriers. Sassen (1995) casts doubt upon economists' assumption of a clear causal relationship between labor mobility and convergence of economic outcomes. If labor mobility is not exogenous but is itself dependent on capital mobility, if higher profits and not higher wages induce higher labor mobility, if migration policies increase migration instead of stopping it, a divergence of wages and incomes is to be expected.

Even if factors are immobile, the Stolper-Samuelson theorem claims that convergence should still be the outcome. Prices would converge as a consequence of trade (all sorts of transportation and other transaction costs would still allow for some differences in prices). Wages and incomes would also converge, since (immobile) capital and labor are incorporated in mobile goods. Immobile factors cross borders in their transformed version as commodities. However, critics would stress that trade does not take place by means of free and unlimited competition on markets. As Bellak (1995) shows, only one-third of worldwide trade is really free trade. The rest is managed trade and trade by the hierarchies of multinational firms. That is, non-market institutions determine a substantial portion of international trade.

Economic convergence theories usually refer to the real outcome of economic policy, to the convergence of real variables (physical measurable variables), such as real income distribution or growth of real GDP. Convergence of nominal variables was never an economic issue, since poverty, structural inequalities, or disparities in income were the long term economic concerns. Only recently, since the planned Monetary Union of Maastricht, did the convergence of

nominal variables (inflation rates, nominal interest rates) become an issue. I will refer to these as "Maastricht-style convergence". The problem with this is that there is no theory, explaining why convergence of such variables should take place and through which mechanisms this should occur. As indicated, real convergence is mainly an issue in two fields of economics: (1) growth theory, and (2) international trade theory. In the latter the openness of the economy, barriers to trade, mobility of goods and factors explain convergence or divergence. In both theories convergence is the outcome of increased interdependence and market forces and not a prerequisite for integration to take place.

Maastricht-style convergence, which deliberately imposes a set of convergence criteria on countries wanting to join the currency club, addresses a third channel of convergence. Here convergence is not the result of imitation of technology or of market forces, but the result of political norms and collective enforcement. This form of convergence is of course not new, as throughout history states have invaded other states and imposed their culture, religion, or language on the conquered. In economics, however, this concept is new. For the first time, convergence of economic outcomes should be realized through political enforcement, rather than through imitation or market forces.

Maastricht-style convergence also has a much shorter time horizon (1997 or 1999) than real convergence. It, furthermore, does not have an explicit theory. The Maastricht criteria are quite arbitrary. The fiscal norms, for example, were set according to the status quo of the year in which they were decided, and turned out to be unfeasible in the years of crisis that followed. By 1994 no country fulfilled the Maastricht criteria anymore (see Buiter 1992, who heavily criticizes them).

The idea behind Maastricht-style convergence is that a monetary union should be a low-inflation union. Therefore, countries should be forced by means of nominal variable convergence to keep inflation low. The price a high inflation country has to pay in order to bring inflation down can be many years of recession, high unemployment and real income dispersion. Maastricht convergence can thus lead to divergence of real variables and to increased inequalities in welfare, since the price which countries have to pay for it, differs. The trade-off between different variables is a concern in the convergence debate. If nominal variables are forced to converge, real variables will have to bear the full burden of adjustment. This shows that the planned currency union is inherently unstable. Europe is no optimal currency area (Eichengreen 1991). Free riding of countries joining the currency club is obviously feared by those in favour of convergence criteria (Unger 1995). In other words, problems of collective action seem more important than traditional

economic causes for the convergence of such economic policies and policy outcomes.

Policy Convergence: The End of Policies?

Whereas sociologists have studied the convergence of nation states, and economists the convergence of macroeconomic indicators, political scientists have focused on the policies with which authorities have tried to affect society and economy. These policy analysts have typically taken a single allegedly universal problem and then analyzed how different nations have reacted to it. Among the problems they have selected have been the demand for welfare, the fiscal crisis of the state, rising unemployment, the arms race, the new poverty, the increase in crime, or the decline of air and water standards. They have found that nations tend to react differently in their policy goals, instruments and styles. Dye (1991) compared policies of the fifty American states over time and found some evidence of convergence. Waltman and Studlar (1987) investigated whether the coming to power of neo-liberal governments produced a convergence of policies in the US and Britain. Döhler (1990) did the same for neo-conservative health policies in Britain and Germany, and Grande (1989) for French and German telecommunication policies. Vogel (1986) studied possible convergence in US and British environmental policies and Bennett (1988) did the same for data protection policies. The overall results have been somewhat inconclusive. The neo-liberal shift in policies during the early 1980s did not produce the degree of convergence, expected by the authors.

