

**THE LOGIC OF REGIONALISM: A COMPARATIVE STUDY
OF REGIONALISM IN EUROPE AND ASIA**

A Dissertation

by

MI-KYUNG KIM

Submitted to the Office of Graduate Studies of
Texas A&M University
in partial fulfillment of the requirements for the degree of

DOCTOR OF PHILOSOPHY

December 2003

Major Subject: Political Science

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ABSTRACT

The Logic of Regionalism: A Comparative Study of Regionalism

in Europe and Asia. (December 2003)

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Why do some states develop deeper regionalism while others do not? Comparing European and Asian regionalism, this study provides an alternative explanation of different types of regionalism and the national variations in regionalization since the mid 1980s. It defines regionalism as a strategy pursued by a state that desires to enhance its governability of the national economy when market authority outgrows state authority. The rise of regionalism in the neoliberal world economic order changes the balance between the state's public power and the state's market governability, consequently resulting in a political convergence toward a majoritarian political system based on individualism and delegative democracy. However, regionalism is realized in very distinctive patterns across different regions as the different historical paths of regional capitalism shape the state-society relationship and the state's capability of governing the national economy.

European welfare states developed a deeper regionalism because they sought to impose a neoliberal economic transformation on their societies by shifting their economic priority of equality and economic policy making based on social concertation toward efficiency and the formation of an encompassing distributional coalition. In contrast, Asian developmental states prefer preserving national autonomy to relying on a formal regional institution to constrain states' national authority because they are more capable of implementing the neoliberal economic transformation in terms of market governability and the formation of encompassing distributional coalitions.

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empirical analysis and the reward and challenge of careful measurement. Although we may have different notions of political science, I truly respect his rigor in pursuing scientific research.

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When I left my country in order to pursue my degree in U.S. five years ago, I was a new student of political science. However, I was far better equipped for the challenges of this venture than many others who have gone before me because I was guided by a great Korean political scientist, Jang Jip Choi. To him I wish to express my special thanks for all he has done to prepare me with the indispensable intellectual foundations that have guided me through my doctoral studies. These have sustained me during the most challenging moments during these last five years.

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TABLE OF CONTENTS

	Page
ABSTRACT	iii
ACKNOWLEDGMENTS.....	iv
TABLE OF CONTENTS	vi
LIST OF FIGURES.....	viii
LIST OF TABLES	x
INTRODUCTION.....	1
 BRING THE STATE BACK IN AGAIN: EUROPEAN STATES IN THE CHANGING INTERNATIONAL POLITICAL ECONOMY	 5
Two Competing Theoretical Traditions of International Political Economy	 10
The European State in a Globalized World Economy: Tax Competition and Financial Liberalization	 20
 UNDERSTANDING THE NATURE OF THE EUROPEAN UNION: IS A PLURALIST THEORY GOOD FOR EXPLAINING THE EUROPEAN UNION?	 36
Comparing Theories of the European Union	39
Between Intergovernmentalism and Supranationalism: Three Debates over the Nature of the European Union	 44
Comparing European Political Traditions to American Democracy	50
The State as a Public Authority and Political Community: A Weberian Perspective of the State	 53
Aggregation, Deliberation, and Delegation: Three Models of Collective Decision Making.....	 60
 EUROPEAN SUCCESS VS. ASIAN FAILURE?: ASIAN REGIONALISM AND THE COMPARATIVE RESEARCH OF REGIONALISM.....	 67
Two Fallacies in the Study of European Integration: Between European Exceptionalism and European Universalism.....	 67
Three Approaches in the Comparative Study of Regionalism: Explaining Different Institutional Outcomes Regionalism	 69
Cultural Homogeneity and Regional Identity: The Myth of a European Identity and the Invention of an Asian Identity	 72
Shared Economic Interests and Institutionalization of Regionalism	83

	Page
An Unsolved Question: Why Do States Choose Different Regional Institutions in Different Regions?.....	109
BEYOND IDENTITY AND INTEREST: A CONTEXT-BOUNDED RATIONALITY APPROACH OF REGIONALISM.....	111
A Context-Bounded Rationality Approach	111
Understanding States' Social Situation	116
Market Stability vs. Market Formation: Different Stages of Market Development in Europe and Asia	128
Conceptualizing the Economic Role of the State.....	141
EXPLAINING THE STATE'S CHOICE OF REGIONALISM.....	157
Causal Mechanism of the State's Choice of Regionalism.....	157
The Rise of Neoliberal World Economic Order: Different Responses in Europe and Asia.....	168
Explaining National Variations of Regionalization: Still the Century of Nation-State?.....	177
Main Propositions.....	194
A CROSS-NATIONAL QUANTITATIVE ANALYSIS OF THE CHOICE OF REGIONALISM AND REGIONALIZATION	196
The Level of Regional Economic Cooperation and Economic Growth in Asia and Europe	197
Explaining a State's Choice of Regionalism: The Economic Role of the State and The Level of Regional Economic Cooperation	211
National Variations in Regionalization: The Effect of National Political Institutions on Regionalization.....	236
Summing up the Cross-National Quantitative Analysis of Regionalism and Regionalization	252
CONCLUSION.....	253
REFERENCES.....	260
APPENDIX	302
VITA.....	303

LIST OF FIGURES

FIGURE	Page
1-1 A Right of Veto to Preserve National Interests in 15 EU Countries	7
1-2 The Comparison between the Transnationalist Approach and the Neo-mercantilist Approach of the Relationship between International Economy and Nation-State	18
1-3 Globalization, Tax Competition, and European Welfare State	23
2-1 Models of Collective Decision Making	63
3-1 Intra-EU Foreign Direct Investment as % of Total Foreign Direct Investment (1985-1997)	89
3-2 Japanese Manufacturing FDI in Asia (1973-1990)	97
3-3 Intra-Regional Trade Intensity in EU, Asia, and NAFTA	102
3-4 The Share of Intra-Regional Trade in EU, Asia and NAFTA (1986-1994) ...	103
3-5 The Correlation of Trade Structure between Asian States, U.S.A, and Japan (1993)	104
4-1 Ideological Position of Political Parties in Asian States (1975-2000)	125
4-2 A Conceptual Map of the State's Economic Role	145
4-3 Total Tax Revenue and Direct Taxation in Europe, Asia and North America (1975-1997)	148
4-4 Consumption and Social Security Taxes in Asia, America and Europe (1973-2000)	155
5-1 A Causal Mechanism of the State's Choice of Regionalism	158
5-2 Regional Economic Cooperation as an Assurance Situation	163
5-3 Economic Growth by Region (1975-1997)	175
5-4 National Variations of Regional Capital Market Integration (1981-1997)	180

FIGURE	Page
6-1 The Level of Regional Economic Cooperation and National Policy Autonomy	200
6-2 Region as an Interacting Variable.....	209
6-3 Effect of Tax Revenue on the Predicted Probability of Levels of Regional Economic Cooperation.....	235
6-4 The Effect of Electoral Systems of Regionalization	250

LIST OF TABLES

TABLE	Page
1-1 Corporate and Personal Income Tax Rates in EU Countries (2000)	21
2-1 Four Theoretical Perspectives of the Nature of the European Union	40
3-1 The Comparison between the EU and APEC	70
3-2 The Heterogeneity in Cultural Heritage and Political Value in Western, Central, and Eastern European Countries	76
3-3 The Development of the European Cohesion Policy (1957-2002).....	94
3-4 Major Trading Partners in Japan and Other Asia as % of Total Trade	99
3-5 Regional Bias and Intra-Regional Trade (1986-1996).....	101
3-6 Intra-Regional Trade as % of All Trade in APEC, ASEANS and APT.....	106
4-1 Four Ideal Types of Interaction Modes.....	118
4-2 Two Models of National Political Economy	146
5-1 Growth Rate of GDP in Asian Countries after 1997(% per year)	176
5-2 Interest Rate, Exchange Rate, and Monetary Autonomy by Economic Interest Groups.....	181
5-3 The Executive-Parties Dimension in Consensus vs. Majoritarian Democracy	190
6-1 EU Membership and the Evolution of European Integration	203
6-2 The Level of Regional Economic Cooperation by Economic Growth (1975-1997)	204
6-3 The Level of Regional Economic Cooperation by Economic Growth Elaborated for Region (1975-1997)	206
6-4 The Means of Economic Growth by the Level of Regional Economic Cooperation and the Result of One-way ANOVA Test.....	210
6-5 Mean Values of Independent Variables per Level of Regionalism (1975-1997) ...	216

TABLE	Page
6-6 Discriminant Functions at Group Means and Coefficients based on Rotation of Structure Matrix	217
6-7 Classification Results.....	219
6-8 Tax Revenue, Direct Taxation and Economic Growth in Europe (1975-1997)...	223
6-9 The 1994 EU Referendums in Austria, Finland, Norway and Sweden	224
6-10 Alternative Ordered Probit Regression Analyses of the State's Choice of Levels of Regional Economic Cooperation: Index Function for Probability	232
6-11 Comparing the Model Prediction to the Actual Data.....	233
6-12 Marginal Effects of Variables in the Panel Ordered Probit with Random Effects	234
6-13 Variables, Indicators and Hypotheses	238
6-14 Regression Results: Domestic Political Institutions, Regional Institutions, and Regional Capital Market Integration in 28 Countries (1981-1997).....	245

INTRODUCTION

This study attempts to explain why European states voluntarily pooled their national sovereignty to create a highly legalized supranational institution such as the European Union despite their long history as a nation state system. In search of an answer to this puzzle, this study comparatively examines the European and Asian approaches to regional economic cooperation. The Asian choice of preserving national autonomy and rejecting any formal institutionalization of regional economic cooperation is a direct contrast to the European approach. A theoretical framework is developed which focuses on the state's economic role in governing the national political economy and states' strategic choice of how to enhance their governability in the changing international economic order. In this theoretical framework, the state is conceptualized as an institutional actor that defines national interest, and competes and cooperates with other states in pursuing its national interest. Two points should be clarified to begin with. First, the state does not define its national interest in terms of 'rational calculations of relative gains' in an international system constrained by the international anarchy. Second, the state's preferences and actions cannot be reduced to the result of competition of social interests in domestic politics. The first point challenges some variants of realism, which underestimate the possibility of international cooperation based on common interests and common institutions. In contrast, the second point criticizes some variants of liberalism which insists states' action constrained by dominant social groups in domestic politics.

The state does not simply reflect society and aggregate individual interests. Rather, it defines what is good for society and projects its definition as public interest even if, as Stanley Hoffmann argues, it is sometimes, "victimized by the need to respect the laws of capital accumulation" and "bloated by the growth of a quasi-professional, representative elite for whom politics is a career

rather than a service” (1995:214). Therefore, we need to analyze the state itself in order to explain state actions without relying on either the primacy of social groups or the primacy of international anarchy. In this regard, this study takes a state-centered approach. However, at the same time, the distinction between state and society is important to this study as it considers that a state’s capacity to realize its preferences depends on the nature of state-society relations. More importantly, a historical path of national economic development institutionalizes the nature of state-society relations in a society. In other words, the economic role of the state in governing the national economy historically constructs a national pattern of the interaction between the state and society. On the other hand, the economic role of the state can be redefined according to the changing nature of international political economy, represented by globalization. However, the path dependent effects of national patterns of interaction between the state and society will determine a state’s capacity to adapt to the changing international political economy.

On the basis of this theoretical framework, the present study develops a causal mechanism to explain states’ choices of regionalism in Europe and Asia. The logic of this casual mechanism is quite simple. First, it assumes that states consider regionalism as a strategy for improving their national economic performance. This assumption implies that states have no strong motivation toward regionalism if their economies perform well. For instance, while most European states have experienced persistently low economic growth since the 1960s, Asian states, particularly East Asian states, have enjoyed rapid economic growth. Consequently, European states considered the European Union as an institutional leverage to improve their national economic performance by increasing states’ capacity to implement neoliberal economic transformation within their domestic societies. In contrast, Asian states feel no strong motivation toward regionalism, as they do not want their economies to be disturbed by a regional institution requiring a formal binding effect on member states and constraining national autonomy.

Second, the logic of regionalism also assumes that the institutionalization of regionalism is a function of the interaction mode between the state and society. If states are in the negotiation mode with their societies, it is more difficult for them to transform their national economies toward neoliberal economic order. In such a situation, states are more likely to develop a more institutionalized form of regionalism. In contrast, if states are in the hierarchical direction mode in which the state is more plebiscitarian and more independent from societal constraints, it is less difficult for them to transform their national economies toward the neoliberal economic order. In this situation, states are less likely to develop a more institutionalized form of regionalism.

This causal mechanism of a state's choice of regionalism is explained theoretically and empirically in the present study. In the first section, "Bring the State Back in Again", I directly address the issue of the decline of the nation-state in the globalized world economic order. My theoretical purpose in discussing the issue is to show how the pervasive notion of the decline of the nation-state is rooted in a particular theoretical view of the state and analytical approach to the relationship between national and international political economy. For this purpose, I compare two dominant theoretical views of international political economy, neo-mercantilism and transnationalism. The second section, "Understanding the Nature of the European Union", provides a critical review of the literature on European integration, questioning the validity of a pluralist theory of the European Union. The main argument of this section is that we can understand the relationship between European states and the European Union in terms of "fiduciary relations" in the light of Majone's theory of delegation. More importantly, the fiduciary model of delegation cannot be understood without a notion of public interest and the state as a collectivity. In this regard, I criticize a pluralist theory of European states, which have historically developed political traditions based on collectivism and positive constitutionalism.

In the third section, "European Success vs. Asian Failure?" I examine some conventional explanations of the peculiarity of European regionalism based on the assumption of European

common identity and interest, providing empirical evidences for my counterpoints. In this section, I challenge both ‘European exceptionalism’ which assumes that a European experience of regional integration can be explained only by the existence of a European identity and ‘European universalism’ which assumes that the present European Union can or should be the model for Asian regionalism. In a theoretical extension of the third section, the forth section offers an alternative approach to comparative study of regionalism in Europe and Asia, namely, “ A Context-Bounded Rationality Approach” which emphasize the importance of the understanding of states’ social situation. I comprehensively compare European welfare states and Asian developmental states in terms of different interaction modes between the state and society in the light of Scharpf’s theory of actor-centered institutionalism. Finally, in the last two sections, “Explaining the State’s Choice of Regionalism” and “A Cross-National Quantitative Analysis of the Choice of Regionalism and Regionalization”, I develop a causal mechanism to explain the states’ choice of regionalism based on my analytical framework and conduct a quantitative cross-national study of comparative regionalism in order to test the main propositions and hypotheses derived from my causal mechanism. I also offer conclusions on what I believe to be the most important findings in this study and discuss implications of these findings for the comparative study of regionalism.

**BRINGING THE STATE BACK IN AGAIN:
EUROPEAN STATES IN THE CHANGING INTERNATIONAL POLITICAL
ECONOMY**

Modern history is the history of nation-state. The historical origin of the nation-state stemmed from the Treaty of Westphalia that validated the idea of the institutional separation of political authority and religious authority. However, it was since French Revolution when the state was legitimated as ‘the ultimate source of authority’ and ‘the unconstrained expression of the national will’ with the idea of national sovereignty (Shinoda 2000). According to Krasner (1999), we can distinguish “Westphalian sovereignty” from “international legal sovereignty”. While the former concept of sovereignty concerns the territorial boundary of a national authority structure based on the exclusion of external actors, the latter refers to states’ legal abilities based on mutual recognition in international relations. To use Wendt’s phrase, if the former concept is about a territorial property ‘right’, the latter is an ‘institution’ to help states to survive the dangers of anarchy (1994:388).

However, as Krasner argues, “neither Westphalian nor international legal sovereignty has ever been a stable equilibrium from which rulers had no incentives to deviate”(1999:24). His point is that the concept of national sovereignty can be considered as an international norm or institution, but it can always be violated when there is an absence of centralized authority in international politics. In this regard, he considers the idea of national sovereignty as ‘organized hypocrisy.’ As a result, the idea of creating a higher supranational authority to be able to impose international norms has, as Mazower (1998) points out, appeared repeatedly in the history of modern Europe. More importantly, the idea had to motivate severe conflicts among competing ideologies such as liberalism, fascism, and socialism, which always resulted in massive destruction of European civilization. German Nazism can be seen as an extreme expression of this idea, in its pursuit of a European racial entity. After the failure of Hitler’s New Order Project, the idea of a European entity

seemed to lose its 'appropriateness' in the mind of European people. With European psychological trauma resulting from German Nazism, the view of the nation-state as the only legitimate political authority has dominated European political life.

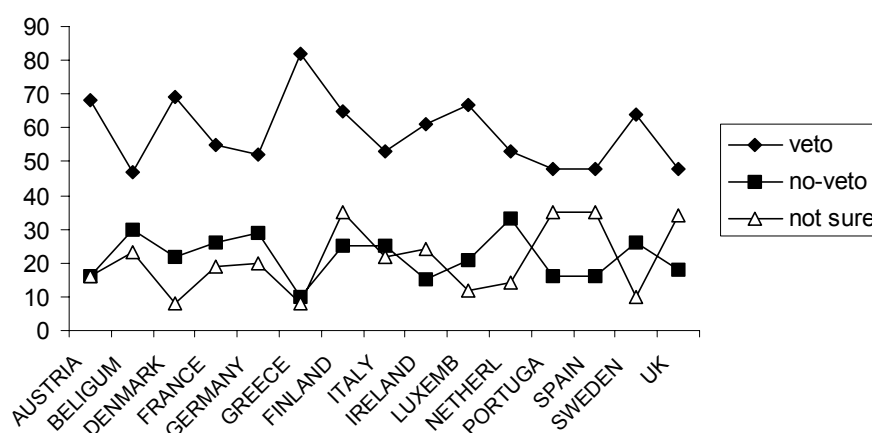
This deep-seated commitment to the nation-state system enables us to understand a series of events in recent European politics. Among these, the wave of public protests held in Denmark and France against the Maastricht referenda, the decline of the Austrian Socialist and People's Parties who supported Austria's entry into the EU in the 1994 election, and more recently, Ireland's voters rejection of the Nice Treaty that paves the way for the enlargement of the European Union in 2001. According to a study of European public attitudes toward the European Union, there is a reverse relationship between national identity and support for the European Union. That is, "higher feelings of national identity decrease support for the European project because of the conflicts over sovereignty that have developed in this era, such as the creation of a single European currency, the European Central Bank and the increased primacy of European Law"(Carey 2002:388).

