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for Business and Government 30 YEARS

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February 2015

M-RCBG Associate Working Paper Series | No. 38

Published in: Kim, Ashley and Lambright (eds), 2015: *Public Administration in the Context of Global Governance*. Cheltenham: Edward Elgar Publishing. pp. 116-137.

Mossavar-Rahmani Center for Business & Government
Weil Hall | Harvard Kennedy School | www.hks.harvard.edu/mrcbg

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INTRODUCTION

The dominating neoliberal international economic system of the past few decades pressures countries to become more similar in a number of economic, social and political affairs (Friedman, 1999; Knill, 2005; Rodrik, 2000, pp. 181–2). This is true within the World Trade Organization (WTO) on the global level, and even more in the European Union (EU) on the regional level. In the WTO, several negotiation rounds after WWII have deepened integration between nation-states through tariff reductions between most countries, with some supranational authority given to the organization after 1994. In the EU, the processes are much more far-reaching, as a number of directives and regulations are issued that harmonizes policies across Member States. In some cases policies are common, such as the Common Agricultural Policy (CAP) and a common trade policy established in 1958. Later, the introduction of the Single Market in 1993 and the euro in 1999/2002 represent the most *de jure* comprehensive harmonization of rules, regulations and practices, and transfer of power from the nation-states to EU policy makers and institutions. This is unique in an international economic integration context.

In spite of common rules and regulations, different national policy goals and practices are, however, often *de facto* sustained (Drezner, 2001; Holzinger and Knill, 2005). Isomorphistic policy homogenization may take place in some instances, but otherwise the degree of political convergence seems to depend on national situations and preferences, path dependency, ideological divisions in political practices, regulatory interpretation and policy implementation. To what extent does member state heterogeneity and contradictions between policy areas influence policy formulation and harmonization in an economic integration area? Do public managers and politicians have a particular motivation for convergence or divergence? Are there transnational organizations with their own managers guiding this process? Will differences remain, or is it mainly a question of time before the same policy is fit for and desired by everyone? Should and could common policies more strongly be enforced at the supranational level?

This chapter discusses the scale and scope of countries' ability to manoeuvre in a transnational economic integration process. Drawing from convergence, integration and international trade theories, it analyses what could be an optimal degree of economic integration. The first section outlines a general framework for understanding degrees of social and political convergence as a prerequisite for, and consequence of, advanced levels of international economic integration. The dynamics of such processes are then outlined, showing how the pressure for deeper integration is challenged by member states with diverging situations and preferences. The interaction between domestic and foreign policy is discussed within the framework of a two-level game. The differences between short- and long-term effects of trade liberalization in terms of gains, and the redistribution of income and economic restructuring are discussed. The chapter argues that the optimal degree of integration is to be found in a dynamic process where the marginal benefits of economic, political and social restructuring equal their marginal costs. This may vary across sectors, countries and time, and depends partly on political choice.

ECONOMIC INTEGRATION AND POLITICAL CONVERGENCE

Microeconomic theory is often used for the identification of the goals of an international economic integration process. According to the theory, the ideal situation exists when markets are unified across borders, and firms adjust production where their respective marginal costs equal a common price.[1] A first-best economic integration area operates under conditions of social efficiency (Pareto optimality). Common policy should (only) correct market distortions (caused by, for example, externalities or monopoly power) so that there is consistency between the company's desire to maximize profits and the participating societies' desire for maximizing welfare, as in a perfectly competitive national market.

However, in the real world, this is rarely possible. Economics may first of all give insight into the processes around and the purpose of interventions, describing important forces operating towards optimality. Mostly we live in a second-best world where policy measures generally aim for second-best solutions. In a second-best economic integration area, compromises between theoretical first-best solutions and the real market are adopted and recognized, acknowledging that integrated markets are not only influenced by rational economic behaviour, efficiency goals and the need to correct market failures, as defined in economics, but also by diverging institutional, cultural and historical situations and interests.

Accordingly, most countries seek an optimal rather than maximal degree of openness in their economies. National interests concerning degrees of autonomy and sovereignty, conflicting interests between and within countries and inertia in markets and politics often contribute to a slowing down of the integration processes. In some areas (for example, in agricultural products) complete global free trade may never become a reality. From the outset, the different second-best national situations, the divergent understanding of rules and regulations (with or without intent) and the gaming around these rules and regulations when it comes to interpretation and implementation hamper a full harmonization of policy practices. Hence, a static economic equilibrium model demonstrates the benefits of free trade in an infinite future. To understand the process of policy harmonization, however, the understanding must become dynamic and more social science theories must be applied.

Social and political convergence is often defined as a tendency where countries become more similar, albeit not equal, in economic, political, social and cultural institutions and policies over time (Bennett, 1991). Hence, convergence understanding is inter-temporal (dynamic) and goes further than regular comparative research that examines the degree of similarity between investigated objects (Seeliger, 1996). As Inkeles explains, 'convergence means moving from different positions towards some common point. To know that countries are alike tells us nothing about convergence. There must be movement over time toward some identified common point' (1981, p. 13). The change in policy is made through rules, regulations, processes and practices that can be transferred or spread from other countries.