Policies do not change easily, since policy preferences are often rooted in systems of institutions. The more policy content, procedure or intended outcome affect the core of such institutions and the cultural values that underlie them, the stronger the resistance to change will be. For basic policy preferences, major shocks such as war, revolution, or severe economic depressions are usually required in order to induce change (Crozier 1964, Lehmbruch 1987).

Although not a sudden event, the persistent increase in economic and political internationalization could be the kind of shock that might elicit major policy change and possibly policy convergence. That it will have effects seems certain. This begs further questions: On what policies and policy choices will it have an effect? And how much of an effect?

More to the point, does this process of internationalization promote convergence or divergence in policy responses? And, if so, is it a deterministic and

irreversible effect? Or does it leave room for choice and changes of mind with respect to change? Will nations that do not adapt their policies loose out in international competition and perform poorer? Is it a matter of survival of the fittest? Social Darwinism was one of the early approaches in sociology. It remains the dominant paradigm in economics, and it has recently reemerged among sociologists in the form of population ecology theory .

Interdependence does not necessarily require or produce similarity. On the contrary. Men and women are interdependent, as are employers and employees, precisely because they are dissimilar, i.e. capable of contributing differently to the production of the same product. Interdependence between nations may produce even greater differences, as nations specialize in a worldwide division of labor. However, interdependence may also enhance competition between nations in similar fields, and this competition may force them to act similarly or become more alike.

Some Problems of Measuring Convergence

According to the dictionaries the term 'convergence' means' to move towards each other or to a common point'. It originally stems from mathematics, where the idea of a 'limes' - a limit - to which indefinite series approach (converge) in infinity is very old. The concept of convergence is well defined and understood in mathematics and statistics: The difference between two (or more) series should become arbitrarily small (or converge on some constant a) as time elapses. For random series, such as most economic variables, this can be extended so that only the probability that the two series differ by a specified amount is required to become arbitrarily small (stochastic convergence).

However, even the discipline of econometrics, used to formalized models and precise definitions, has its problems when it comes to the operationalization of these intuitive criteria of convergence: "The principle of convergence arises in many contexts in the economics literature and each application seems to have evolved its own measure of convergence with little regard for existing measures" (see Hall/Robertson/Wickens (1992, p.100). There is, nowadays, a proliferation of measures of convergence in econometrics. A very simple and popular way is to calculate measures of dispersion (like the standard deviation or the coefficient of variation, i.e. the mean corrected standard deviation) for the series across countries. If the dispersion measure declines over time this is supposed to indicate convergence. More sophisticated methods are testing for cointegration of the series,

i.e. one wants to make sure that the differences between the (non-stationary) series do not drift infinitely far apart (do not have infinite variances, cointegrate). In a further step one can ask whether their means tend to zero or an arbitrarily small number (see Grandner/Unger (1993) who apply this method to test for the convergence of unemployment and inflation rates). For a quite readable survey and for further techniques and measures see Hall/Robertson/Wickens (1992). For a more sophisticated but insightful survey see Bernard and Durlauf (1991).

The choice of convergence measures in practice is quite arbitrary. One problem that emerges is that while the dispersion measure indicates convergence, the cointegration test may indicate no convergence or even divergence. Convergence and divergence results are then arbitrary and only depend on the choice of model (this problem of econometrics is indeed not limited to convergence). Another problem, which is especially relevant in the current EU-Maastricht-convergence-discussion, is the arbitrary combination of variables. If convergence is measured by examining whether the sum of changes in inflation rates, interest rates and budget deficits of different countries becomes more similar, this pre-assumes a linear relationship between economic fundamentals. But, if the world is round, why should the economic world be linear? Even if each convergence indicator is calculated separately: how can we prove anything about convergence in general, if the decline of the dispersion measure in one variable (e.g. inflation) is causally related to a rise of the dispersion measure in another variable (e.g. nominal interest rate). Two variables might be dependent on each other differently in each country (e.g. monetary policy in order to reduce inflation has to raise interest rates a lot in order to restrict inflationary demand in one country, while in another a short talk among the social partners is sufficient to bring inflation down)? There is evidence for a trade- off between different kinds of convergence. Hall/Robertson/Wickens (1992) used a sophisticated time-varying parameter model to discover that, for EU countries, convergence in real exchange rates was associated with divergence in real interest rates between 1970 and 1991 (p.111).