Figure 1-1 represents public opinion in 15 EU countries regarding keeping a right of veto to preserve national interests. As we can see, while a large majority of EU citizens (53%) favor keeping a right of veto for the preservation of national interests, only 24% EU express a willingness to give it up in order to make the EU more efficient. There is abundant evidence demonstrating European commitment to the nation-state over the European Union, in spite of half century-long process of European integration.

Pascal Lamy who was Jacque Delors's *chef de cabinet*, claimed, "the people weren't to agree to integration, so you had to get on without telling them too much about what was happening"(Ross 1995:94). Hoffman also makes the same point:

... neither effort has been accompanied by a popular, mass movement. In the first enterprise, there was often considerable domestic opposition ... the

Figure 1-1 A Right of Veto to Preserve National Interests in 15 EU Countries



Source: Eurobarometer 58 (December 2002)

moves toward integration were the product of a small layer of key politicians and civil servants (1995:235).

Based on this brief overview of modern European history, the evolution of European integration after the World War II appears a puzzle since European states have voluntarily decided to delegate their national authority to a supranational institution, the European Union despite their commitment to the nation-state. The process of European Integration has evolved from the European Coal and Steel Community (ECSC) of 1951 through the six-country Rome treaty of 1957 to the Single European Act (SEA) of 1985, the Maastricht Treaty of 1992, and finally the European Monetary Union of 1999. For most social scientists, regardless of their optimistic or pessimistic prediction for the future of European integration, these historical events seem to represent a critical challenge to the supremacy of modern nation-state system. How can we explain the inconsistency between European commitment to the nation-state system as the only legitimate source of political authority and European integration to pursue the creation of a supranational institution with delegated authority from member states?

Most analyses of the evolution of European integration tend to consider the relative economic decline of European states in the world economy as the most important factor motivating European integration. As Hobsbawm (1997:271) argues, the European project has been motivated by ‘a negative European identity’, a shared feeling of insecurity and frustration caused by the fact that “European national economies are too weak to stand alone today.” In particular, as Calleo (2001) points out, the fear of external shocks caused by a chaotic and unpredictable global financial market that seems to have been dominated by the United States encouraged European integration. It is interesting to see that contrary to the popular belief that globalization will create a world economy that functions beyond all kind of economic blocs, globalization may enforce a European block and an integrated Europe. In this view, Europeanization is another name for globalization in Europe (Fligstein and Merand 2001; Hirst and Thompson 1999). However, why should we assume the causal direction runs from the increased global market to European integration?

The causal linkage between globalization and European integration is closely related to the debate over the decline of modern nation-states in the age of globalization. For instance, Mazower (1998) contends that the European Union is the institutional product of European nation-states’ collective effort for survival in the age of globalization. That is, Globalization erodes nation-states’ economic and political sovereignty by reducing the capacity of the state to pursue independent national economic policies and increasing the inability of nation-states to preserve social solidarity from the overwhelming strength of the market. Therefore, for a half-century European states have worked collectively to solve their common problems. This kind of explanation of European integration as a necessary strategy for survival seems to be based on the simple logic that European states developed a collective solution to overcome their common problem, the decline of economic governability in their national economies.

Therefore, it is a dominant interpretation to explain the development of European integration in terms of the need of a joint problem solving by creating the ‘joint decision trap’ or ‘the irreversible

self-binding mechanism' among European states who have faced increasing interdependence and economic internationalization (Streeck 1996; Wessels 1997; Scharpf 1997; Majone 2001b). However, the critical question is: what is the consequence of European integration on the future of European states?

Some studies claim that the European nation-state is not 'the final West European innovation' because the European state is transformed and remodeled through the move toward a European state beyond national territorial boundaries (Bornschieer 2000; Sbaragia 1992; Hooghe and Marks 2001; Marks et al. 1996; Schmitter 2000b). On the contrary, others reject the idea of the rise of a supranational polity and the decline of nation-state, arguing that European nation-states are improving their economic governability through developing an intergovernmental institution to provide policy credibility and commitment (Moravcsik 1998; Milward 2000a; Hoffmann 1995; McCarthy and Jones 1995; Muller and Wright 1994).

The decline of economic governability within the nation-state did not happen only to European states. It has become a general phenomenon in a globalized world economy. However, the European solution of this general problem is different from states' economic cooperation in other regions, as it has been realized in a very highly legalized institutional arrangement. Why have European states gone as far as they have? Answering this question will be the first step toward solving the puzzle of the inconsistency between European commitment to the nation-state system and European integration. The primary goal of this section is to provide a theoretical framework of how states' choices and actions in the changing nature of international political economy can be understood. Contrasting two competing theoretical traditions in the study of international political economy, transnationalism and neo-mercantilism, this section argues that the thesis of the decline of nation-state is based on a particular assumption of the relationship between the international economy and the nation-state. That is, the nature of international economy determines nation-states' action. Transnationalism assumes the causal direction from international economy to states' choices

and actions. More importantly, transnationalism offers exogenous explanations for changes in the structural change of international economy, rather focusing on domestic sources in powerful states, specifically, the American domestic political economy. Furthermore, transnationalism characterizes the state as ‘the passive victim’ of a changing international economy. This section directly discusses the issue concerning European states’ capacities in the age of globalization, providing a critical review of two policy issues, tax competitions and financial liberalization.

Two Competing Theoretical Traditions of International Political Economy

We all agree that the world economy is outgrowing states’ territorial boundaries. As Streeck (1996:300) argues, it undermines “economic governing capacity of the nation-state” and “the capacity of the society to civilize its economy”. It is a very general perception that something happened to nation-states caused by the changing nature of contemporary capitalism. The literature concerned with explaining the impact of globalization on the nation-state tends to focus on the economic role of the state and to use effective market governability as the most important criterion to evaluate the capability of the state. Ohmae, in his book, “The End of Nation State”, presents a positive view of the rise of globalized world market. He claims that nation-states lost their effectiveness as the primary economic actor in the world economy as the logic of market grows beyond the territorial boundaries of nation-states. Instead, ‘region states’ can now play an important role as “effective engines of prosperity and improved quality of life for the people of the global economy” (1995:149).

In spite of the differences in her assumptions and a critical perspective of globalization, Strange arrives at the same conclusion as Ohmae that the state is losing its political authority to govern market relations in her works, “The Erosion of the State”(1997) and “The Retreat of the State” (1996). She contends that the rise of global markets has generated the consequent decline of state

authority in terms of control over financial market, the provision of welfare and political accountability.

Strange defines the concept of globalization as ‘the relatively recent acceleration in the pace of technological change and capital mobility’ (1996). Structural changes in the international financial and monetary markets have granted increasing power to non-state actors such as global firms and international banks, private networks and systems of governance, who are working at the level of world market, with global market integration in the domain of production and trade (Strange 1994). One of her central themes is that there has been a fundamental transformation from state-based financial structure to market-based financial structure. This kind of structural change in world political economy, Strange argues, heavily constrains the capability and autonomy of states’ national and international monetary management. More importantly, the effect of the structural constraints generated by the world political economy were asymmetrically distributed across different states (Strange 1976).

Although the normative implications of their arguments differ, both Ohmae and Strange share a common analytical framework for explaining the relationship between globalization and the nation-state: 1) their explanations for the decline of the nation-state assume a causal direction from the structure of the international economy to state action and national politics; 2) their concept of the state is based on the separation of state and market.

The present controversy regarding globalization and the demise of nation state is hardly new. It was already discussed by transnationalism in the 1970s (Scholte 1997). It is widely accepted that the structure of the international economy constrains state action. However, the current controversies about the relationship between an international economy characterized by “transnational mobility of capital and the construction of global production network” and the national political economy based on limited territorial boundaries and state monopoly of the political authority to govern a national economy, go beyond a general consideration of the interaction between international and national

economy (Evans 1997). The present debate over the decline of the nation-state reflects a deeper conflict between two major schools' approaches to analyzing the impact of the international economy on national political economy: 'the transnationalists' and 'the neo-mercantilists' or the 'society-centered' approach and the 'state-centered' approach.

Twenty five years ago Gourvitch (1978) describe the 'transnationalists' in the following manner:

In the seventies, the centrality of government itself in the formulation of foreign policy was the question. Nay and Keohane, Karl Kaiser, Edward Morse and others stressed growing role of transnational, international and multi-national actors, and global, non-military forces such as technology, trade, communication, and culture, in shaping policy. Instead of explaining foreign policy, which is implicitly state-centered, the emphasis is on "international regimes" in various issue areas, and not just the international system, which essentially stresses military power.

Hence modernity through interdependence has altered the nature of the international system so much that the "anarchy" model of sovereign units loses its relevance. All modern societies in interdependent situations acquire certain common political characteristics such as strong welfare pressure, bureaucratization, legitimization problems, which increase the relevance of domestic politics in foreign policy making compared to the period of diplomacy. Thus the international and domestic spheres become more important while the intermediate level, national government, diminished. (Gourvitch 1978:893).

According to Gourvitch, the transnationalists first contrast an international system based on state actors and military power with an international regime based on transnational or multi-national

actors and non-military power. They believe that economic modernization generates interdependence and convergence among states across territorial boundaries and that it also undermines the centrality of the state in international and domestic politics. Basically, the transnationalists assume actors at three levels of analysis, domestic societal actors, state actors, and transnational non-state actors are competing for the control of influence and power in both international and domestic realm. Therefore, one actor's decline means another actor's prominence. This idea arises from their criticism of 'a state-centric interaction pattern'.

Nye and Keohane (1976) define a state-centric interaction pattern by three features: 1) governments as agencies; 2) the conceptual distinction between interstate politics and domestic politics; 3) the discount of transnational interaction. In contrast, a 'transnational interaction pattern' emphasizes two points: 1) the politics of coalition formation among individual societal actors in domestic politics; 2) a direct interaction between domestic society and transnational society without state intervention. The first point refers an important assumption of domestic politics as political competition among societal actors seeking their own interests. Based on this assumption, transnationalists argue that preference convergence among societal actors becomes possible as a result of the increased transnational economic exchanges beyond territorial boundaries. And the idea of preference convergence is expressed by the concept of 'interdependence' and 'international regime'.

The second point is related to the idea of international pluralism, "the linking of national interest groups in transnational structures, usually involving transnational organizations for purposes of coordination" (Nye and Keohane 1976:xviii). The concept of international pluralism is simply the projection of the idea of pluralistic domestic politics and society into the international domain. An important implication of this kind of projection, however, is the resulting rise of 'autonomous or quasi-autonomous' actors such as multi-national firms, international interest groups, non-

governmental organizations and the consequent decline of the state as an autonomous actor in international politics.

For transnationalists, it is economic interdependence that causes international pluralism while at the same time, eroding state authority in controlling domestic and international interactions. They argue that economic interdependence has been increased by the cross-border, open-border, and trans-border economic exchanges in trade, investment, and immigration and the flow of goods, money, people, and information accelerated in the second half of the nineteenth century by rapid technological innovations such as telecommunications, computerization, and transportation (Rosecrance and Stein 1971; Vernon 1971; Keohane and Nye 1976 and 1977; Rosecrance 1986; Thomson 1995; Scholte 1997). According to Rosecrance, an important consequence of economic interdependence is that “the increasing deconsolidation of traditional states and the decline of national loyalty as they seek to serve such purposes gradually undermines the military-political system” (1986:214). Vernon (1971) expressed this same situation as ‘sovereignty at bay’.

However, for the neo-mercantilists, it is not the state itself that is deconsolidated, but the liberal concept of the state.

the importance of the state in shaping response to international forces. ... does not deny that the international economic system constrains states, nor that the system affects the concern of the policies which they formulate. Rather, it challenges the tendency of some liberal, transnationalists, Marxists, and dependencists to make the state wither away

. . . when the state chooses to act, its power is greater than that of any subunit, including such transnational actors as multinational corporations. In general, whenever states assert their views they are able to prevail over international organizations. Interdependence derives from states policy, not the other way

around; that is, it exists because states allow it to exist (Gourvitch 1978:893-894).

As Syvan (1981) and Calleo (2001) point out, the theoretical roots of neo-mercantilism are various from Adam Smith, a liberal economist in the eighteenth century through Friedrich List, a German liberal nationalist who defended 'selective forms of protectionism' in the nineteenth century to Karl Polanyi, a sociological economist who criticized the idea of self-regulating in opposition to Adam Smith and John M. Keynes, a technocratic nationalist who influenced by List and Marx in the twentieth century. However, the central idea which identifies them all as mercantilists is their emphasis on the economic role of the state even though they have different thoughts regarding the specific ways of state intervention on the economy.

As Gourevitch explains, the neo-mercantilists are realists in the field of international economy. However, they differ from structural realists in their belief that "policies designed to enhance the technological and economic fortunes of states may be pursued to increase a state's political leverage and independence even in the absence of military-security consideration." (Heginbothan and Samuels 1999:197). However, this difference between neo-mercantilists and structural realists should not be understood as implying that neo-mercantilists disregard the importance of political and security concerns in defining national interests. Rather, they assert 'the primacy of politics' in understanding international relations (Gilpin 1971). Gilpin distinguishes 'state-centric realism' from structural realism. Structural realism, what Gilpin calls as 'system-centric realism', interprets the anarchic nature of international system as 'a constant and universal Hobbesian war' (2001:17). However, 'state-centric realism' does not consider the concept of anarchy in terms of the impossibility of international cooperation. It is the latter, state-centric realism that has influenced Neo-mercantilism. More precisely, neo-mercantilism is a hybrid of nationalism in international

economy and realism in international politics, integrated by the idea of state-centrality as a common theoretical denominator.

For the neo-mercantilists, increased economic interdependence enhances the role of the state because a transnational economic system needs politically powerful states “to manage and stabilize the system” (Gilpin1975a: 40). In his book explaining changes in international economic order, *U.S Power and Multinational Cooperation*, Gilpin argues that there is a ‘reciprocal’ relationship between political hegemony and foreign investment. His point is that the contemporary liberal international economic order “characterized by relatively free trade, currency countibility, and freedom of capital movement” (1975b:39) was “a cause of and a response to the historical tendency of advanced economies to decline industrially relative to their foreign competitors” (1975a:44). For historical corroboration, he points to British portfolio investment in the nineteenth century and U.S foreign direct investment after WWII. Gilpin’s argument is useful for understanding the domestic sources of powerful states’ influence on the changing international economic order, as its explanatory focus lies in actions of states, particularly powerful states.

The neo-mercantilists have a different concept of the state from that of transnationalists. For instance, Krasner (1978), a neo-mercantilist, defines the concept of state as ‘an autonomous actor’ whose interests cannot be reduced to societal actors’ interests in the distinction between state and society. In his analysis of U.S foreign raw materials investment policy, he tries to demonstrate counter-evidences of liberals and Marxist interest-group approach disregard the state as an autonomous actor from societal interest groups. He writes:

Here the argument that a statist paradigm is more powerful rests upon two examples. The first is the effort of the American government to buy Aramco during the Second World War. A violation of the basic norm of capitalism-private property-in a situation in which there was neither immediate pressure

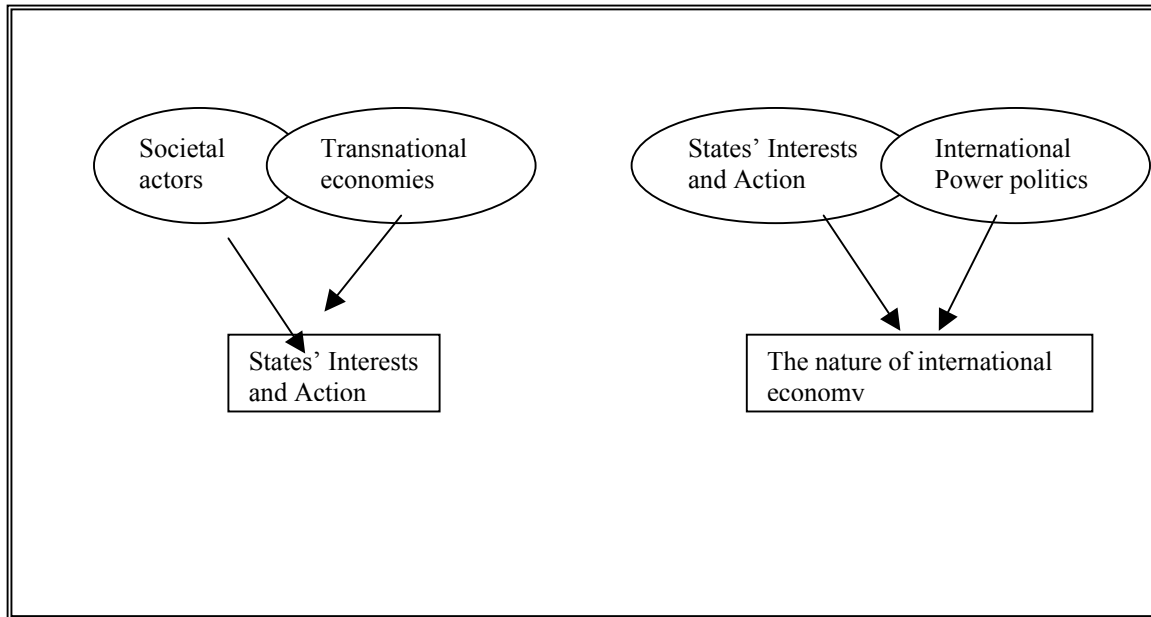
from the working class nor a clearly demonstrable long-term need cannot fit easily with a structural Marxist interpretation (1978:333).

Following the comparison of transnationalism and neo-mercantilism, Figure 1-2 summarizes the theoretical differences between the transnationalists and the neo-mercantilists. The crucial difference between the transnationalists and the neo-mercantilists is their different interpretations of the economic role of the state in both national economy and international economy. This difference arises from their different understandings of the relationship between the state and society and the state and the market. While transnationalism emphasizes the centrality of the society or the market, neo-mercantilism assumes the centrality of the state for explaining political phenomena.