Policy transfer represents 'Knowledge about policies, administrative arrangements, institutions and ideas in one political system (past or present) (that) is used in the development of policies, administrative arrangements, institutions and ideas in another political system' (Dolowitz and Marsh, 2000, p. 5). Policy spread is a more gradual, socially conditioned adaptation to international change (Stone, 2000). The policy harmonization that will actually take place applies both to (a) policy formulation and formality and (b) actual policy content. The outcome of policy harmonization and ways to exercise policy may, but need not, be increased depending on the similarities in how two countries' political systems actually work (Knill, 2005, p. 766). Transfer and spread of policy is the dependent variable in studies concentrating on the integrative effects on policy formulation, while in convergence studies the dependent variable is the actual effects. Hence, economic integration can lead to greater similarity in political forms and processes (through transfer or spread) and may or may not also lead to greater similarity in actual political content and, therefore, to political convergence.

Political convergence can also be caused by isomorphistic homogenization (Radaelli, 2002). Isomorphism implies that a group or a subject matter of the country may be forced to act like, or be treated equally with, others who are facing the same or similar situation or environment (DiMaggio and Powell, 1983, p. 149). The similarity may be due to similar (but independent) responses of different countries to parallel problems, for example, the age wave, environmental or economic problems (Bennett, 1991, p. 231). Communication and information spread can contribute to parallel political solutions across national borders regardless of the harmonization of prices of products and production factors, and explicit regulations introduced (Holzinger and Knill, 2005). Isomorphistic homogenization means that greater similarity emerges between one or more elements of a policy in two or more countries, especially when it comes to organizational, institutional and cultural issues.

Hence, political convergence is the result of processes of policy change towards a common equilibrium point, regardless of what caused the change (policy transfer, spread and/or isomorphism).[2] The process is not hierarchical or discrete, but appears rather as continuous sequences of negotiations, interpretations and adaptations (Dolowitz and Marsh, 2000, p. 15; Heichel et al., 2005). The actual outcome will often be second-best in economic terms, but perhaps ranking better than the measurement from economics in a long-term social and political context.

For an economic integration area it is therefore important to determine whether requirements shall be set in terms of similarity in policy form and process, and/or also in terms of *de facto* policy content. When situations and interests are common, political convergence requirements are less important, as isomorphism makes member states act in similar ways to common rules and regulations. When situations and interests are not fully shared, however, a *de facto* common or fully harmonized policy will be less ideal and potentially cause conflict. Uncommon situations can be caused by different economic structures and levels of economic development, uneven degrees of market sector maturity, different relations to third-party countries and unique culture and history. Conflicts can also arise when the common market aims at maximizing the benefits for the whole integration area, rather than aiming to benefit nation-states, companies or institutions. The outcome of such a situation is called 'redistribution effects', a concept that hails from trade creation theory.

When situations or interests differ, the processes of harmonization between policy form and process will trigger diverging national interpretations, innovative implementation of said policies and create the potential for different actual policy content. For example, if in the EU a policy is weakly formulated (such as in a directive), a nation-state has a greater opportunity to be innovative with respect to the interpretation and adaptation to its formality than when the formulation process is stronger (such as in a direct regulation/law). If formulations are weak, domestic policy can be revised more easily to follow formalities while simultaneously in pursuit of maintaining important national (and not EU) goals (Austvik, 2010, pp. 111–13).

Hence, to approach the second-best reality of an economic integration process, an optimal strategy for a single country could be:

1. enter into economic integration with relevant partners to reap the benefits of free trade while simultaneously
2. optimizing, formulating and promoting national sectorial policies whenever relevant and possible to avoid its disadvantages.

Such sectorial promotion in a free trade regime can be achieved by 'hidden' measures and 'clever' adaptation to agreed upon rules in an attempt to help a specific nation-state's export and import industries, a now common situation that is perceived as a steadily increasing challenge to trade negotiations for countries pariticpating in either the WTO and the EU or both. Hence, the struggle between open and restrictive trade may take place as an open debate before an agreement is signed, and then continue in more innovative forms after its ratification, when traditional trade barriers (tariffs, quotas) are abolished. Hence, the relative national or sectorial political competence can be decisive for which country will benefit the most from an integration process. The aims for each country may be, under such a strategy, to receive the benefits of market access for and political influence over, and support of, its industries adapted to their unique national situations without experiencing corresponding retaliation from other member countries.

The optimal second-best strategy for the integration area could similarly be:

1. to balance the width and depth of common rules and regulations so countries can – within reason – adapt individually to them, while,

2. enforcing *de facto* policy convergence when situations in each country have evolved sufficiently to similar levels.

It takes time to restructure an economy, and if time is not permitted the integration process may be a loss for underdeveloped sectors and economies. Policies should not only aim for a long-term (infinite) future equilibrium but also for transitional challenges in the short and medium term.

Compensatory policy packages may be necessary to help speed up the processes of reaching sufficient degrees of isomorphism, acknowledging that the integration area may never reach a first-best level, as defined in economics. Hence, in complex matters with large differences between member countries, policy for integration areas easily becomes more concerned about form and process than hard realities, if implemented at all. The process should not often rely on a single area policy only but on policy packages, where interrelated areas and support to help market and economic maturation are addressed. When/if markets mature and economic and political preferences converge sufficiently, a single policy requiring real political convergence may be more easily sustainable. In some cases, however, exceptions from the general rule must be expected to remain.