Another problem is that the content of what convergence really means differs in different models. For example, a famous convergence study by Baumol (1986) analyzed whether there is a negative correlation between the initial per capita income of a country and its subsequent growth rates. He found empirical evidence for the catching up of poorer countries. But is this convergence as Baumol claims? Income inequalities need not vanish. If the world experienced a single technological change, we would observe a spill over from rich to poor countries and, hence, a catching up of the latter. We would also observe a negative

correlation between income and growth. But this would not be sufficient to trigger a long-term growth development that would make income inequalities vanish.

Another statistical concept (see e.g. Streissler 1979, Bernard and Durlauf 1991) would speak of convergence only if this catching up leads to an eventual disappearance of income inequalities. Barro/Sala i Martin (1991, p.112) distinguish between these two forms of convergence by calling the first 'beta-convergence' (poor countries grow faster than rich ones) and the second 'sigma-convergence' (a decline over time in the cross-sectional dispersion of per capita income).

What we can conclude, so far, is that even in the 'precise sciences', convergence is an unclear concept. An agreed definition of it is still missing in econometrics and economics.

The 'Clogged Channels' of Economic and Policy Convergence

I shall analyze four main channels of divergence in greater detail to look for evidence of how they might become distorted or blocked. (1) What if imitation of technology is not always possible or wanted? (2) What if the assumptions of market competition fail, e.g. because factor mobility itself is a political variable? (3) What if political actors decide not to conform and try to avoid state competition? (4) What if collective actors decide to free ride?

Limited Imitation Possibilities

The belief in catching up through the diffusion of technical progress among countries can be traced to Veblen (1915), Gerschenkron (1952) and Kuznets (1966). Veblen claimed that Britain had to pay the penalty of low growth rates for its early industrialization and, hence, was overtaken by other countries. Gerschenkron (1952) drew attention to the 'advantage of backwardness', leaving space for catching up by poor countries. For Kuznets (1966, p.1), economic growth is a sustained increase in per capita or per worker product, most often accompanied by an increase in population and usually by sweeping structural changes. He discovered that modern economic growth is first and foremost characterized by growth of total factor productivity (efficiency). He came to the "inescapable conclusion..that the direct contribution of man-hours and capital accumulation would hardly account for more than a tenth of the rate of growth in per capita

product.. The large remainder must be assigned to an increase in efficiency in the productive resources, or the effects of changing arrangements, or to the impact of technological change, or to all three" (Kuznets 1966, p.81). According to Kuznets, modern growth was based on the existence of a **'transnationally available stock of useful knowledge'**. This knowledge is "invariant to personal traits and talents and to institutional vagaries and hence..fully transmissible on a worldwide scale, in ways in which, say, handcraft techniques in traditional agriculture and industry were not, because they were based on personal knowledge of conditions specific to a given country..." (see Kuznets 1966, p.287 quoted in Terhal 1987, p.79f).

Nevertheless, Kuznets empirically found out that inequalities on a worldwide scale persisted or even widened. He attributed this to the fact that countries differ with respect to the date of full entry into the worldwide process of application of this knowledge. The main reasons for this 'divergence', he postulated, lay in the retardation of political and institutional adjustments, which have to occur before countries can 'take off' (see Kuznets 1966, p.468). His explanation for divergence,- i.e. the role of institutions and their policies - lay outside the field of neoclassical economics.

Many reasons are given nowadays for divergence of income and growth rates (see Helliwell/Chung 1990,p.2):

1. the technologies of the richer countries may not be directly applicable to poorer countries (e.g. due to different relative factor prices and different levels of education),

2. political and social systems of the poorer countries may not be willing to accept the degree of international interdependence (Abramovitz 1986 refers to it as "social capabilities" of poor countries),

3. technologies are privately owned and not public goods (the rents on imported technology would then flow to the rich countries and raise their income instead the income of the poor),

4. countries that have enjoyed economic progress in the past may lose their desire or ability to keep up with productivity improvements. A recent study by Windhoff-Heritier (1995) on environmental production standards gives empirical support for the argument that countries, once they implement a production technique are not willing to adjust it regularly. Therefore, the

leading and lagging of specific countries can occur consecutively over time.