According to Skocpol (1985:4), the society-centered approach is based on 'pluralist and structural-functionalistic' perspectives which consider the state as "an arena within which economic interest groups or normative social movements contended or allied with one another to shape the making of public policy decisions." In contrast, the state-centered approach assumes the state as an autonomous and rational actor able "to pursue transformative strategies even in the face of indifference or resistance from politically weighty social forces" (1985:9) or to be judged by its ability of "formulating holistic and long-term strategies transcending partial, short-sighted demands from profit-seeking capitalists or narrowly self-interested social groups" (1985:14) in the light of Weberian-Hintzean perspective. Put most simply, they have different concepts of the state.

In a similar vein of conceptual distinction, Stropert and Salais (1997) contrast two different concepts of the state, namely, the 'absent' state and the 'external' state. If we apply this conceptual distinction, we can say that the transnationalists assume the concept of the 'absent' state, defined as "structure of opportunities which maximizes for each person the chance to

Figure 1-2 The Comparison between the Transnationalist Approach and the Neo-mercantilist Approach of the Relationship between International Economy and Nation-State



pursue his or her particular interests” (1997: 211). In contrast, the neo-mercantilists prefer the concept of the ‘external’ state that is defined as the embodiment of common good and which intervenes in the market for the purpose of the maximization of common good.

Such different perspectives of the state between the transnationalists and the neo-mercantilists influence their different ideas of the economic role of the state. The societal centrality or concept of the absent state suggests that the economic role of the state should be minimized as much as possible. The state, more specifically bureaucrats and politicians, can also be considered as an interest group seeking their own organizational and political self-interest. In this sense, politics can be understood as a kind of market (Downs 1957; Buchanan 1962; Tullock 1998). Under this view of the state, the Weberian theory of bureaucracy can be also criticized as it disregards the nature of bureaucrats such as utility-maximizers, cost-benefit calculation, and ‘rent-seekers.’ Therefore, in order to achieve market efficiency, the best way is to insulate bureaucrats and politicians from the

market on the logic of invisible hand. At the same time, it is necessary to develop efficient political institutions to prevent 'state failure.' This is the reason why many public choice theorists have been preoccupied with the study of constitutional designs.

In contrast, the state-centered approach assumes that the state always constructs the market. Thus, it rejects the idea that there is a zero-sum relationship between the state and the market (Evans 1997). Basically, this interpretation of the economic role of the state is influenced by Weber's theory of the mutual cooperative relationship between the modern bureaucratic state and the modern capitalist development. In *Economy and Society*, Weber (1978:1394) wrote, "The progress toward the bureaucratic state, adjudicating and administering according to rationally established law and regulations, is nowadays very closely related to the modern capitalist development." To Weber, the critical difference between politics and economy is their different way by which they create social order with solving conflicts among actors. That is, while political order requires the use of coercion, economic order can be realized by compromise. However, Weber's point is that "the economic order is ultimately guaranteed by the political order and, hence, behind every economic order there is and must be the use of coercion" (Sewdberg 1998; 56).

This point can be extended to the relationship between international politics and the international economy. As noted earlier, Gilpin (1975a:40) argues that international economic order cannot be achieved without the active intervention of politically strong states "to manage and stabilize the system." Also, Krasner (1978) claims that a state's goals (national interests) cannot be reduced to particular social interests. Given both Gilpin and Krasner's neo-mercantilist view, the structure of the international economy is determined by the national interest of politically powerful states. Therefore, it should come as no surprise to argue that international politics constructs international economy as the state constructs the market in national economy.

The European State in a Globalized World Economy: Tax Competition and Financial Liberalization

Different conceptualizations of the state and its economic role of the state generate different interpretations and empirical findings of the effect of globalization on a state's authority to govern national economy. The following section will discuss the issue of the decline of nation-state. The two phenomena most frequently analyzed in order to support the hypothesis of the effect of globalization on a state's authority to govern national economy are tax competition and financial market liberalization. These issues have been analyzed as the important rationales supporting the hypothesis of the decline of nation-state.

Table 1-1 presents the overall features of the tax systems in EU countries in 2000. It is clear that the top marginal corporate tax rate is lower than the top marginal personal income tax rate in all European countries. What explains this general feature of national tax systems in EU countries? One possible explanation is the effect of transnational mobility of capital on tax competition. According to the tax competition literature, globalization can constrain states' capacity to raise revenue through its impact on national tax systems (Tanzi 1996).

The logic of this argument is simple. Globalization allows firms to locate freely across the territorial boundaries of nation-states. As a result, if one state taxes business more heavily than other states, firms can relocate to other states. States may, therefore, reduce their corporate income tax rates in order to improve national competitiveness in the world market and to restrict capital outflow. Following this logic, Jean-Marie Guehenn, who was French ambassador to the European Union in his book argues, in his book, *The End of the Nation-State*, that "a state cannot allow itself to increase taxes above the level of that in comparable countries" (1995:11). However, this tax policy change can cause states to increase personal income tax rates in order to compensate for their reduced corporate income tax revenue. Supporting this relationship, *the Economist* (1997) reported that the average rate of corporate income tax decreased from 50% in 1981 to 35% in 1994

Table 1-1 Corporate and Personal Income Tax Rates in EU Countries (2000)

COUNTRY	TOP MARGINAL PERSONAL INCOME RATE (%)	TOP MARGINAL CORPORATE TAX RATE (%)
Austria	50	34
Belgium	60.8	39
Denmark	46	34
Finland	55.5	25
France	54	37.8
Germany	51	40
Greece	45	35
Ireland	44	38
Italy	46.4	53.2
Luxembourg	50	32
Netherlands	60	35
Portugal	40	39.6
Spain	48	35
Sweden	56	28
UK	40	33

Source: Fuest, Huber and Nielsen (2002), p.159

whereas the average rate of income tax increased from 35% to 41%. However, it is harder to tax personal income because globalization increases the labor mobility of skilled professional workers and the self-employed as well as capital mobility. After all, state revenue will be reduced.

In fact, many studies point out that tax on business will be reduced as capital mobility increases (Frankel, Razin, Sadka 1991; Steinmo 1993; Helleiner 1994; Cohen 1996; Dehejia and Genschel 1999). Their more recent study of globalization, capital mobility and tax competition, Rodrik (1997), Fuest, Huber, and Nielson (2002), and Bretschger and Hettich (2002) confirm the theory of international tax competition to assume a negative relationship between capital liberalization and capital taxes and a positive relationship between capital motility and labor taxes.

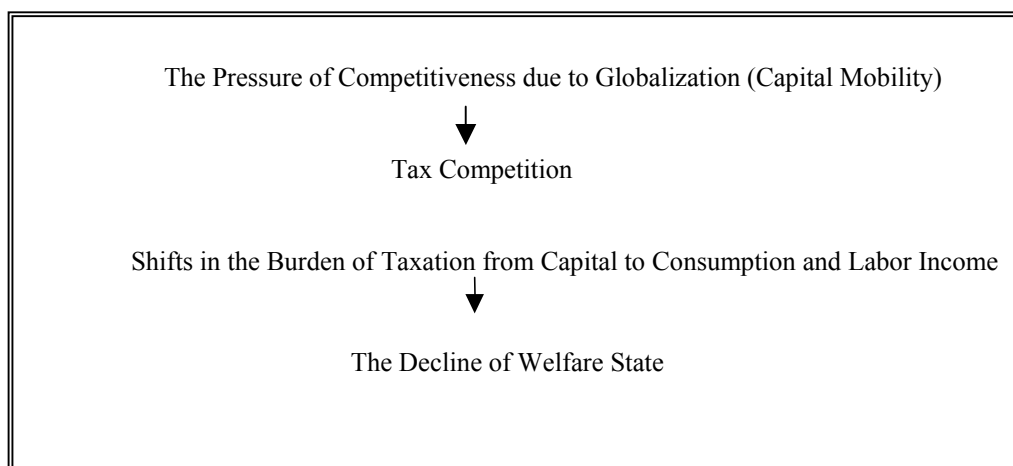
On the contrary, Quinn and Shapiro (1991), Garrett (1998b), and Swank (1998) found that capital mobility is positively related to corporate taxation. Providing a brief review of competing arguments concerning the stability of taxes on business, Kiser and Laing also argue that “marginal corporate tax rates have gone down in the past couple decades in many countries, but various

exemptions and deductions have been reduced or eliminated as well. The net effect is very little change in corporate income taxes” (2001:51-52).

The reason why it is important to analyze the change of corporate taxation is that we believe it has implication for the fiscal capacity of the state concerning social welfare provision. Figure 1-3 presents this hypothesized relationship between globalization and welfare state. There are two competing hypotheses of the relationship between capital mobility, fiscal policy, and the welfare state: the ‘efficiency’ hypothesis and the ‘compensation’ hypothesis (Garrett 1998b and 2001a; Bretschger and Hettich 2002; Adsera and Boix 2002). Figure 1-3 presents the efficiency hypothesis which predicts that capital mobility is negatively related to capital taxation, and, in contrast, positively related to labor taxation as it shifts the tax burden from capital to labor and government consumption at the expense of welfare provision. On the other hand, the compensation hypothesis states that capital mobility and the extension of international trade increase social insecurity and inequality. Thus, in turn, it necessitates that states undergo economic adjustment and compensation by increasing welfare expenditure. Beyond the issue of the relationship between capital mobility and corporate taxation, the broader issue of the effect of changing tax systems on government expenditure, in particular, social welfare expenditures has been analyzed. The literature of this issue also does not reach a shared conclusion. Garrett and Mitchell (2001), in their extensive analysis of the relationship between globalization and welfare spending in OECD countries, found that the extension of trade, considered as an important indicator of globalization, had a negative and significant effect on government spending.

More important, they argue that most European states have tried to compensate for their fiscal constraints caused by trade expansion by shifting the tax burden onto capital. As empirical evidence for this argument, they mention higher ratios of capital taxation (progressive) to labor and consumption taxation (regressive). This finding is consistent with Garrett’s (1995b) previous study arguing that a rising exposure to international trade is positively related to capital taxation. This

Figure 1-3 Globalization, Tax Competition, and European Welfare State



observation also implies that there is an increased tendency toward progressive taxation in OECD countries. However, this does not mean that government compensation of the social losers from economic liberalization also increases. The point is that the progressivity of taxation is not directly related to the generosity of public spending programs. As Garrett (1998b) stresses, the combination of the progressive taxation and generosity of public spending is conditional on the existence of strong left-labor power.

At the same time, Garrett and Mitchell (2001:147) challenge the logic of tax competition, providing a statistical result which shows that “foreign direct investment tends to move to higher tax location.” This point is very interesting because it implies that business groups’ investment decisions are not just made by their consideration of their future tax burden but rather with comprehensive consideration of a business environments such as industrial infrastructures, government regulation policy, and government incentives. Consequently, Garrett and Mitchell claim that there is no systemic relationship between capital mobility and government spending.

Garrett and Michell’s study focuses on criticism of conventional arguments emphasizing efficiency and competitiveness in the global economy. They show, however, a more cautious

position regarding the impact of globalization on the welfare state. Their conclusion is that “globalization has not induced a pervasive race to the bottom in welfare state regime. Nor have governments responded to market integration by increasing their welfare effort across the board”(2001:176).

Unlike a pervasive belief that globalization will reduce tax revenue and therefore reduce welfare expenditure, Swank (2002) argues that most European states changed their tax policy with the consideration of both seeking economic incentives from cutting tax on business and protecting overall revenue by eliminating special business benefits such as allowances, credits, and exemptions. This logic is different from Garrett and Mitchell’s contention that globalization increases capital taxation as a means of achieving fiscal compensation. Swank claims that European states adapted a more active strategy, that is, “a strategy of mixing a low tax with few investment reliefs” rather than a strategy that relies on the shift tax burden from a social interest to another social group (2002:250). An important point to note is that this strategy did not result in any significant redistribution of the tax burden from business to labor and consumption. Therefore, we can observe an important stability in tax revenue in most European states.

Steinmo (2002) also claims, in his detailed case study of the Swedish welfare state, that in spite of ideological pressure from the neoliberal economic idea of the small government, the Swedish welfare state did not lose its nature of redistributive state. Interestingly, his analysis of 1990s tax changes, taxes on capital income have increased from -0.2 in 1992 to 0.2 in 1995. In addition, the return of a Social Democratic government in 1995 resulted in a tax policy change which increased the top marginal tax rate on very-high-income earners by 5% and decreased the Value Added Tax on food by 50%. Furthermore, all of these policies were supported by public positive attitudes toward tax increases to ensure the continuity of the most comprehensive Swedish welfare model.

On the other hand, Genschel (2002) put the issue of the effect of globalization on national taxation in a different perspective, relating it to the issue of European national autonomy in fiscal

policy. His concern is not to criticize the argument concerning taxation stability itself. Rather, he questions the contention that tax competition does not have a negative effect on “national tax autonomy” (2002:246). Genschel suggests we should distinguish between the fiscal ‘capacity’ of the state and its fiscal ‘autonomy’. His central argument is that globalization has decreased European state autonomy in fiscal policy as “it does not force the welfare state into a race to the bottom but trap it in between external pressure to reduce the tax burden on capital and internal pressure to maintain revenue level and relieve the tax burden on labor” (2002: 246).

The underlying logic of his argument is that if there is no tax competition pressure due to the increased capital mobility, then the level of total tax revenue will be higher. Higher revenue enable states to deal with many problems, that are not directly caused by globalization per se, for instance, ‘slow growth, high unemployment, high levels of precommitted spending, and mounting public debts’. This is an important point since Genschel’s argument implies that there is a significant difference between ‘redistributive’ fiscal policy and ‘austere’ fiscal policy in terms of policy priority in European welfare states. In a sense, his point is similar to Garrett and Mitchell’s (2001)’ argument that globalization did not induce the increase in welfare state efforts to compensate for the negative social effects of globalization even if it did not destroy the basis of welfare state regime.

Bretschger and Hittich (2002) challenge all of above arguments, arguing that there is a mixed tendency of the decline of capital taxation to consistent with the efficiency hypothesis and, at the same time, the rise of welfare expenditure in the global economy to be predicted by the compensation hypothesis. Another element of their argument is that the real effect of globalization on fiscal policy depends on the size of a state’s economy. That is, larger economies show higher capital tax rates than small economies since “the larger the country, the lower the elastic of capital supply” (2002:700). Thus, when we correct for size induced bias, they suggest that there is a ‘tax-mix’ policy of lower capital taxation and higher labor taxation, enabling increases in welfare expenditure. In short, the real story of the relationship between capital mobility, state fiscal policy,

and state capacity to provide welfare is more complicated, confounding a perfect fit to either the 'efficiency' or 'compensation' hypothesis.

From the discussion so far, however, we cannot derive any conclusive and direct implication of the decline of European states' fiscal capacity in the global economy as the efficiency hypothesis dictates. Rather, European states' adaptability and 'transformative' capacity in the face of an international economic structural change can be seen in important policy changes and reforms. For instance, according to a 1998 OECD report, *Harmful Tax Competition*, most European states introduced "Guidelines on harmful preferential Tax Regimes" in order to prevent them from adopting harmful preferential tax regimes for the purpose of attracting foreign capital, subsequently shifting the national tax burden onto less mobile tax bases such as labor and consumption. This policy reflects a collective effort by European states to avoid 'allocative distortions' through tax harmonization of corporate and capital income taxes among European States (Sinn 1997; Gordon 1992; Razin and Sadka 1991). Of course, as Genschel asserts, it is also clear that the changing nature of the international economy limits the range of possible options for managing national problems. It also induces important policy changes in Most European states. Therefore, the point is not to argue that globalization does not effect states' capacity to govern their national political economy. Rather, it is to criticize that the debate over the decline of the nation-state exaggerates the effects of international economic structural constraints on state action and national political systems. As Evans (1997:73-74) claims, "the economic logic of globalization does not dictate eclipse (of the state)." Such debate underestimates the domestic sources of structural change on the international economy as well as concealing the historical origin of such change. In order to make this point clear, let's consider another issue, the rise of unregulated world financial market. A historical illustration should help clarify this issue.

Moran (1994) argues that the rise of an 'unregulated' world financial market does not mean the decline of state regulatory authority of financial markets. The deregulation (liberalization) of

financial markets, which happened in the United States, Britain, Germany, and Japan in the 1970s and 1980s, was the very result of legalization and institutionalization of transactions and exchange behaviors in financial markets, undertaken by states. The growing world financial market was originally created by the 'American financial services revolution'. More importantly, behind this revolution lies the history of the formation of an American domestic political coalition between the state, financial business, and industry from the late 1960s to mid-1970s. This period can be characterized by three structural changes in American politics and economy. First, by the 1960s, American state regulatory authority finally achieved "the professionalization of regulatory knowledge"(Moran 1991:34). The state was consequently, able to establish its independent regulatory agencies without relying on the private financial sector, which has previously monopolized the supply of financial experts and knowledge.

Second, competition for market expansion within the financial business sector increased with the dominance of the American dollar in international securities markets and technological innovations in computers and the telecommunication sectors. This also resulted in increased challenges to the old financial regulation system, which discouraged severe competition within financial sector by restrictions such as limits to price competition and the prohibition of the formation of inter-state branch network. For instance, at this period, the new finance business interest groups demanded the relaxation or repeal of the Glass-Steagall Act of 1933. In 1933, responding to the public hostility of financial big business after the Great Depression, the New Deal reformers enacted the act in order to prohibit the concentration of financial power. The act established the institutional separation between investment and commercial banking that prevented commercial bankers from investing in the securities business and entering the business of investment banking after the stock market crash of 1929 and the subsequent banking panics of 1930-32 (Perkins 1971; Kroszner and Rajan 1994; Ramirez and Long 2001). For the new finance

business groups, however, the act increased an institutional protection of the old interest groups such as the biggest securities firms, from severe competition (Moran 1991).