THE DYNAMICS OF AN ECONOMIC INTEGRATION PROCESS

International economic integration makes the nation-state subject to regulation, and not just the one that regulates activities of others. What previously were national political questions about the rules for policy have become a legal question about what should and could be policy (Arnesen, 1995, p. 659). The dynamics of the process indicate that the lower level of integration pushes for higher levels of integration. Over time, trading countries must become more alike in their policies if free trade is to work. Greater integration would speed up growth in a period of recession, but also reinforce the speed of structural change, as reviewed by the Organisation for Economic Co-operation and Development (OECD, 2005). The challenge for an integration process is to prevent unemployment in non-competitive sectors from growing too much when processes are developing rapidly. In such a situation, not only long- and short-term interests are confronted but also winners and losers from trade liberalization. Integration processes should, as a consequence, take time in order to give people, businesses and society time to adjust. The 'rich' world has actually given itself half a century after World War II for this adjustment, while new market economies and developing countries are pressured for much faster adjustments.

From a liberal perspective, cooperation is the best response to interdependence and achieving economic win-win solutions. Within single sectors, however, all countries and companies try to reap the benefit of trade in general, and to avoid the problems trade creates for said country/company to the disadvantage of other countries/companies. In strategic trade theory, the orthodox liberal understanding of the benefits of trade is replaced by a more interventionist liberal approach, sometimes coloured by realist/economic nationalist attitudes (Krugman, 1988). However, a strategy of mixed blessing is limited. In international trade negotiations a given country's (economic) benefit of increasing exports is weighed against the (political) cost of increasing imports. In this way, exporting and importing sectors within a country are positioned against each other. Still, within limits it remains in many situations an option for most countries to adopt an interventionist attitude to trade liberalism, fought with 'hidden' political (often *de facto* protectionist) measures.

The ability of nation-states to reach their goals, despite the loss of sovereignty that the integration process entails, is important for the balance of dependency (Cooper, 1968). The response of states to this loss can be passive or even defensive, aggressive and exploitative, or constructive and cooperative. Often large states can be more aggressive and exploitative than small states because of asymmetric relations. From a realist perspective, the larger state as the less dependent actor will not only let market transactions passively dictate its interdependence with the smaller state but demand a change of terms of operations or even 'side payments'. For the small country, such an asymmetric interdependence may turn into something close to one-sided dependence.

However, in spite of being small, small states can achieve objectives in dispute with larger states and organizations because they often benefit from a 'complex interdependence', where societies are connected in multiple ways and the hierarchy of issues is absent or weak (Keohane and Nye, 1977, pp. 24–9). Peter Katzenstein (1985) argues that small countries more easily adjust to changes because it is easier for them to reach consensus-oriented decisions in corporate domestic structures, indicating that the small country could potentially be more dynamic than the bigger in decision making. Both the WTO and EU systems, for example, must continuously compromise interests across countries, and this may delay and weaken decisions. In spite of the obvious power imbalances between the international organizations and single member states, and between large and small states, policy outcomes as a consequence depend on more than just the formal economic and political matters.

A prerequisite for all levels of economic integration is that solutions are in place about how disputes concerning understanding and implementation of treaties are to be resolved. Harmonization of laws and regulations are pushing governments to solve common problems through common institutions (Drezner, 2001, p. 60). The scale and scope of changes in policy goals and practices increases with the number of countries and sectors involved (Holzinger and Knill, 2005, p. 778). When common institutions are established, they constrain and shape national governments' ability to manoeuvre.[3] The higher the level of integration, and the deeper it goes, the greater the formal limitations are put on national policy. The closer the cooperation, the more competence is required from both national and common institutions. At the same time as the pressure for more supranational institutions takes place, new economic regions may evolve within and across national borders. New cross-border regions can be given authority that was previously executed by a nation-state. The transfer of power from nation-states to international organizations, and the harmonization of competition rules through political decision making and market pressure, may consequently strengthen regional institutions (Veggeland, 2000, pp. 42–82).

Neofunctionalists and constructivists argue that merging of identities and preferences over time will increasingly lead to more political similarities across countries, and the transfer of power to common institutions to make it work is to the benefit of all. Intergovernmentalists and institutionalists explain, however, that resistance to economic integration and the policy converges needed to make such integration a reality remains, citing instances where nation-states and their domestic institutions resist and undermine the gradual transfer of power out of their domains. The bargaining and consensus-building techniques in international organizations are considered by these critics to be refinements of intergovernmental diplomacy where important domestic political autonomy can be retained, rather than the ultimate transfer of power to a supranational entity. In such situations nation-states may see themselves served by changing the real content of the common policy through delays, innovative interpretation and implementation, and/or find compensatory domestic steps or put forward new external requirements. In which case the integration process risks not working according to its goals.[4] Only when economic situations become common can a common policy work, and therefore, can a full political convergence take place.