As stated above, in the neoclassical growth model the rate of technological progress is assumed to be exogenous and identical in all economies. Lucas (1990) has expanded the neoclassical model by adjusting the rate of technological advance for effects resulting from the accumulation of human capital. According to this model, different levels of education, i.e. differences in the amount of human capital between countries, lead to differences in productive performance. Furthermore, human capital accumulation generates economies of scale. If one employee makes a technological innovation, other employees may benefit from it. As Buiter and Kletzer (1991) add, the presence of a non-traded (home-grown) human capital good which is an essential input for its own accumulation is sufficient for the existence of persistent international differentials in levels and growth rates of labor productivity, even if there is perfect capital mobility and even if technologies are identical across the world (p.43). Buiter and Kletzer show furthermore, that different policies (e.g. different levels of public spending on education) can increase growth rates. But even this expansion of the neoclassical model leaves out the decisive question, what leads to different policies and accumulation of human capital outside the sphere of economics. A somewhat more 'sociological' answer has been offered by Durlauf (1992), who incorporates the choice of neighborhood, and makes it responsible for human capital accumulation through education and cultural influences through things such as successful role models, in an intra-generational endogenous growth model. He shows that persistent income inequality and poverty can emerge from individual differences in the choice of neighborhood. This brings us precise technical results, but does not say very much about the content and conditions of these sociological choices.

Convergence of labor productivity levels or per capita income would thus occur if there is no impediment to the dissemination of technological knowledge, if there is no difference in country specific, non-traded, human capital accumulation and no barrier to the accumulation of capital. The hope that diffusion of technology will bring technical progress everywhere and will lead to the disappearance of income disparity and poverty in the long run depends on too many unrealistic assumptions. In the recent debate on the comparative advantage of the Japanese economy over the US economy, a new issue has been stressed. Imitation can be asymmetric due to the nature of the product. While Japanese firms are famous for their ability to imitate US technology of production, US firms have problems in imitating Japanese production advantages. The Japanese advantage consists mainly in better organizational know-how, which is much more difficult to copy than a

production plant due to differences in culture and regulations (see Aoki 1988, Dore 1986).

Limited Mechanism of Competition

The reference model for economists is the perfectly competitive market. An indefinite number of anonymous suppliers and demanders trade goods and services at a market clearing price. A market economy consists of all kinds of sub-markets for labor, capital, goods, services and futures. If there is an oversupply in some market, the price will fall; if there is excess demand, the price will go up. As long as the state does not restrict any of the actors from doing what he or she likes to do and to bid and offer what he or she prefers to bid and offer, the price mechanism will work. Scarce resources will be allocated to their best and most efficient use. There are, of course, all kinds of market failures due to things as information asymmetries, externalities or natural monopolies which are treated as deviations from the standard model.

The neoclassical convergence theory strongly depends upon the functioning of the perfectly competitive market. Unfortunately, that model seems to be a very poor one for international trade. First, trade does not take place exclusively through markets. If only one third of trade goes through the market (see Bellak 1995) - and this market is far from being a perfectly competitive one! - and if two thirds of world trade is 'managed' trade or negotiated within firms, the market model would be manifestly inadequate. If international trade functions through hierarchies of firms and depends on political decisions, why should we expect convergence from competition on a perfect market? Convergence of prices and wages through competition and trade stems from the neoclassical design of a market economy which simply cannot be found at an international level, except for raw materials, coffee beans, sugar cane and wheat.

Moreover, many firms involved in international trade are not anonymous units too small to influence the market price. They are price setters, oligopolies, and hence strategic actors. Concentration instead of competition, hierarchy instead of the price mechanism are the principles of governance of multinational enterprises. They create their own capital and labor flows, which differ from the neoclassical market model.

Furthermore, the neoclassical convergence debate considers all factors as somehow equally mobile. But the penetration of borders has not generated an

indefinitely smooth and quick flow of factor adjustments. Financial capital can cross borders with almost unlimited speed. The mere push of a button on a computer can transfer funds all over the globe, and this brings it closest to economists' perception of a perfect world. Physical capital is already less mobile, as it is more tied to sales markets, proximity to raw material markets, or the availability of qualified labor and transport facilities. Nevertheless, the number of multinational and transnational enterprises and the speed with which firms change their location has also increased over the time. Foreign direct investment (FDI) - an instrument by which multinational enterprises transfer whole packages of physical and financial capital - has increased dramatically since the 1980s. By the early 1990s, FDI has reached the importance of international trade. FDI outflows grew at an average annual rate of 24% between 1986 and 1990 (Bellak 1995, p.102). This is about four times the rate of world output growth (for further impressive numbers see Brigitte Levy in this volume). Yet, the mobility of physical capital is not indefinite and smooth. Firms agglomerate instead of spreading over space. Poor regions stay poor and in the periphery, while the core expands (see Dehesa and Krugman 1992).