Third, Vogel wrote that “the contemporary changes in the pattern of government regulation in the United States cannot be understood apart from the substantial shift in public attitudes toward business that occurred during the second half of the 1960s” (1986:250). That is, the American public’s attitude toward business was changed from relatively ‘supportive’ to relatively ‘hostile’. This change can be explained by the economic downturn, characterized by low economic growth and high unemployment, after the 1954 recession and persistent high inflation rates during the late 1960s and the 1970s (Salant 1982). An interesting point is that state regulatory authority tends to be enforced when public attitude is negative toward business as is shown by a substantial increase in terms of state regulatory authority following the Great Depression. More importantly, in pluralist democracies negative public attitudes toward business mobilized through ‘the politics of scandal’, provides the validity of state regulatory authority of business. American financial business is always a venerable target of the politics of scandal since as Moran argues, “insider dealing feeds American passions perfectly” for openness and public disclosure of conspiracy (1991:138).

In addition to this cultural factor, public hostility toward financial business was intensified by the fact that financial business interests and public interests could not be harmonized in domestic economic policy. In the early 1960s, the American financial business community resisted the Democratic government’s expansionary and interventionist domestic economic policy, such as Johnson’s Great Society regardless of whether its request for deflationary measures and reduced government expenditure could not gain political support from both government and Congress (Conybeare 1988).

These three factors (increased state regulatory capacity, constrained competition within the finance business community, and the politics of scandal) drove the American state into the direction of enforcing its regulatory authority over financial market through “grater codification,

institutionalization, and juridification” (Moran 1991:40). With the passage of the Securities Investor Protection Act designed to provide government backed insurance for stock brokerage firm customers in 1970, the extensive hearings of the securities industry, under the leadership of John Moss were launched.

The American financial services revolution was finally realized in the financial reform of 1975. The 93rd Congress mandated the Securities Acts Amendments to establish a national market system and to encourage fair and efficient securities transactions. In the National Market System, which began operation in 1978, prices for stocks and bonds on New York Stock Exchange and the regional exchanges were listed simultaneously by Intelligent Transportation Systems (ITS). According to Joel Seligman (2001), Chair of the Securities and Exchange Commission (SEC) on Market Information, the primary goal of National Market System is to create “a central market system in which investors would have access to information from all market” and to introduce ‘unfixed brokerage commission rates, effective market linkage, and vigorous price competition.’

With the financial reform of 1975, the old political coalition between the weak state and the self-regulating private financial business interest, created in the 1930s, had to be transformed. A new political coalition between the regulatory state and the fragmented financial business interests based on jurisdiction over financial markets was created (Conybeare 1988; Moran 1991). The process of American financial regulation in the 1970s should be also understood in the context of American state’s move toward greater trade liberalization in the 1960s. In 1962, the passage of the Trade Expansion Act, under the new Democratic administration, represented an important policy change toward free trade and free investment (Cox and Skidmore-Hess 1999). At that time, the American financial services revolution was a necessary task for establishing an overall institutional framework for economic liberalization. The point is that at the core of American financial services revolution lies the dynamics of American domestic political and economic changes. More importantly,

American financial liberalization can be considered as the product of the American state's vigorous efforts to innovate their financial market and to increase efficient market competition.

Contemporarily, the American financial services revolution became the most important external constrain forcing for European states to conform to the Anglo-American model of financial liberalization. In fact, the growing American balance-of-payment problem mostly, caused by expansionary domestic economic policy and Vietnam War in the 1960s, decreased confidence in the dollar's convertibility into gold under the Bretton Wood post-war international monetary system. This resulted in the significant instability of New York financial market. As a result, the American state decided that a capital control program, such as 'the interest equalization tax (IEI) on foreign securities and equities sold in the United States in 1963 was necessary. This capital control program was based on the idea that the backwardness of the European financial market made European business too much dependent on the American financial market, resulting in the instability of the American financial market (Hawley 1987; Helleiner 1994). Therefore, the American state enforced European financial market liberalization and deregulation.

This explanation also makes sense in the context of the contemporary power configuration of international politics, American hegemony. As Ikenberry (1989:376) states, however, after World War II, American hegemony in Europe can be defined as "an empire by invitation" as American hegemony in Europe was not direct and European states have always interpreted it through their own prism. In comparison to the American financial market of the 1960s, the European financial market was in a very early stage. The Euromarket was not created until the late 1950s with strong supports from Britain and United States.

Particularly, in the situation of the 1954 sterling crisis, Britain strongly desired to preserve the London international financial market as a centre of international finance. Then, the Eurodollar market was a very attractive solution to overcome Britain's dilemma, that is, "the problem to reconcile the goal of restoring London's international position with the Keynesian welfare state and

Britain's deteriorating economic position" (Helleiner 1994:84). As many studies point out, the development of the Eurodollar market was stimulated by Britain's exchange control of 1957 which banned the use of sterling to finance foreign trade and refinance credit in sterling (Strange 1976; Silber 1976; Gibson 1987). Also the Eurodollar market was the product of a situation where British business had to pursue funds outside of the domestic market since restrictive domestic monetary policy increased interest rates as well as "a response to the liquidity preferences of the Midbank" (Schenk 1998).

For other European states, however, financial market liberalization and the Eurodollar market were not as attractive as Britain considered since unlike U.S and Britain, they were confronting with the problem of capital inflow rather capital outflow. For them, the control of capital inflow was a necessary condition for deflationary monetary policy, as deflationary monetary policy resulted in the excessive inflow of short-term capital causing an external payment surplus (Helleiner 1994). Therefore, as Eichengreen and Frieden (2001) note, European states except Britain, had already launched a collective response to the Anglo-American model of financial liberalization in 1969. That is, as we can see from the Werner Report of 1969, European states already had an ambitious vision of the future European Monetary Union, even if the vision was only realized after three decades.

In the light of the aforesaid, it can be seen that European states have been not simply declined due to the changing nature of the international economy. Rather, they have increased their the ability to act strategically in shaping their economic environment (Weiss 1998). Strange (1996:44) herself points that, "the shift from state authority to market authority has been in large part *the result of state policies.*" She recognizes that the structural transformation of world political economy was the consequence of states' strategic choice. This argument raises an important theoretical puzzle regarding the future and nature of the nation-state in the age of a global world economy. If states are not passive actors, simply adjusting to changing world, but rather changing the world itself, how can we say that they are on the decline? This question requires us to rethink the relationship between the

state authority and the market authority, the economic role of the state, and the fundamental sources determining the nature of international political economy. These considerations shape the present study.

The international political economy has been constructed by the configuration of power among nation-states. In other words, world politics constructs the world market rather than the reverse. More importantly, the nature of world politics is also determined by domestic political changes and the economic role of the state in powerful states. Therefore, understanding domestic sources of international political economy is the first step for understanding states' behavior and the changing nature of the international political economy.

For Strange, the meaning of the decline of the state is more political and normative. Her real concerns are as follows: 1) Who has the political authority to control the "four interlocking structures of the world economy": finance, money, production, and technology (Underhill 2000:5); 2) What are the political consequences when states can no longer monopolize the political authority of these four interlocking structures and when they diffuse their authority to non-state international actors? In a world where non-state international actors, particularly, transnational corporations (TNCs) are gaining authority in the world economy, the real problem is that there is no 'a system of global governance' to check and balance them in order to make their authority "acceptable, effective and respected" (Strange 1996:198). Therefore, for Strange, the decline of nation-state signals a crisis of political legitimacy. Strange also writes that "at the heart of international political economy, there is a vacuum, a vacuum not adequately filled by inter-governmental institutions or by a hegemonic power exercising leadership in the common interests" (1996:14).

However, behind all of her arguments regarding the diffusion of political authority in one single global market, is her questioning of the assumption that "the study of politics in most of the twentieth century has been 'colonized by the state'" (1994:32). She suggests reconsidering the concept of the state as the only source of political authority and legitimacy under the condition of

the shift in authority from states to markets. Her logic is that, when we cannot deny the reality of globalization to reduce the state political authority over the market, it is not realistic to cling to the idea of the state as the only source of political authority. If so, what does she offer? What is the future of the nation-state? Has the state really lost its significance as the only source of political authority and political legitimacy? When taking those questions seriously, it is meaningful to remember Evans' observation that "preoccupation with eclipse cripples consideration of positive possibilities for working to increase states' capacity so that they can more effectively meet the new demands that confront them"(Evans 1997:64).

This study shares Strange's understanding of the changing nature of world political economy and her sensitiveness of the tension between state authority and market power. However, this study challenges her interpretation of the relationship between the state authority and market power, by approaching it from a different theoretical perspective of the relationship between the state authority and market. Her interpretation of the decline of the nation-state in the globalized world market basically assumes that the state is always in conflict with the market. In other word, the relationship between the state and the market is a kind of zero-sum game. Thus, when the market is outgrowing the political authority of the state, the state should be declining.

In contrast to Strange's interpretation, however, this study contends that states are not simply 'the victims of the market economy'. Rather, as many economic sociologists note, "state action always plays a major role in constituting economies, so that it is not useful to posit states as lying outside of economic activity" (Block 1994:696; Chang 2000; 16; Fligstein 2001). Of course, this view does not suggest that the state is always conducive to the market. Rather, "when not properly structured and operated, the state can be become a 'problem' instead of a 'solution'"(Evans 1995; Burlamaqui 2000:34). The crucial point, however, is that we should reconsider the conventional idea of insulating the market from the state in contemporary capitalist economy.

Someone may ask the following question: why is it so important for understanding the nature of the European Union to discuss whether the state is declining or not? If we analyze the European Union from the perspective of the decline of nation-state, then the European Union can be conceived as a new form of supranational governance based on the shift from national to supranational authority and the shift from state authority to market authority. That is, this new form of supranational governance will be characterized by the diffusion of authority between the state and the market. The problem is that this diffusion of authority leads to the diffusion of loyalty, and, in turn the diffusion of loyalty leads the confusion of identity. Therefore, Strange asks, “where do allegiance, loyalty, identity lie?” (1996:199).

More importantly, it does not make sense to argue the political legitimacy of the state who lost its authority to the non-state actors to act according to the logic of the market because there is no legitimacy without authority. So, if we are in search for a new source of legitimacy, loyalty, and identity to be able to replace the state, then we will be caught in Strange’ famous metaphor, “Pinocchio’s problem”. The problem is, however, that as Polanyi argues, the market cannot be the source of democratic legitimacy as “the idea of a self-adjusting market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society. It would have physically destroyed man and transformed his surroundings into a wilderness” (1944:3). Furthermore, in the decline of the state, the market will also be declined. As Joseph Stiglitz (2001:100) argues, “not only can government actions thus improve the behavior of market participants, but the government actions themselves can be shown to be incentive compatible” Again, it is meaningful to recall Evans’ point that “preoccupation with eclipse cripples consideration of positive possibilities for working to increase states’ capacity so that they can more effectively meet the new demands that confront them”(Evans 1997:64).

On the other hand, if we assume that European states are not just the passive victims of market economy, then it is logical to expect their strategic actions to preserve their authority. The European

Union can be understood in this context. However, an important point is that ‘strategic’ actions do not always equate to ‘appropriate’ actions. That is, the preservation of state authority is not always the structuration of legitimate authority. Therefore, there has long been the problem of democratic deficit of the European Union. And this problem of democratic deficits is closely related to the specific way that European states act strategically. Between the commitment to the preservation of state authority and the necessity of the reconstruction of efficient market, European states chose the strategy of “the alliance of nationalism and neo-liberalism” (Streek 1996:305). However, even if we criticize the hypothesis of the decline of the nation-state, there still remains the controversy of how to explain states’ actions in domestic and international politics. This point will be discussed in detail in the following chapters.

UNDERSTANDING THE NATURE OF THE EUROPEAN UNION: IS A PLURALIST THEORY GOOD FOR EXPLAINING THE EUROPEAN UNION?

Contrast to Strange's pessimistic view of the future of nation-state, European states have long pursued their political project of the European rescue of nation-state, in Milward's phrase, to overcome the absence of a system of global governance in Europe. They rejected to be 'defective' by creating a new institution of a joint problem solving. In order to achieve this task, European states *voluntarily* delegated their authority to a super-national institution, the European Union. In this regard, the European Union can be considered as an institutional innovation pursued by European nation-states. European integration required the peaceful 'surrender of sovereign prerogative', which as Moravsik (1998:1) notes, must be 'the most extraordinary achievement in world history.'

Why did European states voluntarily delegate their national sovereignty to a supranational institution rather than remaining at the point where the process of international cooperation usually stop for preserving national sovereignty as much as possible? As previously discussed, the changing nature of the international economic system characterized by the increased interdependence and economic internationalization in international political economy is one of the most important factors for explaining European states' choice. However, an explanation relying on the international economic system is underdetermined despite the importance of this stimulus. The critical intervening variable between international economic stimuli and European states' responses and choices remains to be found.

This present study contends that this critical intervening variable is the nature of the relationship between the state and society within national political economies. In this study, the state is defined as the actor who constructs the society and is in turn reconstructed by societal actors. This mutual relationship between the state and the society can also be considered in terms of the collective action between the state and society. The legitimacy and autonomy of the state determines a

particular pattern of collective action between the state and the society, influencing its capacity to construct its society. It is important to understand for the state how to define what is good for its society, how to justify its definition, and how to realize it in order to explain states' actions and preferences in both domestic and international political economy. This chapter addresses these issues.

British economic historian, Allan Milward argues “ the evolution of the European Community since 1945 has been an integral part of reassertion of the nation- state as an organizational concept” (Milward 2000a: 2-3). The primary goals of European integration were to modernize and to reform European states, and reflected the political consensus of a strong, interventionist welfare state after World War II. In this sense, the European Union was a collective effort to defend the achievement of European welfare states, protecting domestic societies against the full force of economic liberalization and globalization.

From the view of European postwar rebuilding, European integration was a new form of international framework created by nation states to develop particular sets of domestic politics and designed to secure benefits for large social groups, particularly agriculture and industrial groups, from rapid economic and social changes. At this point, integration involved a ‘limited but voluntary’ surrender of sovereignty and strengthened the nation state. Milward also argues that “ without the process of integration the west European nation-state might well not have retained the allegiance and support of its citizens in the way that it has”(p.3). Therefore, his work emphasizes the domestic rationality of European integration.

Most controversies over the European integration have been generated from different assumptions of the capacity of the European states in the circumstance of economic internationalization and interdependence. Milward criticizes a theoretical tendency of ‘exaggerating incapacity of the state’ shared by theorists of integration, particularly both functionalists such as Deutch, Hass, and Linderberg and federalists such as Lipgens. He believes that “nation-states had played the dominant role in its formation and retained firm control of the new creation [the

European Community]”(p.12). More importantly, according to Milward, such theoretical tendencies are based on ‘rationalist’ and ‘progressivist’ assumptions of institutions and international organizations. Furthermore, he argues that “these assumptions seem to have been simply transposed on to European history from the conventional and comforting liberal interpretation of America’s own history”(p.13).

Milliard’s work is an important challenge to many studies that have analyzed European integration by exclusively focusing on the process of formal institutionalization of European integration. Such an approach emphasizes the construction of new supranational institutions and the primacy of external factors such like the Cold War, the Soviets, and the Americans. Milward describes the idea as “myth-making” that national states’ power is declining as the European integration has advanced. In contrast, he argues that “the European nation-state rescued itself from collapse, created a new political consensus as the basis of its legitimacy and thorough changes in its responses to its citizens which meant a sweeping extension of its functions and ambitions, reasserted itself as a fundamental unit of political organization”(Milward 1992:3).

Thus, for Milward, European integration does not mean the replacement of the nation state with another form of governance, just a limited surrender of national sovereignty. He suggests a new set of assumptions for developing new explanations of European integration, arguing that “integration was not the suppression of the nation-state by another form of governance as the nation-state became incapable, but was the creation of the European nation-states themselves for their own purpose, an act of national will” (Milward 2000a:18).

Streeck (1996: 304) maintains a similar point; “in the process of the Community’s character as an intergovernmental arrangement was continuously reinforced – an arrangement that, rather than replacing national with supranational sovereignty, often *served to enable national states to assist one another in protecting as much of their sovereignty as possible*, to a large extent turning their Union into a mutual insurance arrangement for nation-states worried about losing their independence.” He understands

the European Union as a collective institutional innovation based on the principle of “the elective affinity” between nationalism, intergovernmentalism, and a neo-liberalism of deregulatory market expansion (p.305).

Comparing Theories of the European Union

Inevitably, Milward’s criticism of ‘myth-making’ integration theories, specifically, supranationalism, leads us into broader theoretical questions regarding the nature of the European Union, as well as the debate between intergovernmentalism and supranationalism. To understand the nature of the European Union necessitates an understanding of the main actors, how they interact, what they want and chose, and why they chose particular options in the process of European integration. Table 2-1 provides a comparison of the four dominant theoretical perspectives of the nature of the European Union.

First, when Theda Skopold published the book, *Bring the State Back in* in 1985 it represented the crucial criticism of ‘the hegemony of behavioralism, pluralism, utilitarianism, and reductionism’ to see ‘political phenomena as the aggregate consequences of individual, groups, or class behaviors’ and to see the state as the agency of ‘the functional requirements of society as a whole’ (Colburn 1988:485-486; Jessop 2001:152). On the contrary, the state-centered approach highlights the state as an autonomous actor acting in its own right, interests, and capacities, emphasizing the return to the theoretical traditions of Weber and Hintz.

Ironically, the period during which the supporters of state-centered approach were trying to gain primacy within the discipline of comparative politics was also a critical moment for realists in the discipline of IR. Realists have always emphasized the primacy of the state as the main actor in international politics. However, the publication of *After Hegemony* (1984) and *International Institutions and State Power* (1989) by Robert O.Keohane presented a challenge from neo-liberalism, which emphasized the role of international institutions in international politics with. Of course, some may

Table 2-1 Four Theoretical Perspectives of the Nature of the European Union

	Neofunctionalism	Federalism	Realist-intergovernmentalism	Liberal-intergovernmentalism
Approach	Society-centered	State-centered	State-centered	Society-centered
Ontology	Technocratic-Supranational	Constitutional-Supranational	Intergovernmental	Intergovernmental
Main actor	Supranational entrepreneurs and transnational societal actors	State actor	State actor (national leaders and beaucrats)	State actors (national leaders and economic interest groups)
National Interest	Economic interest	Political interest	Political Interest	Economic interest
Preference formation	Exogenous Preference convergence	Exogenous	Exogenous Determined by power position in international politics	Exogenous Preference convergence and Aggregation of domestic interests
Process	Spill-over	Constitutional reform	Negotiation and intergovernmental bargaining	Negotiation and intergovernmental bargaining

argue that there is no significant difference between realism (structural-realism) and neo-liberalism because neo-liberalists also accept the primacy of the state as the central actor. However, behind this superficial agreement, there lies a deep epistemological gap between realists and neo-liberalists in terms of the concept of the state.