These debates partly contradict and partly support each other's views on the progress of integration processes, particularly in the EU. Neofunctionalists and constructivists point to the potential for further integration: neo-functionalists through functional and political spillovers;

constructivists through changes in identities and preferences resulting from cooperation over time. Institutionalists and intergovernmentalists are more sceptical to both spillovers and socialization. For them institutional and policy integration is unlikely to change in the foreseeable future (Moravcsik, 2001, p. 163), and policy will continue to be defined by interstate processes. Hence, considering the EU utilizes a 'weak' state structure (as compared to the United States), the resulting form of intergovernmental bargaining facilitates greater manoeuvring room for a national political entrepreneur.

Economic ideology is important in the assessment of these different views. The economic ideologies of each group expresses said group's beliefs when it comes to the role of perceptions, models and values in how the economic situation is perceived and the political circumstance, which, in turn, for these groups influences preferences and behaviour. Such ideology may exist among political and economic elites in the population of a country, in the population, as well as among public managers in both nation-states and international organizations. A change of ideology will lead to a change in the weighting of preferences and the behaviour of institutions, electorate and state structures. Most political parties and the European public and many administrations have, for example, moved their basically consensus-oriented social democratic and Keynesian interventionist economic ideology in a direction that favours more (political 'hands off') liberal solutions. This has *inter alia* resulted in a number of New Public Management (NPM) arrangements for public utilities and services.

In this context, Europeanization has been defined as 'a set of processes through which the EU political, social and economic dynamics become part of the logic of domestic discourse, identities, political structures and public policies' (Ladrech, 2001, p. 3). The compatibility between EU and domestic policy has increased with structural convergence between institutions and policy (Cowles et al., 2001) but also through dynamic processes of adaptation. Globalization has similarly been defined as 'the norms, institutions, and laws that support global capital accumulation along neo-liberal principles' (Laxer, 1995, p. 302). The processes can lead to a 're-evaluation of interests, re-formulation of conflicting issues and adoption of new perspectives or knowledge' (Claes, 2002, p. 300). Hence, Europeanization and globalization have exerted an influence on legal matters, institutions, as well as on norms and ideology as a continuous process.

In this context, the EU is a much stronger regime than the WTO, and especially the International Monetary Fund (IMF), giving countries less freedom of action in relation to EU rules and regulations than in relation to the two global institutions. At the same time, the EU is much weaker than a federation like the United States. However, politics shape markets and markets shape politics. In some cases, international markets determine the amount of room a nation-state has when it comes to political manoeuvring than supranational regulations. One example is how global free movement of capital gives countries little political manoeuvring room for national regulations (such as the introduction of a so-called Tobin tax or increased capital requirements for banks), even if the regulations from the IMF or other bodies are more advisory rather than regulatory (and do not forbid a tax or can require increased equity for banks). The international capital market restrains national credit and monetary policies. The more a country is exposed to international economic competition, the more probable it is that policy will converge with other countries with the same international exposure, and domestic change can only be done via international cooperation.

THE INTERPLAY BETWEEN INTERNATIONAL AND DOMESTIC SPHERES

International economic integration represents a win-win situation on aggregated national levels and a win-lose situation on domestic sectorial levels. Trade policy in most countries is directed to support the sectorial losers of trade (importing competing industries), albeit some policy is also directed to support the sectorial winners (exporting competing industries). Bearing this is mind, the outcome of an integration process will almost never follow an economics textbook in a straightforward way. The interplay between national and international public managers and politicians becomes central in shaping real policy outcome. Weiss (1998, 2003) questioned the effects of convergence between integrating economies' institutions and policies associated with globalization (international economic integration), and pointed to the mediating role played by domestic nation-state institutions. She argued that the effect that non-state powers have upon a government can be enabling as well as constraining. Rather than a movement towards a neoliberal model, she sees the emergence of what she calls 'governed interdependence'. In analysing the relation between two international political parties (countries), the liberal intergovernmental approach of Andrew Moravcsik (1993) similarly underlines the importance of administrative and political bargaining power and skills, along with the constellation of domestic and international actors in defining and understanding policy outcome.[5]

In his two-level game, Robert Putnam (1988) presented a model for how to understand the interaction between domestic and external agents in determining policy outcome when signing an international agreement. The outset is that an international agreement is negotiated because parties think they will benefit compared to a no-agreement situation. The set of possible international outcomes that might be accepted on each of the domestic tables is called a 'Win-Set'. The relative size of the Win-Sets effects the distribution of gains from a bargaining situation. It is only when Win-Sets in both countries overlap that an agreement can be made.

Often the size and shape of the Win-Sets are uncertain, both at home and abroad, and the expectations about them become important elements in shaping strategies. The more that can be accepted (the larger the Win-Set), the more room there is for the other party to manoeuvre; and a small (according to the other party's perception) domestic Win-Set can represent a bargaining asset. If the negotiator is unable to make concessions because his domestic actors are not willing to accept much change, the other negotiator must make concessions to prevent the agreement from breaking down. Small Win-Sets bring a greater risk of stalemate or breakdown of negotiations.