A study by the Dutch Social Economic Council (SER-COB 1994) found that physical capital mobility was even low between official European border regions (Euregios) in Germany and the Netherlands, where national authorities cooperate across borders and try to stimulate similar patterns in the relations between private businesses. The survey showed that Dutch businessmen rarely look over the border for business (Van Houtum en Van Kerkhoff 1994, Corvers and Dankbaar 1994). Problems with language, legal regimes, differences in mentality and product preferences - coupled with the specialization of firms - all seem to limit mobility.

Labor mobility - the amount and speed with which workers move across national borders - has also increased, though to a still lesser degree. It is certainly much lower than capital mobility. Furthermore, labor mobility is not a homogenous flow across countries. It is institutionally, historically and culturally embedded. Whatever there is in terms of labor mobility follows specific and usually officially controlled patterns. Sassen (1995) shows that labor mobility takes place within specific segments of the labor market, is restricted to specific historical phases, typically occurs between a limited set of countries and thus affects some countries more than others, i.e. it creates divergence. Furthermore, migration streams between countries are often established by multinational corporations (MNCs). They create networks. People in the host country come to know the culture and opportunities of the MNCs country of origin and come to consider it as a potential migration

country. Interestingly enough, immigrants often originate from countries which receive foreign aid, investment, and exports of consumer goods. Measures commonly thought to deter immigration seem to have precisely the opposite effect. On the one hand, labor mobility is socially produced by transnational enterprises and thus is not a migration influx suffered by the labor receiving country. On the other hand, labor mobility is also politically steered. Sassen's (1995) analysis of migration policies shows that the globalization process leads to converging anti-migration policies across nations and gives labor and capital an uneven chance to "cross the globe".

Labor mobility is very limited, except for some very specific, very high and very low skilled jobs. Even in the United States, with a more homogeneous working population than Europe that speaks basically the same language, labor mobility is not unlimited. Wage and unemployment rates still differ significantly and do not automatically trigger "compensating" flows of labor (Dye 1991). Unemployment rates by state varied in 1991 between 10.5 per cent in West Virginia and 2.7 per cent in Nebraska. In Europe, the language and cultural barriers to migration are much higher. Labor mobility in Europe is about one-third of the US. Unemployment rates in the European Union differ between 23.8 per cent for Spain and 6.0 per cent for Portugal (OECD 1993).

Pressures for internationalization are higher coming from capital than from labor due to these different factor mobilities, which are, in term, due to their intrinsic nature. Land cannot be transferred at all, while financial capital can be transferred almost effortlessly and at quasi zero cost. Labor is largely stuck with its cultural and linguistic endowment. The opening of territorial borders and the interdependence of economies give capital and labor an unequal chance to adjust.

The Non-market Conforming Responses of Political Actors

Even if production factors are not perfectly mobile, most countries are benefiting (and suffering) from the pressures of increased flows of capital, labor, and goods. Through these exchanges, they come more in contact with each other and have to compete for the same pool of production factors, goods, and consumers. They are under pressure to attract or keep capital, labor, and markets for their goods and services. Since a large share of international trade takes place within multinational companies, countries are also under pressure to compete for the location of such enterprises. Their competitive position in the world economy will depend in large part on their economic policies and policy outcomes. Do they have a secure

currency, low inflation, a good infrastructure of transportation and communications, pleasant living conditions, low costs of living, high wages (to attract labor) or low wages (to attract capital), qualified labor, educational institutions, research and development facilities, attractive tax regimes, few regulations that bother industry, and whatever else goes in the making of the competitive position of nations? As international competition increases, so will the pressure to compete with other nation-states. Nations will have to adjust their economic policies and the chance is great that these policies will become more similar. Countries will try to offer similar infrastructures, tax regimes, inflation rates, wage levels and regulations on production and consumption. Insofar as convergence could take place, there are contrasting hypotheses as to the level at which this will happen. First there is the *thesis* that internationalization will produce a "race to the bottom", i.e. a convergence at a low level of product regulation and consumer protection. A rival thesis is that it will promote a convergence toward a high level of regulation and protection, a "race to the top".