For both the proponents of the state-centered approach in comparative politics and realists in IR, state actions cannot be reduced to the sum of individual social interests. Rather, state actions shape social interests and social changes. Also, they consider institutions as the product of state action rather than an equilibrium of competing social interests. For realists, in particular, the effect of international institutions on state behavior is marginal as “institutions cannot get states to stop behaving as short-term power maximization” (Mearsheimer 1995:82). Realist-intergovernmentalism in table 2-1 represents this state-centered approach.

The theoretical roots of neo-liberalism formed in the functional integration theory of the 1940s and the early 1950s, neo-functional regional integration theory in the 1950s and 1960s, and interdependence theory in the 1970s (Grieco 1995). Considering this fact, we can expect significant similarities between neo-functionalism and liberal-intergovernmentalism. In the theoretical tradition of liberal international theory, political phenomena should be analyzed by a 'bottom-up' approach, in other words, the society-centered approach. Moravcsik's (1997) article, "*Taking preferences Seriously*", is an excellent review of the liberal international research program. In this work, he defines very clearly the state as "a representative institution constantly subjective to capture and recapture, construction, and reconstruction by coalitions of social actors" (1997:518). Therefore, the primary actors are social actors mostly defined in terms of economic interests. Both neo-functionalism and liberal-intergovernmentalism are based on the society-centered approach even if they have different perspectives of the relationship between nation-states and the European Union.

On the other hand, the federalists' position in the study of the European Union is ambiguous for clear classification as either a state-centered or society-centered approach as they have no consistent theoretical framework Rosemond (2000:27) captures the dilemma of proponents of European federalism as follows: "their logic is potentially two faced. The rationale behind the advocacy of federalist solutions is the hope that the conflictual tendencies inherent in the (European) states system might be overcome. Yet, the normal outcome of federalist engineering is the reproduction of a state-like entity, replicating the format of the nation-state, albeit in supranational form." In the present study, however, federalism will be classified as a state-centered approach because it does not consider social forces and social changes as important sources proceeding European integration. Rather, it is concerned with 'political solutions' by political elites.

Both federalism and realist-intergovernmentalism apply an up-down approach to analyzing the European Union. That is, they consider the role of the state and state authority as the driving force behind the development of European integration. However, they differ from each other in their

understanding of the political authority pattern in the Europe Union. As Calleo (2001) points out, there have been two competing models of the Future of Europe between the Brussels federalism of Monnet and Hallstein and the confederal Europe of States of de Gaulle. The crucial difference between these two models is their different ideas regarding how much national sovereignty to preserve.

Second, in terms of ontological view of the European Union, both realist-intergovernmentalism and liberal-intergovernmentalism share the idea that the European Union is an inter-government system as the product of strategic actions of European states to complete their own domestic agendas (Milward 2000b; Moravsik 1998). Therefore, they emphasize the primacy of the consent of member states and the Council of Ministers in EU decision-making and, more significantly, they do not regard the future of the European Union as a European polity. By contrast, federalism and neo-functionalism assume that the evolutionary development from nation-state system to supranational institution will result in a new form of governance by either constitutional reform or technocratic necessity.

Third, who is the primary actor responsible for leading and controlling the process of European integration? For this question three theories, federalism, realist-intergovernmentalism and liberal-intergovernmentalism, emphasize the prominent role of state actors and the Council of the European Union, rather than paying attention to the autonomous role of EU institutions such as the European Commission, the European Court of Justice, and the European Parliament. Basically, neo-functionalism was influenced by pluralist political theory, rejects 'elite-mass depictions of society' and 'traditional high politics' (Hix 1994; Rosemond 2000; Chrysochoou 2001). Consequently, it emphasizes the prominent role of 'technocrats' who have managerial expertise and administrative capacity to initiate the process of social and economic integration across national and ideological cleavages (Rosemond 2000).

Forth, concerning the definition of national interests and the formation of state preferences, federalism and realist-intergovernmentalism think that the process of European integration would be ultimately constrained by political interests such as territorial/non-territorial issues and foreign and security issues that have no common denomination among different states. By contrast, neo-functionalism and liberal-intergovernmentalism argue that for states, the most essential concern of European integration is economic interests such as a common agriculture policy, intra-trade and investment, and policy coordination for financial liberalization. Such economic interests are formed by the structural factors of economic internationalization and interdependence. Hence, all states have a motivation to pursue 'collective gains' or 'aggregate welfare gains' through economic cooperation. However, all four theories share an assumption of the exogenous formation of state preferences because they assume that state preferences are exogenously given and relatively stable. Also as could be expected, the final outcome of competing state preferences can be considered as a Pareto-optimal equilibrium created by the process of negotiations and bargainings among states.

Finally, how can the process of European integration be characterized? While neo-functionalism understands integration as an 'unintentional and cumulative' process of spillover by driven 'the logic of functional self-sustaining' (Risse-Kappen 1996:55), federalism conceives it as the process of constitutional design. This difference between the two theoretical approaches reflects the difference between neo-functionalism's positive concern regarding how European integration has proceeded and federalism's normative concern over where the process of European integration should be heading (Muller 1997; Watts 1998; Burgess and Gagnon 1993). Both realist-intergovernmentalism and liberal-intergovernmentalism, however, do not have any presumption of the final destiny of the process of European integration. For them, it represents a repeated-game of intergovernmental negotiations in which to barrow game theorists' metaphor, 'the shadow of the future' exists.

Between Intergovernmentalism and Supranationalism: Three Debates over the Nature of the European Union

On the basis of the above theoretical distinctions among the main theories of European integration, I turn to a review of the three theoretical debates of the nature of the European Union and the future of European integration. The first debate is between the old-functionalism and neofunctionalism. As Rosamond (2000) notes, neofunctionalism is a theory of European integration rather than a general theory of integration. Neofunctionalism is influenced by Mitrany's theory of the functional organization of international relations. However, Mitrany's functionalism has been criticized in that his technocratic and rationalistic theory cannot explain the complex, competitive, and distributional nature of international politics.

A pioneer of neofunctionalism, Haas (1964) criticized functionalism's disregard of the influence of power politics in achieving 'the spillover of functional needs' at the level of international politics. For neofunctionalists, it is necessary for interdependent states to cooperate with the evolutionary strategy from the integration of low politics to the creation of a high authority. They assume that political integration based on supranational institutionalization will be an inevitable event of economic integration.

However, we should note that neofunctionalism rejects the idea of federalism as it understands supranational institutionalization in terms of the concept of technocracy rather than the concept of constitutional political order (Chrysochoou 2001). In other words, neofunctionalists' supranational institutionalism is rooted in the idea of 'managerial' governments responsible for satisfying the welfare and material need of self-interested groups. The idea of European federalism, on the other hand, comes from the idea of European constituents and the creation of a state-like polity at the level of Europe as a whole. On this point, as previously discussed, neofunctionalism can be considered as a theoretical extension of pluralism to the level of international politics.

In reality, however, neo-functionalism and federalism have been fused by Monnet's federal functionalism. The idea of federal functionalism is a mix between the functionalist emphasis on the gradual nature of European integration and the federalist prospect of the creation of a new democratic polity beyond nation-state system. Schmitter (2000b:46) clearly presents this idea of federal functionalism that "federalization and democratization can only be accomplished gradually by building upon existing institutions rather than in the classic American manner that Tocqueville so admired, that is, by drafting an entirely new constitution". Jacques Delors declared his vision of a federal Europe in his speech to the 1990 Intergovernmental Conferences (IGC):

My objective is that before the end of the Millennium [Europe] should have a true federation. [The Commission should become] a political executive with can define essential common interest . . . responsible before the European Parliament and before the nation-state represented how you will, by the European Council or by a second chamber of national parliament. (Cited in Grant 1994:135)

As we know from Delors's description of a federal Europe, the federalization of Europe is not so much about transforming traditional national political systems into a new political system, but rather, the extension of a national political system beyond national territorial boundaries.

The second debate between neofunctionalism and realist-intergovernmentalism started from the question of how to incorporate historical events, such as 'the empty chair crisis' of 1965 and Britain's reluctance in the 1980s, into a general theoretical framework of European integration. Realist-intergovernmentalism is a more complicated theoretical view of European integration. As Hoffmann (1966 and 1995) argued, neofunctionalists' optimistic prospect of supranational institutionalization at the Europe level cannot understand the persistence of the dominance of the nation-state and the importance of national interest as reflected by 'the empty chair crisis' in 1965

and Britain's reluctance in the 1980s in the history of European integration. Realist-intergovernmentalists ask an important question concerning European integration: Has European integration weakened the authority of nation states? To this answer, their answer is 'Never'. For them, nation-states are still the most important actor in both domestic and international politics. Consequently, they want to be cautious between idealists and realists on the relations between nation-states and international institutions such like the European Union since "if the idealists of integration have often ignored the difficulties, realists have tended to ignore the reality of the EU" (Hoffmann 1995:6). Realist-intergovernmentalism rejects the idea of European integration as a completed project. Rather, they consider that the absence of a clear vision of the final destination of European integration is the most important feature of its process. Thus, there exists a continuous tension between the conflict among national interest and the integration among states.

However, in the third debate, realist-intergovernmentalists' state-centric explanations are also challenged by liberal intergovernmentalists. Liberal Intergovernmentalism modified the realist-Intergovernmentalism approach represented by Hoffmann, in terms of the emphasis of domestic sources of state preference formation. The most important modification is their understanding of the process of the formation of national interests. Liberal intergovernmentalism assumes that the relations between state and society shapes national interests, whereas realist-intergovernmentalism supposes that the nature of the international system and the distribution of power among states exogeneously determine national interests.

In other words, while the realist-intergovernmentalism argues that the power configurations determine states' choices and outcomes, liberal-intergovernmentalists assume that 'the configuration of interdependent state preferences' determines states' choices and outcomes (Moravcsik 1997:520). This difference between the two theoretical perspectives is deeply rooted in the theoretical debate in IR between neo-realism's state-centric approach and neo-liberalism's society-centric approach. We

already addressed in detail their crucial theoretical differences in the previous section, comparing between transnationalism and neo-mercantilism in the study of international economy.

In a word, liberal-Intergovernmentalism is neo-liberal theoretical view of European integration. It applies the analogy of a two-level game to the analysis of the formation and change of international institutions and bargaining. More importantly, it assumes that national interests (state interests) have been aggregated through political competitions in domestic politics. That is, national interests are formed by the dynamic interaction of domestic political actors and social groups (Moravsik 1993; 1998). Furthermore, national interests are considered to converge through intergovernmental bargaining among national leaders. Thus, European integration can be understood as the process of the 'convergence' of national interests (Moravsik 1997).

In a review of the literature review on European integration, Pollack (2001) summarizes main criticisms of liberal-intergovernmentalism from three theoretical positions: constructivism, institutionalism, and EU governance theory. For constructivism, the crucial problem of liberal-intergovernmentalism is its theoretical assumption regarding the formation of national interest. Their key point is that liberal-intergovernmentalism disregards the endogeneity of state preference formation. Wendt (1995:385) writes that "state identities and interests are important part constructed by these social structures, rather than given exogeneously to the system by human nature or domestic politics"

For constructivists, Moravsik's model of the formation of state preference is simply a replacement of realists' notion of national interest based on security concerns and relative power positions in international system with the liberal conception of state preferences based on domestic political competitions, national commercial concerns and relative bargaining power. That is, both of them have the same problem to define the concept of interest and preference in material terms, and not considering the possibility of the formation of collective identity among states in interaction contexts such as the structures of regional and global international systems.

On the other hand, institutionalists discredit Moravcsik's intergovernmental bargaining model of EU policy-making, emphasizing the role of European entrepreneurs and the existing EU institutions such as European Commission and European parliament in EU policy-making (Pierson 1996; Pollack 1996; Sandholtz and Sweet 1998; Amstrong and Bulmer 1998). Puchala (1999) points out that Moravcsik 'downplays' the influence of European entrepreneurs such as Jean Monnet, Walter Hallstein and Sicco Mansholt in completing the Treaty of Rome and the CAP, whereas he 'elevates' the influence of national leaders such as Charles de Gaulle, Adenauer, Mitterland, Thatcher and Kohl. Concerning this issue of supranational entrepreneurs, Young (1999) argues that Moravcsik cannot properly capture the essential role of entrepreneurial leadership in interstate negotiations because his theory is based on game theoretic and economic models which assume well defined utility functions for actors, and Pareto optimal outcomes in interstate negotiations.

The third group to criticize liberal-intergovernmentalism consisting of comparativists in the field of the EU study shares Hix's (1994) position regarding the dominance of IR theories in the study of the European Union. The common theme of this group is the contention that "the EU has become a genuine polity" (Rosamond 2000:159). For instance, Hooghe and Marks (2001:72) argue that "government leaders can use international constraints to gain bargaining advantages in domestic politics just as they can use domestic constraints in international negotiations." Their argument shows the opposite logic of liberal-intergovernmentalism.

These scholars conceptualize the European Union as 'multi-level governance' or a 'policy-network'. The concept of multi-level governance is created by the underlying idea that authority can be diffused away from the central state to governments at different territorial levels. Thus states are just a particular type of governance rather than a general type of governance. However, a critical point of multi-level governance theory is that the reason why the state wants to diffuse or shift its authority cannot be explained by the logic of economic efficiency, for example, the concern of the reduction of transaction costs because the reduction of transaction costs per se is not costless.

Rather, as multi-level governance theorists claim, it should be explained by the logic of politics as 'the contestation about the good society' (Marks and Hooghe 2000:811). Thus, they suggest considering ideology, rulers who have individual preferences of authority and reform of authority contested by political coalitions.

In a similar vein, other studies (Peterson 1995; Peterson and Bomberg 1999) try to develop a comprehensive theoretical framework to capture the complexity and dynamics of EU policy making that can be characterized by 'the co-existence of different types of policy networks at different levels of EU governance'. More specifically, they consider that there are three levels of EU governance: 1) the super-systemic level considers the process of European integration in terms of changes in the wider political and economic environment; 2) the systemic-level focuses on the process of institutional change within the European Union per se; 3) the meso-level looks at the process of everyday policy making and implementation. Each of these levels requires a different theoretical model. That is, while neo-functionalism and liberal-intergovernmentalism are good for the super-systemic level analysis, new-institutionalism would be more effective for in the case of systemic level. Finally, for meso-level analysis, the concept of policy-networks is proper. In fact, the underlying idea of this conceptualization of EU governance is that the European Union is a political system but not a state. Therefore, it is important to understand how to work the system in everyday life as much as to explain the process of European integration and the major historical events in the process (Hix 1999; Peterson 2001; Goetz and Hix 2001).

All of three critics contribute to a more comprehensive understanding of the European Union: 1) the constructivists make us reconsider the issue of the formation of state preferences and national interests; 2) institutionalists revive the neo-functionalist concern with the autonomous role of supranational actors and EU institutions; 3) theorists of EU governance motivate a new way of analyzing the conceptualization of state authority.

Comparing European Political Traditions to American Democracy

The purpose of the present study is not to choose between competing theories of European integration and the nature of the European Union. Instead, the ambition is to explain European states' common problems and common interests in developing European integration in European contexts. This study defines the process of European integration as the process of collective action among European states. Therefore, the main actors are individual European states. In this study, however, the concept of the state differs from that of liberal-intergovernmentalists'. Moravcsik writes that "the state is not an actor but a representative institution constantly subject to capture and recapture, construction and reconstruction by coalitions of social actors" (1997:518). More importantly, his concept of the state is based on the idea of political action that "is embedded in domestic and transnational society, understood as an aggregation of boundedly rational individuals with different tastes, social commitment, and resources endowments" (p.517). Therefore, he assumes that there is a society *prior* to politics and the state. Consequently, for him the primary actors in international politics are individuals and private groups. However, the present study rejects those theoretical assumptions of the state and politics.

The reason for rejecting the pluralist concept of the state and political action comes from the consideration of the European context. Within Europe the state has always played an important role in constructing society and there are strong political traditions of collectivism and social solidarity. In a word, the state has always been at the center of European political life. Fabbrini (1999) points to three features of European democracy that distinguish it from American democracy: 1) the role of the state in creating the market; 2) the permanent forms of group identity, based on economic categories and inclusive social classes; 3) constitutional oligarchy.

According to Lipset (1979), in America, the logic of self-regulating market was, from the beginning, considered as a 'natural' institution or a given. However, in Europe the market had to be

imposed by the power of the state and justified by the effort of the state to reduce its destructive effects on society. In his classic work, *the Great Transformation*, Polanyi argues that:

The road to the free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism. To make Adam Smith's "simple and natural liberty" compatible with the needs of a human society was a most complicated affair. Witness the complexity of the provisions in the innumerable enclosure laws; the amount of bureaucratic control involved in the administration of the New Poor Laws which for the first time since Queen Elizabeth's reign were effectively supervised by central authority..." (1944:140)

Gerschenkron (1962:363) also emphasized the role of state. In particular, he focuses on the prominent role of state-supported development banks as a source of rapid capital accumulation and industrial finance in late industrialized European states such as Germany and France during the 19th century. Gerschenkron analogizes the spurt of industrialization in those states to catching a bus that "comes at odd hours and can be missed." State intervention in creating the market also had to be accompanied by state's provision of social protection and welfare in order to obtain the 'appropriateness' of the market as a social institution (Marshall 1965; Esping-Anderson 1994). Bismarck's welfare statism is an historical example of this point, even though it is usually considered reactionary. The traditional European social market model of generous welfare and high taxes can be understood in this context, however, its development was not incompatible with economic efficiency. Rather, it was "a precondition for optimal economic performance" as it also forced industries to move forward higher value-added sectors instead of relying on low cost competition with the help of active labor market policies (Pontusson 1992; Esping-Anderson 1996 and 1999; Iverson and Wren 1998; Soskice 1999).