Generally, there are winners and also losers within a country. If the negotiations are too hard on behalf of the winners (export industries), this may lead to domestic divisions (with import competing industries) and the risk of involuntary defection and no agreement at the international level. The domestic interests that are most effected can be expected to exert most influence during the negotiation and acceptance processes. Hence, the size and shape of the Win-Sets depend on domestic institutions, preferences and coalitions, as well as the negotiators' strategies. This means that the lower the opportunity cost of no agreement (the 'walk-away price'), the smaller the Win-Set. Accordingly, the more dependent a country is on the other, the more must be accepted and the larger the Win-Set. The smaller and more open a country's economy, the larger the Win-Set. The more complicated an acceptance procedure, the smaller the Win-Set.

Secret negotiations without the involvement of public opinion, when there are close ties between government and industry in corporative states, are much more easily ratified: 'the greater the autonomy of central decision makers from their Level II constituents, the larger the Win-Set and thus greater the likelihood of achieving international agreement' (Putnam, 1988, p. 449). Paradoxically, with the larger Win-Set, their international bargaining position is weaker. Thus, a 'strong state' domestically may actually become a weak one internationally; a dictatorship may more easily be 'pushed around' in negotiations than a democracy. The ultimate dictator must only agree with himself, without the need for acceptance from those being affected in the country.

The controlled exchange of partial information, secrecy and surprise, restructuring the game and altering the other side's perception of the costs and benefits of agreements are part of the process. Edward Luttwak (1990, p. 19) describes some of these as belonging to the 'logic of war in the grammar of commerce'. Diplomacy is in this context 'a process of strategic interactions, in which actors simultaneously tries to take account of and, if possible, influence the expected reactions of other actors, both at home and abroad' (Moravcsik, 1993, p. 15). This includes targeting policies and groups in other countries in order to place allies on the counterpart's domestic table. For small countries, more often than for larger counterparts, making alliances with other countries are important. Small countries or interest groups, good reasoned argumentation and good alliances can significantly influence the outcome. There will be a balance between getting acceptance at home, and at the same time pushing the agreement as far towards the other side's minimal acceptance point of outcome as possible. If it is important to both negotiators to reach an agreement, they may also collude, and help each other to get a deal accepted. To expand one or both of the Win-Sets, side payments can be used either for domestic actors wanting/not wanting an agreement (for example, various forms of counter trade deals).

Domestic groups across countries may also cooperate to prevail over other domestic groups and government(s) through transnational alliances with the goal of influencing other domestic groups or the governmental opposition. This can, for example, happen when companies in the same sector in different countries coordinate positions. In the EU, this is dealt with by competition rules in terms of market practices, but not in terms of political lobbying. Informational asymmetries may emerge as part of the negotiation process. Transnational industrial alliances are not concerned with the maximum benefit for their own country, or for the sum of countries, but for the best for themselves across borders. Transnational industrial alliances can also be used to make it more difficult when it comes to the implementation of unfavourable market regulations and interventions. The two-level game comprises both 'Second Image' and 'Second Image Reversed' effects of the interplay between domestic affairs and the international system as identified by Kenneth Waltz (1959) and Peter Gourevitch (1978). The result of a negotiating process may consequently differ from the economic preferences of domestic actors, as well as from how domestic political processes have sought to define national interests.

In integrated economies, traditional trade (and exchange rate) policy measures must often be replaced with 'hidden' barriers and indirect policy steps when influencing, interpreting and adapting to common rules and regulations that are not fully fit for national situations and interests.

This parallels what Michael V. Posner (1961) identified as, respectively, innovative and imitative countries and industries experiencing technological, political and commercial change. A neo-Schumpeterian understanding of trade and international competitiveness (Fagerberg, 2007) supports the role of the state as an important collaborator, and in some cases even leader, in domestic economic developments (Austvik, 2012). The continuous ability to innovate also in the political sphere is a necessary force to maintain and achieve the highest economic standards, as opposed to a potentially more passive (imitative) political attitude. It is not only the costs of production and the freedom of each actor to make her and his choices independent of the macro situation that is important for competitiveness. Optimized individual decisions may in many situations create suboptimal macro outcomes (Schelling, 1978). It has long been argued that an effective state is an integral part of a successful competitive capitalist system (Evans and Rueschemeyer, 1985). In countries where the state has inferior legal, political and administrative capacities for industry to invest and develop, economic developments are slowed down (such as in present-day Russia). Debates over types of design of a liberal economic system and varieties of capitalism, as in Hall and Soskice (2001) and Mjøset and Clausen (2007), demonstrate that liberalism must not necessarily be orthodox. It is the relative ability to develop policy that is important for a country to remain competitive in an economically integrated world, just as relative cost, quality and prices are important for the comparative advantage of firms and industries.

OPTIMAL DEGREE OF POLICY HARMONIZATION

What should then be the optimal degree of integration for a country in an international trading area? Economic integration can be considered the process whereby obstacles to trade are gradually eroded (negative integration); arrangements are created to enhance trade (positive integration); and policies harmonized. The opportunity costs of disintegration increase with integration scope and depth, and the walk-away price becomes gradually more unacceptable. International trade theory assumes full mobility of domestic production factors across sectors to reach a new equilibrium. However, to understand the actual outcome we should also understand the inertia in markets and politics and their dynamic interactive processes.