The more well-known thesis of the race to the bottom implies that countries will try to surpass each other by offering lower wage levels, lower costs of social security, and less regulatory restrictions to business. Conservatives saw this as the great attraction of the Single European Market. Former British Prime-Minister Thatcher called it the "greatest deregulation operation in history". The financial speaker of the Social Democrats in the Austrian parliament, Ewald Nowotny, concurred: "Obviously, this is a race to the bottom. And obviously the one wins this race who is more mobile, better informed or also more ruthless. Hence, it is likely that this will be capital (notably financial capital) rather than labor, the large enterprise rather than the small, and actors with low social and ecological morals rather than responsible businessmen" (translated from Nowotny in *Der Standard*, November 1994).

There are however a number of qualifications to this theory of social dumping. The *first* relates to economic integration. Formal membership in the European Union does not immediately produce a uniform economic reality. That which exists *de jure*, say, in the Single European Act, does not immediately also exist *de facto*. The legal establishment of the "four freedoms" which allows capital, labor, goods and services to move freely within the Union, does not automatically create high factor and product mobility across borders.

A *second* qualification to the assumed 'race to the bottom' is that not all countries are equally affected by the pressures of internationalization. As indicated, labor mobility occurs typically between specific supplying and receiving countries.

Furthermore, the dependence of the various nation-states on foreign trade varies. The degree of openness of the economy to world markets varies between ten per cent of exports to GDP for the US, to about sixty percent for some small European countries such as the Netherlands. Hence, countries are not all affected to the same degree and this should influence the pressure for convergence.

Thirdly, wage levels, regulations and state expenditures are not as malleable as presumed. They serve specific purposes and interests, such as labor and environmental protection, which cannot be neglected for electoral reasons or due to the pressure of organized interest. What is more, they are often also in the interest of business itself. It is not always so clear what makes for an optimal competitive position in world markets. Often, there is a potential trade-off between different factors for improving competitiveness. Lower wages may attract foreign enterprises, however, the resultant lower qualification levels of personnel may keep them away. There is a similar trade-off between lower taxes and less infrastructural facilities, or between less environmental regulation and a worse image with consumers. As Mosley (1995) empirically shows, if all aspects that are favorable for business are taken into account, it is not clear which country is the most attractive for business' location.

Opposed to the race to the bottom thesis is the thesis of a " race to the top" via "Euro-welfarism". As more and more national regulations get invalidated, pressure has been mounting in the EU- Member States to replace national regulations with supranational ones. This has led to a veritable flood of directives from the European Commission. Political conflict has focused on the level of protection to be provided by this legislation. Should it be high or low? Countries which themselves have high levels of protection press for adoption of their norms by the EU. In this case, political integration - and political competition between Member States within this supranational unit - could fuel a race to the top, rather than to the bottom, i.e. to a convergence at a high level of protective regulation.

Both convergence theses could turn out to be wrong, if political actors decided not to compete with similar strategies but to differentiate themselves and to create niches. A specific bundle of location advantages could then attract specific firms and industries.

Some empirical results on European policy convergence can be found in Unger/Van Waarden (1995), where fourteen policy fields have been analyzed by various authors. Neither the social dumping nor the Euro-welfare thesis were confirmed. Bellak (1995) saw divergence of national industrial policies as a more

likely outcome. Since Multinational enterprises do not have homogenous interests, governments may compete for the location of enterprises by means of specialization, by creating a unique environment for specific industries, necessitating different industrial policy measures. According to him, industrial policy will continue to differ, despite increases in physical capital mobility.

Kitzmantel and Moser (1995) argued that **tax policy** in EU Member States - a major economic instrument of redistribution - is substantially influenced by EU laws as well as by the high mobility of financial capital, which enhances tax competition between nations. Thus in most countries foreign operators are typically exempted from income taxation whilst domestic operators are not. Tax competition has been more important than joint action. Concerted measures have been mainly limited to harmonizing indirect taxes (VAT, excise duties), whereas direct taxation (company taxes, personal income taxes) has remained largely a subject of national initiatives. Notwithstanding some tendencies towards convergence, the authors do not expect a convergence to the bottom, to very low tax rates, since nations have financing needs that will prevent them from lowering taxes drastically. Furthermore, considerable discrepancies between national tax systems still exist, both with respect to tax rates and tax exemptions. Since the mobile factors cannot be taxed further due to international tax competition, the tax burden will be shifted more and more towards the immobile factor, in particular labor.