This argument regarding the role of European states in developing capitalist markets does not imply that, in America, the development of the market was guided by the neoclassical economists's notion of an 'invisible hand'. As previously discussed, the American state also played an active role in developing market institutions by increasing its regulatory authority. The point is, however that, unlike Europe, in America the market obtained its appropriateness as "the paramount source of individual freedom" by the beginning with a constitutional basis to resist the formation of a centralized state authority (Fabbrini 1999).

Second, in European pre-modern society, the identities of individuals and groups were formed on the base of socioeconomic categories and social classes with their medieval pluralistic tradition. The rise of modern European society and political modernization meant 'the legitimatization of the concentration of political authority and the breakdown of medieval pluralistic political order' (Huntington 1973:176). In the same vein, the development of the European nation-state fused the 'plebiscitarian' representation with the 'functional' (corporatist) representation (Bendix 1996). Bendix defines functional representation as the legacy of a medieval political structure based on the hierarchical order of estate and guild system, whereas plebiscitarian representation means a direct relationship between individuals and public authority.

The 18th and 19th centuries conflict and compromise between the state (the modernizing monarchs) and parliamentary powers (the medieval representative body), and between 'the society of individuals' and 'the society of groups' represented the political fusion of two different principles of representation. As Fabbrini notes, this political process generated another important difference between European and American democracy: "whereas Europe was laboriously seeking to bring the king into parliament, America decided to exclude its king (the president) from the parliament. Whereas Europe strove to unify power, America strove to divide it" (1999: 472). An important consequence of this difference is European statism and constitutional oligarchy vs. American anti-statism and constitutional liberalism.

Third, the European tradition of constitutional oligarchy refers a tendency toward the concentration of authority. Huntington explains this European tradition in terms of the rationalization of authority. According to his argument, Europe differed from America because in Europe, the rationalization of authority was compatible with the centralization of authority as “the state replaced fundamental law as the source of political authority, and within each state a single authority replaced the many that had previously existed” (Huntington 1973:174). In contrast, America had no traditional authority pattern to be replaced with the new constitutional authority, as a result, the rationalization of authority did not generated the centralization of authority in a single institution.

The State as a Public Authority and Political Community: A Weberian Perspective of the State

All of these distinctive features of European democracy characterized as statism, collectivism, and the centralization of authority shaped European political culture. The critical point is that these distinctive features of European democracy determined “the state’s capacity not only to forge a common identity able to sustain *a shared sense of the public good*, but also to provide its citizens with adequate system of defense, welfare, and economic regulation” (Bellamy 1999:190). As many political sociologists argue, the development of European states was the process of nation-building as ‘the imagined political community’ based on the idea of national citizenship and a sovereign national authority (Breuilly 1983; Flora et al. 1999; Anderson 1983).

Specifically, Bendix points out that “ the central fact of nation-building is the orderly exercise of a nationwide, public authority” (1996:22). For this point, he writes in detail as follows:

While governments vary greatly with regard to the subordination they demand and the rights they acknowledge, the term “political community” may be applied wherever the relations between rulers and ruled involve shared

understandings concerning this exchange and hence are based in some measure on agreement . . . Ultimately, it is a question of “good will” whether the laws and regulations of political authority are implemented effectively by the officials and sustained by public compliance and initiative . . . Any exercise of authority depends upon the willingness of officials and the public to respond positively to commands or rules (or at least not too negatively) (Bendix 1973:23-24)

With the distinction between government and political community, Bendix argues that the concept of political community can be defined in terms of a particular type of social relationship based on ‘the shared understanding of a legitimate order’ among the rulers and ruled. As he also notes, this concept of political community is based on Weber’s distinction between social action based on “a belief (*Vorstellung*) in the existence of a legitimate order” and social action determined by custom or self-interest (Weber 1947; 124).

In his work, *The Fundamental Concepts of Sociology*, Weber distinguishes two types of social relationships, that is, ‘communal’ and ‘associative’ social relationships. While communal social relationships can be defined by the orientation of social action based on a subjective feeling of ‘belong together, associative social relationships require the orientation of social action based on ‘a rationally motivated adjustment of interests.’ Of course, as Weber points out, most social relationships are hybrids of these two kind of social relationships. Furthermore, social relationships can be also distinguished in terms of their degree of openness and closure to outsiders.

A corporate group, therefore, is a group based on social relationships closed to outsiders. Weber defines the state as a corporate group to limit the admission of outsiders by rules. In this group, social actions are either ‘the action of the administrative staff’ with representative authority or ‘the action of the members as directed by the administrative staff’ (1947:146). More importantly, Weber

is concerned with a system of order to govern those corporate actions and he distinguishes two types of social order: administrative order (*Verwaltungsordnung*) and regulative order (*Regulierungsordnung*). Weber defines the state in terms of administrative order.

It possesses an *administrative and legal order* subject to change by legislation, to which the organized *corporate activity* of the administrative order claims binding authority, not only over the members of the state, the citizens, most of whom have obtained membership by birth, but also to a very large extent, over all action taking place in the area of its jurisdiction. It is thus a *compulsory association* with a territorial basis (Weber 1947:156).

Interestingly, Weber refers the theory of laissez faire as an example of regulative order and a regulative corporate group. At the same time, he relates the distinction between administrative order and regulative order to the distinction between public and private law. These distinctions give us an important insight for understanding the transformation of European states from administrative state to regulative state, as well as the nature of the European Union as a regulatory authority. In fact, there are some studies which conceptualize the European Union as a ‘regulatory polity’ even though they are not based on Weber’s theoretical distinction between administrative and regulative order (Majone 1996; Walby 1999; Moravsik 2002).

The argument advanced up to this point allows us to define the concept of the state as a political community based on ‘the shared understanding of a legitimate order’, organizational structure of public authority, and corporate social relationships. However, this conceptualization does not free us from unanswered and troubling questions. In particular, what is a legitimate order? What makes the state legitimate? How can a society reach an agreement of what is good for the society? Or, is it possible for a society to achieve consensus?

In his book, *Defending the National Interest*, Krasner defines the state as “a set of roles and institutions having peculiar drives, compulsions, and aims of their own that are separate from the interests of any particular societal groups” (1978:10). He does not reduce the state to individuals and groups, but conceives it in terms of ‘roles and institutions’. For him, the state is a public institution designed to serve a national community, not a mediator and coordinators for diverse and conflicting private interests. Thus, the utility of a national community depends on values “assigned by the state” (1978; 12). It is the state that decides state goals and values in the name of national interest.

Although the state defines what is good for the society, the state’s definition should be justified by a process of “collective deliberation about public values and the good life” rather than by “a process of aggregating prepolitical desires” (Sunstein 1991:4-14). Furthermore, the state’s definition of collective good needs to be legitimated and justified by the formation of collective identity as a shared understanding of a legitimate order. Therefore, state preference is formed in the subtle tension between its relative autonomy and political legitimacy.

The state is not neutral because “the outcome of state power also depends on the changing balance of forces engaged in political action both within and beyond” (Skocpol 1979; Jessop 1990:353). This does not, of course, imply a simple image of the ‘captured state’ by powerful social interests, such as business or labor. The state has its ‘infrastructural’ power to penetrate, control, supervise, police, and discipline its society (Mann 1983; Hall and Ikenberry 1989). At the same time, the state is a fundamental actor in international politics. The conceptualization of the state as an institutional actor is different from the realist concept of the state as a unitary actor in international relations. As a matter of fact, since Waltz’s structural realism, the realists have not taken the concept of state seriously, because they assume that states’ behaviors are determined by external structural factors. Different states are assumed to respond similarly to external stimuli in spite of their different abilities and the different natures of the interaction between the state and society in the domestic realm. Put simply, the realists neglect agency.

At the same time, neo-liberalists replaced the concept of the state with the interaction of societal actors on their purpose for identifying domestic sources of international relations. However, how can we capture the dynamics of domestic politics without taking the state seriously? The concept of the state as an institutional actor emphasizes “the relational nature of state power and states’ capacities to project their power into social realms well beyond their own institutional boundaries” (Jessop 2001:151). This also implies that we cannot make a clear distinction between the state and society in that “the state enters into the constitution of the society just as society contributes to the constitution of the state” (Caporaso and Levine 1992:192). Rather, we should consider the interaction between the state and societal actors, and the formation of policy network and governance structures through the interaction between the state and societal actors. Therefore, this perspective suggests the potential for overcoming the limits of statism.

In short, as Caporaso and Levine (1992) question Krasner’s theoretical assumption of national interest as *a priori* disregards the problem of legitimacy of state objectives assigned in the name of national interest, as well as the process of deliberation by which the state defines its goals and values for its national community. In other words, national interest per se should be explained rather than presumed. Up to this point, I have discussed the concept of the state in terms of a political community based on a shared understanding of a legitimate order, administrative and legal order to govern corporate social relationships, organizational structure of public authority, and national and public interest. All of these ideas reflect an important theoretical assumption that unlike the pluralist view of modern liberal democracy, the ‘rational deliberation of common good is possible’.

Pluralism, in the radical version, assumes that all values can be replaced by any other and, therefore, there is no supremacy of any particular value (Weinstock 1997). In contrast, the more moderate pluralists response that “we are faced with choices between ends equally ultimate, and claims equally absolute, the realization of some which must inevitably involve the sacrifice of others” (Berlin 1969:5). According to this version of moderate pluralism, making a choice among

equally ultimate values is a matter of commitment to one value over another, not a matter of reason. However, as Lukes (1991:20) claims, if we accept value pluralism, “for the state to impose any single solution on some of its critics is thus (not only from their standpoint) unreasonable.” Also, Crowder (1994:300) argues that “deep multiplicity of human values . . . in itself give us no reason to strive to accommodate, within a single society, as many of those values as possible.”

The problem is that as we should make a choice among various, sometimes conflicting values in our everyday life, the state also should decide something in everyday politics and impose its choice on the society. How can the paradox between value pluralism and the possibility of making choices and collective action in politics be solved? Some argue that politics inevitably distorts the freedom of personal values, so, the area of political choice by the state should be minimized by a constitution. This argument basically reflects the Hobbisan logic of ‘negative constitutionalism,’ focusing on defining what the state should not do. According to this view, constitutionalism is ‘a mean of opposing state power’ for the purpose of ‘the protection individuals and society against arbitrary exercising of power’ (Iverson 1999:85).

More importantly, the principle of the rule of law is considered as a ‘pre-political legal norm’ that transcends the political community. It should not therefore be the subject of political bargaining and compromise. The institutional justification of the rule of law can consequently be understood in terms of ‘functional efficiency’ to guide the interaction among individuals. That is, the rule of law can be justified by the provision of incentives and benefits that individuals can get when they obey certain actions specified by the law, and by the institutionalization of legal punishment that individuals should bear when they disobey (Iverson 1999).

But what pluralists do not really consider is ‘the dimension of political’ (Mouffe 1996: 247; Bellamy 1999). Unlike the pluralist notion of negative constitutionalism, the supporters of positive constitutionalism emphasize the ‘political’ nature of constitutionalism. What is the political? Mouffe argues that:

Relations of power and antagonisms are erased, and we are left with the typical liberal illusion of a pluralism without antagonism . . . because of its refusal of any attempt to construct a “we”, a collective identity that would articulate the demands found in different struggles against subordination, partakes of the liberal evasion of the political (Mouffe 1996: 247)

That is, the concept of the political is about ‘relations of power and antagonisms’ and ‘the construction of collective identity.’ On the other hand, Weber clearly relates the concept of the political to the concept of the state.

Thus there is the “political” official, the “political” newspaper, the “political” revolution, the “political club”, the “political” party, and the “political consequences of an action, as distinguished from others such as the economic, cultural, or religious aspect of the person, affairs or process in question. In this usage we generally mean by “political” things that have to do with relations of authority within what is, in the present terminology, a political organization, the state (Weber 1978:55).

Following these argument over the concept of the political, the constitution is ‘a system of politics’, where the state exercises its authority in the enforcement of its order and ‘politically oriented’ social actions are organized for ‘exerting influence on the government of a political organization; especially at the appropriation, expropriation, redistribution or allocation of the power of government’ (Weber 1978; 54; Bellamy 1996; Ivison 1999).

Aggregation, Deliberation, and Delegation: Three Models of Collective Decision-Making

Two different notions of politics represented by negative constitutionalism and positive constitutionalism also influence different ideas of how states make decisions. There are two ideal types of collective decision making in democratic societies: aggregation and deliberation. Social choice theorists and deliberative democracy theorists have long debated the mechanism of collective decision making in democracies. For social choice theorists, as Lewin argues, “collective concepts such as ‘the public interest’, ‘the common good’, ‘the will of the people’, and the national interest’ could only be determined through aggregating the preferences of the separate individuals” (1991:7). Consequently, for them, the most important issue is to consider how to aggregate effectively.

However, as Condorcet’s paradox of cyclical majorities and Arrow’s theorem of intransitive social orderings imply, there is no method to guarantee that the aggregation of individual preferences may create a coherent group preference. In other words, no guaranteed means of transferring individual rationality into collective rationality (Shepsle and Bonchek 1997). Riker (1980; 443) argues therefore that “disequilibrium is the characteristic feature of politics”, as there is no decisive winner in collective decision making under the majority rule. When we define the concept of equilibrium as an outcome of a game that is stable, in the sense that no single player wants to deviate from an equilibrium point, Riker’s point is that in political games, we cannot achieve such stable outcomes since there is always the manipulability of majority rule outcomes (1982). More important, according to Riker (1982), this very nature of politics makes election and the populist idea of democracy ‘meaningless’, rather, it forges a liberal idea of democracy such as the Sumpheterian view to reject the substantial meaning of election as the expression of collective will.

Deliberative democratic theorists assume that

What is best for society is not the sum of individual interests. It can only be understood if each and every person, without allowing himself to be distracted

by private advantage or the particular interests of others, quietly thinks out what is best for the community as a whole (Lewin 1991:15-16).

Complex modern democratic societies since the Second World War face the task of securing three public goods. These are legitimacy, economic welfare, and a viable sense of collective identity. There are “goods” in the sense that their attainment is considered worthy and desirable by most members of such societies; furthermore, not attaining one or a combination thereof would cause problems in the functioning of these societies such as to throw them into crisis (Benhabib 1996:67)

For the advocates of deliberative democracy, the best way to avoid the disequilibrium of politics, that is, instability, is to induce a shared understanding and common view of what is the best for all. Put otherwise, the idea of deliberative democracy can be interpreted in terms of the ‘homogeneity of preferences’. If individual preferences are homogeneous, then the likelihood of the paradox of voting, as mentioned by social choice theorists, will be reduced.

However, as Knight and Johnson (1994) point out, a shared understanding of political situations does not mean necessarily consensus regarding what should be chosen, or the formation of homogeneous preferences. Rather, the process of deliberation is a process ‘to reduce choice ranges over only one dimension’ in order to avoid cycling majorities and to create single-peaked preferences. Basically, this idea is influenced by Black’s (1958) median voter theorem to argue that if individuals in a group have single-picked preference, in other words, unidimensional preferences, then the paradox will be avoided. Deliberation can be considered as the process of the formation of single-picked preferences in a political community. According to deliberative theorists, it is a shared

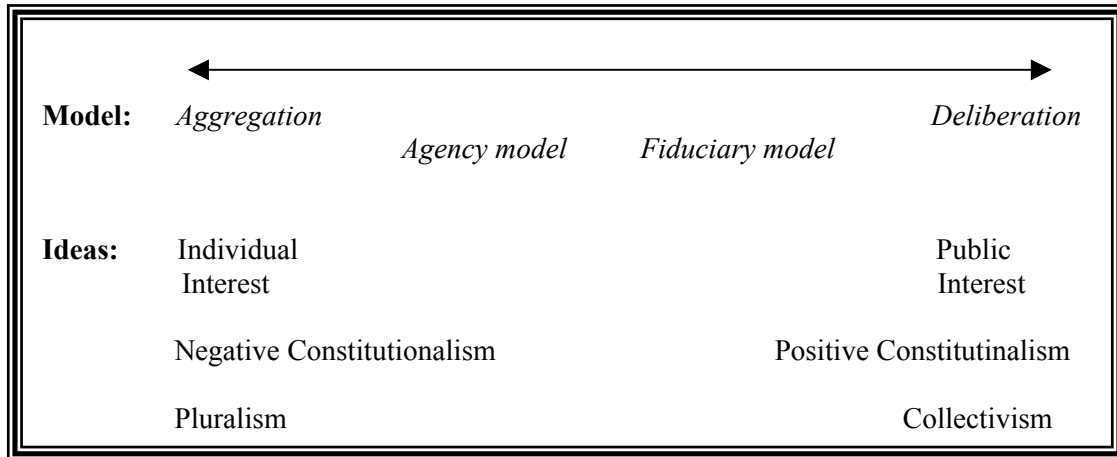
understanding of collective goods that generates single-picked preferences. Also it means the process of creating the genius 'public' beyond aggregated individuals.

Between aggregation and deliberation, there is another mechanism of collective decision-making, the 'delegation', a non-majoritarian mechanism. If the logic of aggregation is a direct representation of the majority will be based on the idea of individual rights and autonomy, then the logic of deliberation is based on the formation of collective identity through the process of mutual understandings, collective identification. The logic of delegation differs from these two mechanisms of collective decision-making in that it is a kind of mixed mechanism between aggregation and deliberation. Delegation pursues deliberative collective decision-making, but it is organized to a very small group of policy experts achieved by transferring the authority of policy-making from elected politicians to a non-elected technocracy. Delegation, however, preserve the value of aggregation (voting) in decision-making because it is elected politicians who originally delegated their authority.

Delegation is effective in achieving two goals: 'to reduce decision-making costs' and 'to enhance the credibility of policy commitment' (Majone 2001b). If the main purpose of delegation is to reduce decision-making costs, the agency should not be independent from the control of the principal. That is, deviations in preference between the agency and the principal should be decreased as much as possible. In this case, therefore the value of aggregation as a direct representation of the majority is more likely to be preserved. However, if the purpose of delegation is to obtain policy credibility and commitment, then deviation in preferences between the agency and the principal can be legitimated in the name of public good. In a sense, this type of delegation is based on the principle of deliberation to assume the idea of a shared understanding and common view of what is the best for all. Figure 2-1 summarizes these arguments of different models of collective-decision making.