The standard economic approach dictates that when a country specializes in commodity X, the production of commodity Y shall be reduced and resources moved from sector Y to sector X. The price of X is raised as compared to the price of Y. This is illustrated in Figure 11.1 as a move-

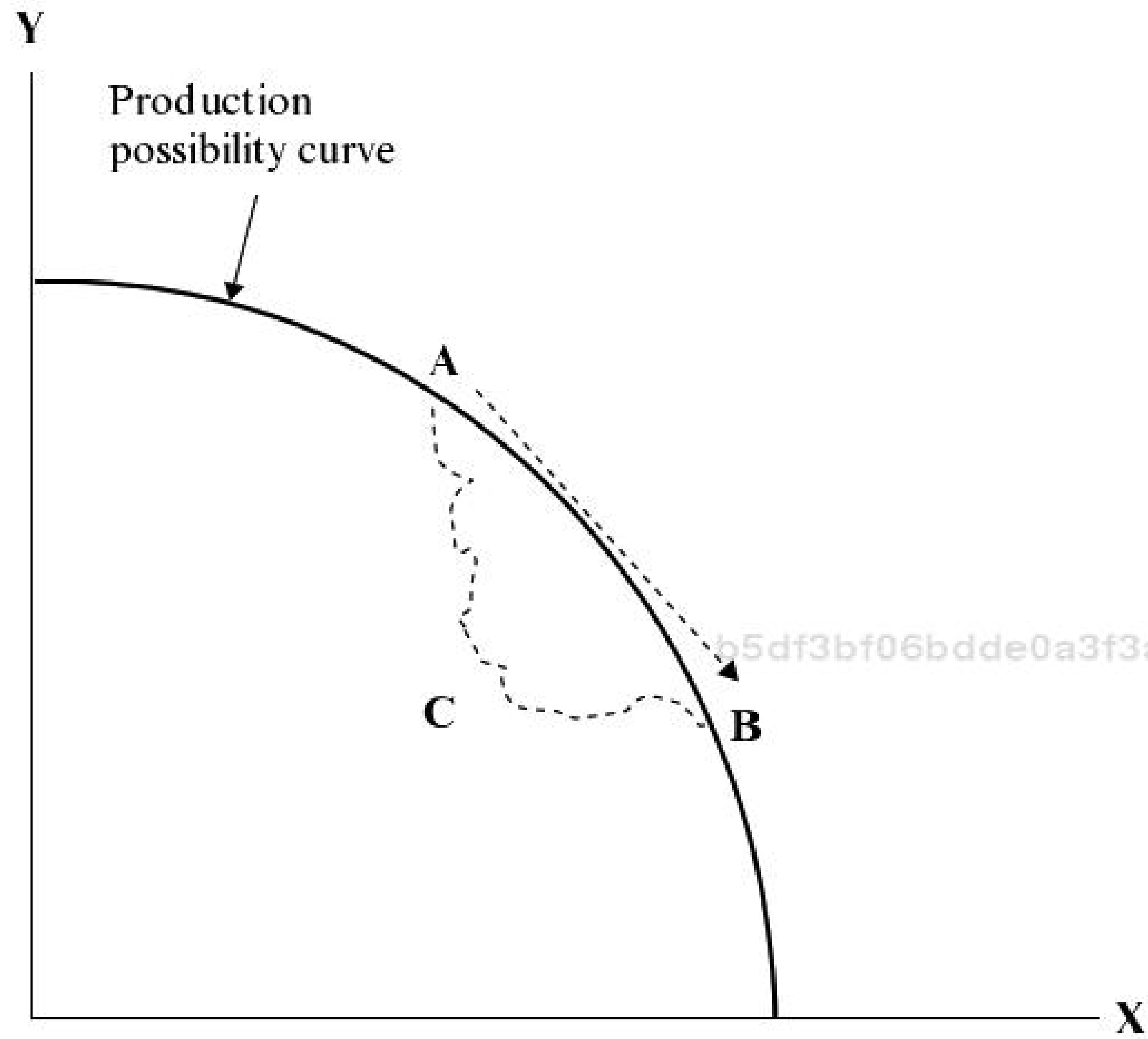

Figure 11.1 Short- and long-term effects of trade liberalization

ment along the country's production possibility curve from point A to point B. In this assumption there is always full employment of labour and capital.[6] If, however, resources are not perfectly mobile, they will not move fully to sector X but become (partly) unemployed as production of Y is reduced. Some companies producing Y will go bankrupt from international competition, without being (fully) compensated by increased activity in sector X. If this effect is strong and long-lasting the country may lose from free trade, as illustrated by point C.