Mosley (1995) analyzed national **regimes of workers' protection** in Europe and argued that economic and political integration is unlikely to result in 'social dumping', but will not lead to an 'upward' convergence through high standards of social protection of a European authority either. While some EU countries have the competitive advantage of low labor costs (the periphery), others have the competitive advantage of higher welfare facilities (the core). Welfare state arrangements are not always a burden, but can create competitive advantages due to e.g. better training and health of workers. Regulations and welfare programmes differ among European countries, but "any hierarchy in the overall 'burden' on enterprises is difficult to discern". Nevertheless, center-core problems related to wage differentials could become important in certain sectors, such as labor intensive industries. Even though social dumping does not occur, social benefits are on the defensive in many EU-countries. Mosley attributes this "convergence towards the worse" to ideological trends and not to internationalization and European integration. Some convergence could emerge in the core countries, while divergence may appear in the core-periphery relation.

Engbersen (1995) investigated the concept of welfare states in his study of poverty regimes in Europe. He showed that poverty regimes in Britain, France, and the Netherlands differ, and so do their outcomes, the life chances of the European poor. The 'residual welfare state' in Britain produces material deprivation including lack of food and clothing, which would be unthinkable in the Dutch welfare state. In this well-developed welfare state, poverty means not so much financial deprivation as well as social isolation, structural exclusion, alienation of the poor from central societal institutions, and permanent dependence on the welfare state. The author expects and fears convergence towards a "residual welfare state". A continuation of the actual trend of lowering welfare benefits could bring about greater social inequality and social problems, such as anomie, in many European nations.

Keller (1995) analyzed **labor regulation policies.** He found some convergence to the bottom, towards minimal standards, but also differentiation at the firm, sectoral and national level. He agreed with Engbersen in that he neither expects a well-developed European welfare state. He argued that a European social policy - especially in the field of labor relations - is unlikely. A Europeanization of labor relations is not to be expected, given the divergent interests and different organizational structures of trade unions. Furthermore, the strengthening of the position of employers makes bargaining above the company level less attractive to them. Interest representation and participation at the company and factory level in transnational enterprises - though rare and difficult - is nevertheless easier to imagine than a centralized European system of collective bargaining.

Eichener (1995) studied **workplace health and safety standards** and neither perceives a convergence to the bottom. He argues that the fear of some countries that their high levels of protection would be undercut by social and ecological dumping is unjustified. Such expectations were based on political integration theories which analyzed European policy making primarily as intergovernmental bargaining, which would only lead to lowest common denominator agreements. European occupational health and safety regulation, however, provides a surprisingly high level of protection and develops even innovative approaches. This is because it is the outcome of interactions among complex configurations of actors, including not only national governments (as in intergovernmental bargaining theories) but also national interest groups and European actors, particularly the European Commission. The latter's institutional self-interest is an important factor explaining the innovativeness of health and safety regulation.

Héritier (1995) analyzed **clean air policies** in Europe. Air pollution is a policy problem which ideal-typically represents 'international interdependence'. Firstly, as atmospheric pollution transgresses national boundaries, it cannot effectively be dealt with within the territorial boundaries of one state. States which suffer from pollution (and from international treaties, designed to reduce the problem) will exert pressure on other states. Secondly, since emission regulation affects the competitive position of the regulated industries in an integrated market, harmonization is a prime concern especially of the high-level regulation countries. Therefore, environmental policy making has become increasingly a matter for European authorities, and for mutual influence between national and European agencies. As Mosley and Eichener, Héritier neither finds a race to the bottom. But whereas Eichener stresses the role of the European Commission in maintaining or creating a high level of protection, Héritier finds the cause in policy competition between Member States. Countries try to stay ahead of EU-regulations and regulatory intentions in their national policies. They try to assume a leadership role to save on costs of harmonizing national legislation with EU-legislation. But once they have installed new regulations they tend to stick to them and become "laggards" instead of "leaders". Upwards convergence takes thus place in a kind of catching up and forging ahead process. Nevertheless, policy differences persist, because of different geographic and geopolitical conditions which influence the concern with air pollution, of different political structures which give environmental groups and issues varying access to the political arena, of different administrative structures and traditions, which influence motives, concerns, and priorities of politicians and civil servants, and of different legal systems which prefer either voluntary self-regulation or detailed, mandatory regulations. These differences produce different perceptions and approaches to the problem of air pollution, which seem to be remarkably persistent.