Majone (2001b) argues that there are two purposes of delegation, the reduction of decision-making costs and policy credibility and commitment, to generate two models of delegation, agency

Figure 2-1 Models of Collective Decision-Making



model and fiduciary model, claiming that standard agency theory cannot provide satisfactory explanations of fiduciary model. He distinguishes two models of delegation as follows:

In the first model [agency model] of delegation implies that the preferences of the principal and the agent should be aligned as much as possible, and the delegation structured so as to minimize bureaucratic drift and slippage. However, an agent who simply carries out the principal's directives cannot enhance the latter's credibility. Hence the second type of delegation [fiduciary model] implies that the delegate should be independent . . . The highest level of independence is where the principals irrevocably transfer their own political property rights in a given area to a separate institution (Majone 2001b:104)

According to Majone, The conventional agency model does not distinguish situations in which public authority is fully transferred to the delegate, the delegate subsequently become a 'trustee', not simply an agent. For instance, when a central bank whose preferences differ from the government's has a right to choose anti-inflationary policies, we can call it a trustee. The critical difference

between the agency model and the fiduciary model is the degree of independence of the delegate. Essentially, the independence of the delegate is about the control of public authority.

In his insightful work on political institutions, Moe (1990) argues that politics is ‘the struggle to gain control over public authority’. The nature of public authority is that “whoever gets to exercise it has the right to tell everyone else what to do, whether they want to do it or not” (1990: 221). The problem is, however, that in a democratic political system nobody can hold well-defined and perpetual rights of public authority to be acknowledged by all parties. Consequently, everybody has a common interest keeping public agencies neutral or minimal in political uncertainty concerning the control of public authority:

There are various ways of doing this, the most direct way is for today’s authorities to specify, in excruciating detail, precisely what the agency is to do and how it is to do it, leaving as little as possible to the discretionary judgement of bureaucrats ---- and thus as little as possible for future authorities to exercise control over, short of passing new legislation (Moe 1990:228).

All efforts to insulate public agencies from the future’s public authority, however, undermine the effectiveness of public agencies. In the absence of their autonomy, they are always forced to stay with the status quo. As Bergman, Muller and Strom (2000) point out, modern democratic political systems are ‘the chain of delegated power’. In democratic political systems, constituents delegate their public authority to legislators. In turn, legislators delegate their delegated public authority to bureaucrats. However, the agency model of delegation assumes that there always exists fundamental trade-off between control of public authority and the effectiveness of public agencies, in other words, ‘the trade-off between control and expertise’ (Bendor, Glazer and Hammond 2001).

Today's majority of constituents will try to institutionalize discretionary judgement of legislators at the minimum level in order to prevent them from using by future's majority who has difference preferences and may impose what they do not want. As a result, they cannot expect effective legislators. By the same logic, today's legislators will also try to insulate bureaucrats from future legislators. An important implication of this argument is that, unlike the conventional logic of delegation theory based on the ideas of effectiveness and the reduction of decision-making costs, the delegation of public authority can be ineffective by the nature of public authority, in other words, the very nature of politics in which there are not well-defined political property rights.

The fiduciary model can be characterized by the autonomy of public agencies. According to the model, if the public agencies have the same preferences, then delegation would not be effective because public authority would have no motivation to control its agent. Rather, the public authority prefers its agency to be independent as much as possible and there is no trade-off between control and expertise. In the chain of delegation, constituents, legislators, and bureaucrats, all of them know what is the best policy for everyone. The problem is that they cannot guarantee their commitment to the best policy because in the short-term, the best policy may be suboptimal for some of them. The achievement of the policy depends on the credibility of the policy. The solution to this problem is to find someone with a strong commitment to achieving the policy and to delegate authority voluntarily to him. It is a kind of self-biding.

Of particular importance is the fact that the fiduciary model of delegation incorporates an assumption that there is a shared public interest. If we borrow economists' terms, it assumes an objective social welfare function that is independent from societal interests. Based on such an assumption, this model of delegation is more likely to be found in the condition that there is a political tradition of collectivism as noted earlier.

In the first part of this section, I asked an important question: Why did European states voluntarily delegate their national sovereignty to a supranational institution? The fiduciary model of

delegation can provide some insight to relevant to this question. That is, we can understand the relationship between European states and the European Union in terms of the fiduciary relations. It is crucial to remember that the fiduciary model of delegation cannot be understood without the notion of public interest and the state as a collectivity. At the same time, as Figure 2-1 represents, the model represents a modification of the deliberation model of collective decision-making, as it does not concerned about how to legitimate the state's definition of public interest.

EUROPEAN SUCCESS VS. ASIAN FAILURE? : ASIAN REGIONALISM AND THE COMPARATIVE RESEARCH OF REGIONALISM

Two Fallacies in the Study of European Integration: Between European Exceptionalism and European Universalism

The study of regionalism has been long considered by the students of comparative politics as the study of European integration. Until recent, there have been few studies that analyze European regionalism from a comparative perspective. For many scholars of European integration, explaining why the European Union is as it is and how got it that way became an old issue. Rather, they want to focus on how the European Union works as a political system (Hix 1999). At the same time, they consider European integration as a unique phenomenon without any comparable case (Wallace 1994). Consequently, their research interests are caught in the cage of 'European exceptionalism' and, since the 1980's there has been few theoretical efforts to put Europe's experience into a more generalized context of the rise of regionalism across different regions. However, a traditional research question that comparativists should be interested is to explain why one differs from another.

Unlike comparativists, who have focused exclusively on European regionalism, IR theorists have showed a much broader scope, and a greater sensitivity to deviations in the institutionalization of regionalism across different regions (Mansfield and Milner 1997; Grieco 1997; Gilpin 2001; Katzenstein et al. 2000; Frankel 1998). For some of them, the study of regionalism has been closely related to the study of international political economy, particularly, globalization and economic liberalization of trade, investment, and finance. For others, regionalism is considered a part of the study of international institutions across various theoretical perspectives. The problem is that most literature of regionalism developed from theories of IR and international political economy has been

dominated by a particular theoretical tendency. Differences between institutional arrangements of regional cooperation are considered to represent as different stages in the evolution of regional cooperation, rather than different paths toward the same goal. In this perspective, the evolution of European integration considered as a universal trajectory for other states to follow. That is, the European Union represents the future of other regionalism.

Moravcsik's liberal-intergovernmentalism represents a revised version of European universalism. His theoretical ambition is to generalize the European experience through the analytical lens of a liberal theory of international cooperation. He rejects any efforts to theorize European integration in terms of European exceptionalism, writing,

All such explanations treat the EC as unique, an exception in world politics that requires a *sui generis* theory. This assumption led the study of regional integration to develop over the past forty years as a discipline apart, one divorced from general studies of international cooperation. The paradoxical result: today no claim appears more radical than the claim that the behavior of EC member governments is *normal*. The revisionist quality of the argument in this book lies precisely in its effort to normalize the actions of European governments ----- to treat them as a subset of general tendencies among democratic states in modern world politics. Government cooperated when induced or constrained to do so by economic self-interest, relative power, and strategically imposed commitments (1998:4-5).

He is absolutely right in arguing that European states' action is normal and should be explained in the light of a general theory of regional integration. However, European states' action is *not general* even if it is normal. That is, the outcome of European states' action is very distinctive in the history of modern world politics. So, our concern should be to explain why a normal action generates such

a distinctive outcome. Unfortunately, Moraviscik does not pay his attention to possible variations in the institutional outcome of states' action in international politics. Unintentionally, this tendency leads us into a theoretical fallacy, disregarding the point that what we should generalize is the underlying logic of European states' action, not the distinctive outcome of European states' action. For instance, in his study of how the European Union implements national adjustment to the EU rules and manages the EU compliance system, Tallberg (2002:637) argues that the EU, as an effective compliance system, is 'the product of a complex historical process of institutional development' and not replicable, since most states are not ready to delegate their national authority to a suprainstitution international cooperation.

Three Approaches in the Comparative Study of Regionalism: Explaining Different Institutional Outcomes of Regionalism

The present study provides a different perspective of the comparative study of regionalism, contrasting European regionalism and Asian regionalism in terms of their distinctive institutional outcomes. From a comparative view, regionalism in Europe and Asia has been realized in distinct institutional arrangements (Lawrence 1995; Grieco 1997; Mattli 1999; Katzenstein 1997; Haggard 1997; Yarbrough and Yarbrough 1992). For instance, the European Union represents a strong institutionalized form of regional cooperation that can be characterized by much stronger 'delegated' power and authority for policy coordination among member states. In contrast, APEC (Asia-Pacific Economic Cooperation) is a type of international forum designed to facilitate the information exchange and to encourage a sense of community among Asian states. It does not have any delegated power or policy coordination authority from member states. Thus, many studies claim that Asian regionalism shows a relatively weak institutionalization. Table 3-1 summarizes important differences between the EU and APEC in terms of institutional features.

Table 3-1 The Comparison between the EU and APEC

EU (1992)	APEC (1989)
<ul style="list-style-type: none"> • Pooling of national sovereignty • Formal institution based on treaty • Ratification process • Engagement with civil society • Active supranational institutions (the European Commission and the European Parliament, the European Court) • Closed regionalism (reciprocity) • Monetary coordination 	<ul style="list-style-type: none"> • Preserving of national autonomy • Informal institution without legal-binding mechanism • Voluntarism and consensus formation • No engagement with civil society • Weak APEC secretariat • Open regionalism (unilateralism) • No monetary coordination
<p>Member states: France, Italy, Germany, Belgium, Luxembourg, Netherlands, UK (1973), Ireland (1973), Denmark (1973), Greece (1982), Portugal (1986), Spain (1986), Sweden (1995), Finland (1995), Austria (1995)</p>	<p>Member states: Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru (1997), Philippines, Russia (1997), Singapore, Taiwan, United States, Vietnam (1997)</p>

How can we explain this difference between European regionalism and Asian regionalism in terms of states' normal actions and the institutionalization of regionalism, as Moravcsik emphasizes? To answer this question is also to answer the question: why have European states gone so far? Making sense of European regionalism is not simply a matter of making sense of Europe. It demands a comparative understanding of different paths of regionalism undertaken in different regions. What we assume by the idea, 'different paths of regionalism' is that the path of European integration is not 'universal' and 'replicable'. At the same time, however, this does not mean that European experience cannot be explained in the light of a more generalized theory of regionalism.

This study provides an alternative theoretical framework for a comparative study of regionalism. It is a context-bounded rationality approach. This approach understands the difference between European regionalism and Asian regionalism as different 'types' of institutionalization rather than different 'degree' of institutionalization of regionalism in different regions. A particular type of institutionalization of regional cooperation depends on different situations where regional states should make their choices concerning how to institutionalize their collective action. Essentially, the

choice of regional institutions depends on members' perception of national autonomy of governing national economy. Then the concept of situation can be defined in terms of the relations between the state and the society and the autonomy and capacity of the state in governing its national economy. More importantly, these are determined by the different historical trajectories of regional development of capitalist economies after the World War II.

First of all, we need to distinguish two different questions: 1) why do states cooperate on the basis of 'geographical proximity'; 2) why do states choose different regional institutions in different regions? While the former question is about the determinants of motivating state's actions in regional cooperation, the latter explains the particular institutional outcome in each different region. While the present literature of comparative study of regionalism which tends focus on separately explaining these different questions without considering both within the same analytical framework, the present study pursues a unified explanation capable of explaining both of these questions in a consistent manner.

The present study classifies the comparative literature of regionalism into three different approaches: 1) identity-based explanation; 2) interest-based explanation; 3) situation-based explanation. This classification contributes to the theoretical task understanding the logic of states' choices and collective action among states in regional cooperation. Identity, interest, and situation represent three dominant logics of collective action. The first two approaches, in fact, assume the self-evident idea that commonalties facilitate collective action. That is, there are two types of bonds which motivate collective action among individual actors: 'cultural and associational' (Florini 2000: 19). While the cultural bond is based on shared cultural sources, such as language, religion, history, and social norms and practices, the association bond assumes shared interests and goals. An identity-based approach tends to emphasize the former, whereas interest-based approaches prefer the latter when explaining collective action. When this kind of a general idea of collective action is applied to the study of regionalism, the existence of common regional identities or common

interests becomes the most important factor in explaining collective action among states across different regions. However, we should reconsider two dominant explanations seriously with the following questions:

Q1. What is a regional identity and does it really exist as the precondition of collective action among states in Europe and Asia?

Q2. What define common interests among states in a given region? Why do states interpret their interest differently in a common situation of economic interdependence?

Q3. Can we say that Europe is more homogeneous than Asian states in terms of identity and interest? If the answer is yes, is there any optima level of homogeneity to determine different institutional outcomes of regionalism?

In this section, I criticize the first two approaches, identity-based and interest-based explanations, providing empirical evidence. As an alternative to these two approaches, a situation-based approach, more concerned with inter-subjective reality where collective action happens. In this approach, collective action always lies in the constrain of time and place and of the relationship to other actors' action. This situational constrain shapes actors' interest and identity.

Cultural Homogeneity and Regional Identity: The Myth of a European Identity and the Invention of an Asian Identity

The Myth of a European Identity

Identity-based explanations of comparative regionalism interpret the concept of regional proximity in terms of common cultural foundations and collective identity among regional states as the pre-condition of successful regional integration. In this approach, the concept of culture is considered as the basis on which construct reality, identity, action, and order. In this view, the formation of collective identity is a 'cultural' phenomenon. The concept of collective identity is frequently related to the concept of homogeneity. In fact, for many theorists of collective action,

homogeneity among actors is an important factor reducing collective action problems. That is, the existence of collective identity forges homogeneity and therefore increases the likelihood of the success of collective action. A collective identity increases the altruism of group members, based on in-group favoritism and out-group-discrimination, while simultaneously decreasing the temptation of defection (Kramer and Brewer 1986; Rapport et al 1989).

There is a pervasive view that European states are more homogeneous than Asian states in terms of historical and cultural consciousness, collective memories and collective self-identification. For instance, Hallstein argues that European integration was the process of “a rediscovery of shared historical memories, culture, social values never forgotten for a thousand years” (1992:15-16). In fact, the Maastrich Treaty of 1992 introduced a new cultural article, Article 128, which specifies the role of the EU in the ‘conservation and safeguarding of Europe’s common cultural heritage’ and declares that ‘the Commission shall take cultural aspects into account in its actions under other provisions of the Treaty’ (OOPEC 1992; 13). In addition, the EU introduced ‘A Chart of European Identity’ inspired by the speech made by the President of the Czech Republic to the European Parliament in Strasbourg on March 8th, 1994. According to this Chart, ‘Europe is a community of value’:

The aim of European unification is to realize, test, develop and safeguard these values. They are rooted in common legal principles acknowledging the freedom of the individual and social responsibility. Fundamental European values are based on tolerance humanity and fraternity. Building on its historical roots in classical antiquity and Christianity, Europe further developed these values during the course of the Renaissance, the Humanist movement, and the Enlightenment, which led in turn to the development of democracy, the recognition of fundamental and human rights and the rule of law. The great currents of culture and art, scientific discoveries and their

application for the general good, and the critical analysis of accepted views and perceptions have all had the effect that we can now live and work together in peace, liberty and free from want. Europe has spread these values throughout the world. Thus our Continent became the mother of revolutions in the modern world.

All of these facts seem to imply that European regionalism is motivated by the idea of Europe as a bounded and historically unified entity. However, many European scholars claim that “what the EU conspicuously lack is a common culture around which Europeans can unite”(Hoffman 1993; Smith 1992; Shore 2000:18). More important, they argue that a European collective identity is not a presumption of European integration but rather the product of European integration. Delanty also criticizes the view of Europe as a ‘bounded and historically unified entity’ as “the illusion of cultural essentialism” and ‘the politics of exclusion based on an adversarial dichotomy of Self and Other’(1998:33). Further, he is pessimistic of the possibility of the creation of a European identity through the political project of European integration because in the European context of multicultural society where there is no common enemy to distinguish ‘us’ from ‘other’, he comments, “culture has decomposed into a plurality of identity politics” and culture does not function as “a unified or homogeneous model” to legitimate the present political system (1998:32).

As Hobsbawm wrote, European identity is ‘conditional’ in that it will be effective only under conditions where the European Union can provide something valuable to its member states (1997:271). European identity is also ‘negative’ since it aims at the defense of ‘Fortress of Europe’ against rival political economic blocs, the hegemony of the United States and the wave of immigrants from the East and the Balkans. For Hobsbawm, Europe will remain heterogeneous and a good example of this is ‘language’. There are eleven separate languages among the fifteenth

member states of the European Union. Furthermore, the vision of a united Europe is 'incomplete' because it does not include all twenty-four geographically European countries.

It is true that 'A Chart of European Identity' shows, the concept of Europe in the process of European integration has been defined as the Western-Christian culture, distinguishing it from the Muslim and Orthodox European people (Huntington 1993; Delanty 1998; Fuchs and Klingmann 2002). While the European Community did not confront the issue of its cultural borderline during the period of the West-East conflict, the present European Union needs to clarify its definition of European identity and cultural border with the issue of European enlargement.

Table 3-2 shows the overview of historical heritage, religion and political values in Western, Central, and Eastern European countries. As we see, there exists a clear cultural borderline between the Western European states, on the one hand, and the Central and Eastern European states, on the other hand. If we define the concept of Europe as Western, Protestant, and rich European states, then the project of European enlargement is problematic. In fact, since Hungary applied for EU membership in 1994 and the Czech republic in 1996, ten Central and East European states plus Cyprus, Malta and Turkey have negotiated with the EU concerning their EU membership. It is possible that Hungary, Poland, the Czech Republic, Estonia, Slovenia, and Cyprus will join the EU by 2005 as their economic and political transitions are advanced (Nugent 1999). Their join will add to the cultural heterogeneity of the European Union. As a result, it will be more difficult for the EU to define its cultural borderline between East-West Europe.

Moreover, if the EU enlarges continuously, then a European identity cannot be considered from a perspective of common cultural foundations. As Schmidtke (1998) argues, it is not useful to develop a European collective identity in the 'traditional pattern' to assume a communicative community of conventions and commonsense based on a common language as well as the 'primordial pattern' based on an exclusive culture and indigenous community members along ethnic lines.