Consumers will, however, immediately benefit from the new international price relationship through a switch towards higher consumption of Y, as they have over-consumed the cheap X at the cost of the more expensive Y with the domestic price relationship (not drawn in the figure). Conversely, as their income is determined from productions of both X and Y, they may lose if this production combination eventually ends up only in point C, rather than in, or close to, the new optimal point B (depending on their indifference curves, of course). The more flexible labour and capital markets are, the faster resources are able to move from one area of production to another.[7] Consequently, consumers' net gain will be determined by the extent to which they are able to benefit from both the exchange of goods and services in the new and larger market and new price relationship, and from specialization in production. The greater the difference there is between domestic relative prices and international prices, the more there is to gain, but then also the restructuring is the greatest. The greater the relative price difference, the further down to the right point B will be on the production possibility curve. This is especially the case for small countries with few products to export, demonstrating that small countries are relatively more dependent on international trade than large ones.

How then to move from A (if necessary via C) to B and have a net positive gain in social surplus from the integration process? The further point C ends up from point B, and the less flexible the economy is, the greater the challenge. The costs can be measured directly in terms of unemployment and loss of production that previously contributed to the economy, and are reinforced by the following social and political costs. Some may also think normatively that the whole idea of aggregated economic gains is over-exaggerated and wish for a different type of society and include undesired change of society in the costs. The difference between the economic, political and social benefits and costs determines its net benefit or loss. When the difference between benefits and costs are maximized, the country has achieved an optimal degree of integration. At this point the marginal benefits of increased restructuring equals its marginal costs. The only way that maximal restructuring is also optimal is when marginal social, political and economic costs are considered to be zero or negligible (true or not).

Most of these costs are difficult to measure. After adjustments and old/uncompetitive industries die off, the costs of re-establishing them are high. The costs of moving closer to point B will accordingly gradually be considered lower. The determination of costs is dynamic and depends *inter alia* on the constellation of domestic actors. The more structural adjustments made, the more interdependent countries will be and the walk-away-price becomes gradually unbearable for all countries. Domestic winners and losers of free trade may, however, have diverging views on the optimal production structure. Exogenous change caused by economic integration also often makes those benefiting the most from a new situation become politically stronger. The preferences of these actors are filtered through the political system and its associations, institutions and groupings to effect the policy choices of national governments. When domestic institutions are weak, the impact from exogenous change will usually be more significant than if they are strong. If domestic institutions are strong, pressure for de-coupling from international requirements may be the product of institutions that shape local identities, norms and preferences (Andersen, 2006). These institutions may find integration costs high and wish for slower developments.

The optimal level of integration and policy harmonization should accordingly be found where the perceived benefits and costs are balanced. This may also be reflected in the diverging views on the whole integration process. For example, in the European financial crises, views are contrasted as to what an acceptable level of structural unemployment is, and how large and for how long this unemployment shall be accepted. Neofunctionalists usually consider it proper to speed up integration to come faster into a new sustainable equilibrium (as demonstrated in comparative static economics), and accept high levels of unemployment as well as the social and political costs. Intergovernmentalists usually assert that a reintroduction of national currencies would be a better solution to give people and firms more time to restructure.[8] Nevertheless, if policy is implemented for the economy to adjust fully to international prices, *de facto* common political practices may differ in order to slow down real political convergence. Hence, the determination of both benefits and costs is partly subjective and depends strongly on both domestic and international perspective and political choice.

CONCLUSION

Globalization, Europeization and the expanding influence of international organizations continue to reshape public administrations as well as international relations. The pressures for convergence at the supranational scale make the interplay between national and supranational preferences and priorities central. As interdependencies deepen it becomes increasingly more difficult for all participants not to reach agreements that further integration. Lower levels of integration push for higher levels and for policies to converge. National policies only become coherent if the government is able to interact simultaneously on domestic and international tables. At the same time, the more complex the situation becomes in scale and scope, the more difficult it will be to reach *de facto* comprehensive supranational arrangements, and as a result, the expansion of manoeuvring room for national adaptation. International demands about the harmonization of political form and process, but not necessarily about political convergence, make it possible for countries to have the same policy in terms of rules and regulations, but with rather different political content.

Paradoxically, the greater the degree of autonomy a country chooses in an economically integrated world, the less influence it will possess over its own situation. This is because international rules of competition and market mechanisms in many situations *de facto* may overrule (irrelevant) national decisions, and a country is increasingly 'pushed around' and eventually forced to adapt. One extreme example is North Korea, wanting something close to autarky rather than economic integration with the world. The result is substantially lower economic standards, with the resulting need to close borders to prevent people from trade and/or escape, police control and an authoritarian regime. As a consequence, North Korea must (mostly) act reactively in its policy making to the outside world, albeit from time to making proactive (even though not always credible) threats. Eventually, the regime will prove unsustainable. A second example is air transportation becoming increasingly cheaper as a form of technical, and not political, initiated trade liberalization. Domestic markets were earlier served by (protected) national airliners. Increasingly these have been subject to international competition. When the difference between domestic and international prices and quality of services has exceeded an acceptable threshold (to be defined), national air traffic policy has eventually converged across countries. A national air policy independent of international regulations is no longer sustainable.

Convergence begets further convergence, and becomes increasingly more complex as integration deepens. Obviously, markets are not only influenced by rational economic behaviour but also by diverging institutional, cultural and historical situations and interests. As economics first of all gives insight into the purpose and methods of interventions and not to the same extent the dynamic politics of reaching policy goals, public managers and politicians must mostly aim for a second-best integration level in economic terms where compromises with the real market are adopted and recognized. This process is occurring dynamically at multiple speeds and under differing relations of political influence from both a nation's domestic population as well as the international norm systems. As policy convergence is more a sequence of key negotiations, there are many factors that inform how the process will unfold. A few of those factors include the strength and level of autonomy pursued by a state, the level of common institutions in conversation with a state and the ability of the state to be innovative in the ways it negotiates and adapts.