Kelemen (1995) did not find a race to the bottom for **environmental policy** either, but was more pessimistic about a race to the top, since EU-countries with low environmental standards get delays for adjustments. He took as his point of departure the potential conflicts between European competition and environmental policy. This gives the European Court of Justice leeway in deciding which should prevail over which. Kelemen showed that Decisions of the Court and the Commission have tended to advance environmental protection but that the Council, where intergovernmental bargaining between high and low standard countries takes place, tends to retard the development of EU environmental policy. The Treaties agreed upon by the Member States can hence be read as steps backward, which should correct for steps forward, made by the Court.

As soon as we take institutional differences among countries into account, the likelihood of convergence declines. There is, of course, also an ongoing debate, whether institutions will converge in the process of internationalization and globalization. Given first empirical results of a volume forthcoming by Unger/Van Waarden on institutional Convergence, this does not seem very likely either.

Problems of Enforcement (Maastricht Problems)

As already mentioned, the idea of enforcing economic adjustment by fixing targets for some monetary indicators, is quite new in economics. This raises the question of which problems of enforcement could occur. On the one hand, **problems of collective action** might oppose the original idea of convergence. As Unger (1995) showed for **fiscal policy**, even if countries fulfilled all Maastricht criteria by 1997 or 1999 and were allowed to enter the currency union, it will be very difficult to exclude free riders afterwards. Whether fiscal policies will converge or not will depend mainly on whether financial markets believe that the European Union will not bail out bad debtors. The solemn declaration of the "no bail out clause" in the Maastricht Treaty itself is insufficient to solve the collective action problem.

Even if all countries planned to fulfill all EU norms and laws, the national outcome may still differ because of differences in policy implementation. To translate laws into different languages and law systems can already be a problem. Van Waarden (1995) argued that countries differ in their dominant styles of **policy implementation** and described the typical styles of the US, Britain, France, Germany, and the Netherlands. While British top civil servant perceive themselves as civilized gentleman, serving society, the French perceive themselves as elite, serving the interest of *la grande nation*. The British civil servants have a relatively high status, allowing for informality and discretionary authority, while the French civil servants distrust particularism. The Germans have legal training and concentrate on legalistic interpretations of law. The 'mediating' role between business and the state that they consider their task would be viewed as 'corruption' and 'capturing' by US civil servants. Van Waarden argued that these differences are not incidental nor accidental, but structural, in that they are strongly rooted in national state institutions, such as legal systems and structures and traditions of the public administration. This makes these policy styles rather resistant to change. Even the pressures of internationalization will be resisted, which is not to say that change could not take place of course. However, as long as implementation styles are different between Member States, this will also affect the degree of real integration. The differences in national styles imply that European policy may be

implemented differently - and unequally - in different countries - as long as EU-policies are implemented by national state agencies.

Conclusion

Forces towards convergence and towards divergence exist and interact within the same time-frame. Sometimes the one is stronger, sometimes the other. Phases of convergence are followed by periods of divergence. Peace follows war; the Post-Fordist period of specialization and selective tastes follows the Fordist period of mass production and homogenous tastes. Convergence wins over divergence and vice versa with the pendular swings of history.

Economic policies which depend on the most mobile factors, i.e. financial and physical capital, lose room for maneuver due to internationalization. A typical example is the inability of monetary policy to set interest rates autonomously. Economic policies which depend on the least mobile factor, i.e. labor, gain in importance. A typical example is wage policy which has still room for maneuver left. These asymmetries of factor mobility and institutional differences make for persistence of differences in outcomes.

The Unger/Van Waarden (1995) comparison of fourteen policy fields within the European Union showed that financial market liberalization, multinational firms' threats of relocation, the spread of political ideologies, and EU-harmonization laws are the main factors of internationalization affecting national economic policies in this part of the world. Of these, state competition for the location of firms seems to be more important for convergence than has been the enforcement of EU-harmonization laws. And imitation of political ideology seems more important than market forces. As has been shown above, internationalization or globalization does not necessarily imply that market forces become more important. Globalization may also mean that hierarchies (such as multinationals), or niches or conglomerates will gain in importance. And these factors work partly against convergence. Even for Western Capitalist Societies, we cannot conclude that poor countries will ever cease to be poor in relative terms. Within the EU, we have seen that some poor countries are catching up, such as Portugal, while others do not, such as Greece. Let us hope with McKenna from the EU Commission that in the long run poorer countries will become richer, but let us not pretend that they necessarily will.

Endnotes

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