The increased international economic interdependence and complexity of decision making indicates that more, not less, albeit different, political competence is required for maintaining a maximal degree of national autonomy in comparison with the situation in the 1970s and 1980s, especially for small countries. The choice between maintenance or a change of existing policy and economic and political structure depends on interests, traditions and values, and/or the active creation of visions and ideology. Transnational integration reshapes public administrations as well as international relations. The interplay between national and supranational preferences and priorities becomes central. Public managers and politicians on both levels are coloured not only by public and political desires but also by their own ideological, institutional and cultural motivations for how much and which form of integration they want. Desires about common regulations are put forward, they negotiate about them and receive results they both like and dislike. In a neofunctionalist view, public managers, as in, for example, the EU Commission, are the driving force towards more integration. In an intergovernmental view the counterparts are more often other nations and governments. In the EU, is it the EU Commission, or say, Germany, that is the main leader of EU developments? Their respective competencies in economics, policy, politics and law are crucial for whether they will reach the goals set up and which goals will eventually be reached.

As a nation-state can achieve substantial political manoeuvring room in proactive and dynamic domestic and international interaction, the degree of policy convergence in the economic integration area itself is constrained. The varying scope, scale and exploitation of the national manoeuvring rooms across countries, time and policy areas indicate how an economic integration organization should seek a dynamic and optimal approach in terms of policy harmonization, be it in the WTO or the EU, rather than seeking to maximize real convergence as fast as possible. The optimal level of policy convergence and economic restructuring is the place where the economic, social and political costs of integration are equal to its benefits, rather than the place where net social surplus as defined in static economics is maximized. The direct and indirect costs of deeper integration should at any point in time be withdrawn to maximize its net benefits, and depend, *inter alia*, on what (normatively/politically) is considered to be an acceptable level and duration of the structural unemployment caused by the trade liberalization processes. For public managers and politicians, as well as for education and research, it is important to understand the integration processes from more theoretical perspectives and disciplines. At a minimum, the understandings of diverging ideologies and analyses from economics, political science and law must be combined for managers to define the room to manoeuvre. Their respective relevancies may vary across sectors and change over time. For a country, in some cases it is the form or process of an agreement that it is important to adapt to – at other times it is the real political content. Whether the integration processes are inter-governmental or (in parts) become neofunctional may also vary. For managers at the supranational level, these dynamic issues are important for defining the optimal level of integration for single political issues. Neither politicians nor public administrators can, however, fully determine the optimal degree of integration without also making a political choice. The inter- and multidisciplinary understandings challenge research in identifying and measuring the dynamic costs of integration (unemployment in the losing sector, social change and so on) and weigh them against their benefits (such as increased production in the winning sector). For all, the aim would be to find an optimal speed, portfolio of issues and level of integration from the point of view of both single countries and the integration area itself, and determine which parts of these issues depend on good academic work and which depend on political choice.

NOTES

1. In a Customs Union (CU) like the EU, no trade policy exists between member countries. A Single Market for all Member States should be the goal. Preferential Trading Areas (PTAs), such as the WTO and North American Free Trade Agreement (NAFTA), have weaker regulations that modify the ideal of a single market.
2. Knill (2005, pp. 768–9) discusses how policy convergence can be measured through degrees of policy similarity. Different criteria can sometimes give different answers depending on the type of convergence being studied. This chapter does not elaborate on the quantification of the degree of change.
3. The independent European Central Bank's (ECB) control over monetary policy in euro countries is a case in point.
4. One recent example is the euro, an economic issue where a single monetary policy appears unfit for those countries that are in rather different situations than a core country such as Germany. As countries in the euro area cannot devaluate/depreciate their currency anymore to address the loss of competitiveness and overspending, some of them (such as Greece) try internal devaluations (wage and price cuts), strong austerity measures and borrowing money from the surplus euro economies. The result is destabilizing unemployment and strong distributional economic effects among persons, regions, governments and countries in Southern Europe and between the North and the South of the EU.
5. This can also be valid for policy formulation in a state in a federation (such as the United States), as well as for a region within a non-federative nation-state.
6. Full employment for labour assumes balance with total supply and total demand. The unemployment remaining represents a frictional and an acceptable level of structural unemployment; this is often called natural unemployment. A situation with only natural unemployment in an economy is usually considered an economy with full employment.
7. For example, labour markets in the United States are considered much more flexible than in Europe, and are consequently better able to adjust to new price structures.
8. In the 1970s when the EU appeared to disintegrate due to many hidden trade barriers, the solution was eventually to integrate more. The Single Act was presented in 1986 as a response, and later the Single Market and the euro were introduced. All were means to proceed to new free trade equilibriums, rather than to move slower and protect free trade losers. (What may be the right policy in one situation may, however, not be the right policy in other situations.)

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