Table 3-2 The Heterogeneity in Cultural Heritage and Political Value in Western, Central, and Eastern European Countries

	Historical Heritage	Religion	Political Culture(%)		Political Support(%)		Political Process(%)	
			DEM	AUT	PSC	CGI	VIO	LAW
Western Europe								
Norway	Sweden	Protestant	93	3	67	67	91	97
Sweden	None	Protestant	93	5	27	39	88	93
Finland	Russian	Protestant	75	10	34	23	91	94
Germany (West)	Prussia	Protestant	93	1	40	20	85	88
Spain	Spain	Catholic	92	8	31	25	76	97
Central Europe								
Germany (East)	Prussia	Protestant	91	2	38	12	85	90
Czech Republic	Habsburg	Catholic	88	4	33	18	80	86
Slovakia	Habsburg	Catholic	88	4	36	30	73	82
Hungary	Habsburg	Catholic	83	5	32	30	80	89
Slovenia	Habsburg	Catholic	82	6	28	24	70	85
Croatia	Habsburg	Catholic	95	13	45	38	87	74
Baltic Europe								
Estonia	Russia	Orthodox Muslim Protestant	84	6	30	36	83	91
Latvia	Russia	Catholic	79	8	24	19	83	83
Lithuania	Russia		87	15	29	23	76	90
South-Eastern Europe								
Yugoslavia	Ottoman	Orthodox	88	10	24	29	74	92
Romania	Ottoman	Orthodox	89	22	11	16	77	94
Bosnia	Ottoman	Orthodox	80	19	32	57	72	97
Eastern-Europe								
Russia	Russia	Orthodox	51	20	7	16	82	85
Ukraine	Russia	Orthodox	75	17	13	29	78	81
Belarus	Russia	Orthodox	75	17	12	26	83	80

Source: Dieter Fuchs and Hans-Dieter Klingmann (2002), "Eastward Enlargement of the European Union and the Identity of Europe" *West European Politics*: 16(18): 19-54.

Note 1: The data for religion are generated by the World Values Survey 1995-1999.

2: DEM= Support of democratic rule; AUT= Support of autocratic rule; PSC= Support of political system of one's own country; CGI= Confidence in government institutions; VIO= Illegitimacy of violence; LAW= Law abidingness.

In fact, the idea of a European collective identity was invented by 'the supranational vision and sense of federal mission' among European entrepreneurs such as Jean Monnet and Jacques Delors and through the cultural project of European Commission (Shore 2000). In a similar vein, Leicester

(1996) argues that the presumption of European collective identity is based on a 'myth of the future' a federal Europe rather than are rooted in inherited common cultural foundations. This myth of the future is, however, challenged by two problems: the democratic legitimacy of the European Union and European enlargement. The former problem has mostly been caused by the creation of dual identities of national and European among citizens of member states. The latter reflects a deeper conflict, the question of What is Europe and Who is Europe? These two problems run in tandem, as "the greater the differences are between countries, the lower is the potential for a European identity on which a European demos can be based" (Fuchs and Klingemann 2002:52).

Asian Regionalism and Cultural Heterogeneity: Does Common Culture Guarantee Common Identity?

When the Malaysian Prime Minister, Mahathir proposed that the 'East Asian Economic Group' (EAEG) excluding non-Asian states a decade ago, most Asian states did not support his proposal. Instead, Asian states chose APEC, a forum of twenty-one countries, including non-Asian states such as Canada, Australia, New Zealand, Mexico, Chile, Peru, Russian, and U.S. After the Asian financial crisis of 1997, however, 'ASEAN (the Association of Southeast Asian Nations) Plus Three' (APT), which in fact, may be considered as the revised version of EAEG failed a decade ago, now is recognized as the future of Asian regionalism with the relative decline of APEC (Ravenhill 2000; Webber 2001a; Alatas 2001). Therefore, Bergersten (2000) notes that this change means Asian states to start taking the European model of regionalism seriously, consequently, the global system will be the 'tripartite' world of East Asia, Europe, and America.

The rise of APT leads us into an interesting question concerning the formation of Asian identity and the possibility of the evolutionary development of Asian regionalism replicating the path of European integration. What caused the rise of APT and the relative decline of APEC, and is it possible for Asian states to reproduce the historical process of European integration? These

questions are important for our understanding of the essential features of Asian regionalism and the logic of collective action among Asian states.

Unlike the case of European regionalism, Asian regionalism has not been understood in terms of an historical and cultural common heritage and a shared self-identification in most literature of comparative regionalism. Rather, Asian regionalism has been exclusively discussed in terms of geopolitical or economic interests. This is one of the most significant differences between European regionalism and Asian regionalism. Of course, this tendency does not imply that Asian states have no 'shared historical memories, culture, social values' comparable to that which European states have tried to rediscover through the process of European integration. However, Asian states do not have their own Monnet and Delors and their own vision of a united Asia (Mjoset et al. 1999). Rather, as many studies argue, Asian states have feared of going far as much as European states did.

Some deny the fact per se that Asian states have shared historical memories, culture, and social values. That is, they emphasize that there is a lack of common cultural foundations for creating a regional collective identity among Asian states as Asian states are relatively heterogeneous in terms of religion, language, ethnicity, and political system, and that this fact explains the weak institutionalization of Asian regionalism (Rostow 1986; Kahler 1988). Huntington's (1993) following argument represents this general view:

On the other hand, economic regionalism may succeed only when it is rooted in a common civilization. The European Community rests on the shared foundation of European culture and Western Christianity. The success of the North American Free Trade Area depends on the convergence now underway of Mexican, Canadian and American culture. Japan, in contrast, faces difficulties in creating a comparable economic entity in East Asia because Japan is a society and civilization unique to itself. However, strong the trade and investment links Japan may develop with other East Asian countries, its

cultural differences with those countries inhibit and perhaps preclude its promoting regional economic integration like that in Europe and North America.

As previously discussed, European identity is a myth of the future, not the reflection of common cultural heritage and homogeneity and a cultural project developed hard by European entrepreneurs and the European Commission. European identity should not be considered as an independent variable for explaining the distinctive feature of European regionalism, but rather the dependent variable to be influenced by the process of integration per se. The present study does not argue whether Asian states are more heterogeneous than European states in terms of their cultural foundations and collective identity or not. As Huntington argues, common culture can facilitate collective action concerning regional economic cooperation among states. But, it does not have a determinant effect on collective action among states.

It is very interesting to remind the fact that Southeast Asian states (Indonesia, Malaysia, Philippines, Singapore and Thailand), who are more heterogeneous than Northeast Asian states in cultural-religious foundations, have cooperated through ASEAN, a sub-regional arrangement based on the principle of 'collective self-reliance' since 1967 (Crone 1983; Webber 2001a). In contrast, Northeast Asian states (China, Hong Kong, Japan, Korea, and Taiwan), which are relatively homogeneous, have not developed any sub-regional arrangement. As Friedberg (2000:153) considers, "ASEAN's success to date owes less to the common culture of its members, and more to their convergent interests and comparatively limited, and roughly equal, strength". More important is the fact that we cannot specify the optimal level of cultural homogeneity as substantial source of collective identity to determine the success of collective action concerning regional cooperation and the specific institutional outcome of collective action among states. As we can see from European experience, common culture does not guarantee common regional identity

Collective Identity and Collective Action

In his discussion of collective identity and collective action, Wendt (1994) very succinctly defines the relationship between collective identity and collective action, introducing the idea of ‘the continuum of identification’. According to Wendt, the success of collective action depends on ‘the extent to which and manner in which social identities involve an *identification* with the fate of the other’ (1994:386). The extent and manner of identification can be located on a continuum between positive or solidaristic and negative or egoistic extreme. Collective identity is more likely to be formed successfully in the situation of positive and solidaristic identification. However, what we should note is that the process of collective identification itself is a collective action. From this perspective, collective action determines collective identity rather than collective identity determining collective action. Thus, collective identity is not exogenous to collective action.

Wendt’s argument provides some insight concerning Asian regionalism and regional identity. Many studies have tried to explain why Asian states hesitate to bind themselves to a regional institution like the European Union. Some studies emphasize structural constraints, such as power positions of Asian states in international politics and the historical legacy of powerful states’ geopolitical policy after World War II. Berger (1999) argues that all pan-Asian initiatives are constrained by US hegemony in the Asia-Pacific region. Hemmer and Katzenstein (2002) also point out the path-dependent effect of U.S.’s post 1945 Asian security policy based on bilateralism unlike its European security policy based on multilateralism.

That is, the bilateralism of the Asian alliance security arrangement has negatively influenced the formation of an Asian collective identity, whereas the European multilateralism of the European collective security arrangement has encouraged European collective identity. Crone hypothesizes a similar argument that there is “an optimum power stratification” among regional states for a more institutionalized regionalism (1993:525). These arguments suggest that a regional collective identity

can be politically mobilized or discouraged through power politics among states, a reminder of neorealists' hegemony stability theory of international cooperation theorized by Robert Gilpin and Stephan Krasner. However, if we apply Wendt's idea to the situation of Asian regionalism, we can say that Asian states have been in the absence of positive identification mostly influenced from international social structure in which it is not possible to see the other states as 'the cognitive extension of the self'. As a result, Asian states define their identity and interest in egoistic and individualistic terms. This point provides some explanation of why Asian states hesitate to bind themselves to a regional institution.

The rise of APT as an alternative for Asian regionalism after the Asian financial crisis shows the dynamics of Asian regionalism. According to Webber (2001a), the move toward closer East Asian cooperation was first encouraged by the creation of ASEM (Asia-Europe Meeting) in 1999. While the EU states were interested in access to Asian markets, Asian states saw economic cooperation with EU states as an opportunity to 'build up their own Asian identity' as Japanese finance minister Miyazawa claimed (*Financial Times* 2001). However, the most crucial factors explaining the rise of APT are Asian states' increased common perception of economic interdependence, and shared resentment of the destructive effect of an international financial market under U.S hegemony on Asian national economies (Higgott 1998a; Bergsten 2000; Wade 2000; Webber 2001a).

Asia states were frustrated by the fact that the virtues of Asian capitalism praised as the 'Asian miracle' were entirely denied in the discourse of the failure of Asian model distributed by the World Bank and IMF. Moreover, Asian states were not certain of the goodness of the neo-liberal orthodox prescriptions of the IMF, suspecting it as 'the dismantlement of the institutional foundations of the East Asian model of development' serving the interests of the international financial business group (Higgott 1998b; Wade and Veneroso 1998; Medley 2000:383). This frustration and distrust seen since the crisis drove Asian states toward resentment of the U.S and its influence.. The former US Secretary of States, Henry Kissinger captured Asian resentment against the U.S very perceptively:

It is critical that at the end of this crisis, when Asia will reemerge as a dynamic part of the world, America be perceived as a friend that gave constructive advice and assistance in the common interest, not as a bully determined to impose bitter social and economic medicine to serve largely American interests (Kissinger 1998)

Despite their shared frustration and resentment, it is not certain that Asian states can construct 'the cognitive extension of the self' among themselves. Wendt (1994) stresses three types of mechanism of collective identity formation among states: structural contexts, systemic processes, and strategic practices. First, structural contexts mean inter-subjective structures in terms of "shared understanding, expectation, and social knowledge embedded in international institutions and threat complexes" (Wendt 1994:389). These structural contexts determine the nature of interaction among states. Second, on the contrary, systemic processes refer the external and objective contexts which constrain states' actions such as economic interdependence, dependency, the existence of common enemy, convergence among states in economic and political values and policy in their domestic realm.

However, inter-subjective and external contexts are not sufficient conditions to determine states' action, because different states interpret their contexts differently and act strategically not in the meaning of being 'omniscient, but rather in the meaning of being 'purposive' (Lake and Powell 1999:7). Wendt emphasizes 'strategic practices' as the third mechanism of collective identity formation among states, arguing that "systemic structures and processes may affect the context of interaction, but specific actions are rarely dictated by them" (1994:390). Strategic practices thus include mutual learning and the projection of national identity and interest through repeated interaction. National identity is 'the nation's sense of self' and national interest is defined in reference to national identity (Ruggie 1998). The nation's sense of self is also influenced by images

of the others (Boulding 1956; Cottam 1977; Herrmann et al.1997; Young and Schaffer 1998; Cottam and Cottam 2001).

The essential point to all is that states' actions can be explained by analyzing states' understanding of their own political community as the nation's sense of self and their images of others as interpretations of reality. From this perspective, we can say that there is a general tendency toward 'shared perception of issues and threats' and economic interdependence among Asian states in terms of structural contexts and systemic processes. However, these factors do not dictate Asian states' strategic practices toward the cognitive extension of the self. The cognitive extension of the self can be considered as a trust-building process. And as Adler and Barnett (1998) argue, the trust-building process is driven by mutual learning that "increases the knowledge that individuals in states have not just about each others' purposes and intentions but also of each others' interpretation of society, politics, economics, and culture; to the extent that these interpretations are increasingly shared and disseminated across national borders, the stage has been laid for the development of a regional collective identity" (1998: 54).

Shared Economic Interests and Institutionalization of Regionalism

Common Interest and Economic Interdependence

Let me bring this point to a close with the discussion of another determinant of the rise of regionalism as collective action among regional states, the existence of collective interest, that is, the idea that 'shared economic interests' encourage states cooperation on the regional basis. In this approach, the concept of regional proximity is understood in economic interest terms. This approach is mostly seen in many studies of economic liberalization, interdependence and internationalization in the field of international political economy. Its theoretical origin is influenced by the study of interdependence and conflict in international relation theory. Liberal international relations theorists have long argued that, as trade and foreign investment increase, states tend to be

more cooperative. Economic interaction, they contend, increases mutual trust and communication among states as well as economic interdependence making the cost of war more expensive in terms of mutual commercial benefits (Rosecrance 1986; Polachek 1980; Gowa and Mansfield 1993; Mansfield 1994; Doyle 1997; Russett and Oneal 2001; Gartzke et al 2001).

According to a recent review of the literature on interdependence and conflict, this type of liberal thought assumes two meanings for economic interdependence, 'sensitivity' and 'vulnerability' (Mansfield and Pollins 2001). The former concept related to the degree of contingency in economic relations, whereas the latter refers to the degree of mutual destruction in the case of the disturbance of economic relations. When we understand economic interdependence in terms of sensitivity and vulnerability, we are directly relating the concept of economic interdependence to the idea of cooperation as collective rationality based on cost-benefit consideration (Barbieri and Schneider 1999). In other words, if each state's economic condition vulnerable to the external shocks from the other states' economies and if each state's prosperity relies on the continuity of economic reciprocity, then states' rational choice should be to cooperate and to avoid war. Under the condition of economic interdependence, therefore, states have a common interest to pursue economic cooperation.

Economic interdependence has, frequently been measured in terms of international trade, investment, and finance, and globalization can be understood as a contemporary expression of economic interdependence (Barbieri and Schneider 1999). An interesting point is that, contrary to a presumption of the rise of a unitary global economy, globalization has enforced the regionalization of world economy (Hay 2000; Wade 2000; Hirst and Thompson 1999; Weiss 1998; Coleman and Underhill 1998; Hurrell 1995; Ikenberry 2000). It is ironic if we interpret the concept of globalization as 'the creation of a single borderless world' (Scholte 1997:431). Specially, in terms of international trade, globalization is represented by the development of multilateral trading systems such as the World Trade Organization (WTO), whereas regionalism refers to "a tendency toward

some form of preferential trading arrangements between a number of countries belong possibly to a particular region”(Lahiri 1998:1126; Tussie 1998).

Of course, there is a controversy regarding whether or not regional trading arrangements undermine the development of a global economy characterized by multilateral trading systems. For instance, while some economists argue that regional trading arrangements can be understood as a strategy for increasing ‘collective bargaining power’ in multilateral trade negotiations (Lawrence 1995;Whalley 1998), others argue that “the world trading system is currently in danger of entering the zone of excessive regionalization” (Frankel, Stein and Wei 1998b:112). These competing arguments reflect a more crucial and broader question, that is, whether or not globalization and regionalism are, in fact, in conflict. Regarding this question, this study suggests two points: 1) while globalization is based on the logic of the ‘self-regulating market’, regionalism is based on the logic of governance and policy; 2) therefore, regionalism is a demanding institutional form for governing the global economy and it can be organized according to various institutional principles and patterns.

European Common Interest: A Competitive Europe and European Competition Policy

Fligstein and Merand (2001:45) claim that “much of what people call ‘globalization’ is in fact Europeanization”. Their point is based on the fact that any change in international trade in Europe will cause a significant impact on a general trend of international trade because Europe accounts for almost 45% of world trade and it has the largest internal market in the world. Hanson (2001) also points out that Europe speeded up the liberalization of world trade by keeping its external trade liberalization policy and by increasing market access for imports from non-EU countries during the 1990s despite the severe economic recession experienced by many European economies. However, Schmidt (2002:42) disagrees with the argument that Europeanization is simply ‘a regional variant of globalization’, suggesting instead the concept of Europeanization as both ‘a regional extension of globalization’ and ‘a regional foil to globalization’.

Why did European states seek European regionalism? More precisely, why did European states develop 'legal' integration through a series of treaties from Treaty of Rome to the Single European Act and the Maastricht Treaty? This question includes two separate questions: 1) what is the motivation behind collective action among European states; 2) why did their collective action generate a particular institutional outcome, such as legal arrangements based on authority delegated from member states?

For the first question, the most general explanation is that the driving force of European regionalism is common economic interest among European states. However, concerning the question of what European states' common economic interest is, there are two different logics of European regionalism: 1) transaction costs theory; 2) regulated capitalism. From the perspective of transaction costs theory, European states' common economic interest is to increase the competitiveness of European economies in the global economy by reducing transaction costs through the creation of a single market. This task is consistent with the economic interests of European multinational firms and corporate actors (Mattli 1999; Fligstein and Merand 2001). In contrast, according to the logic of 'regulated capitalism', European states' common economic interest is "to create a European liberal democracy capable of regulating markets, redistributing resources, and shaping partnerships among public and private actors" (Hooghe and Marks 2001:106; Rhodes and van Apeldoorn 1997a).

The links between world competitiveness, the creation of a European single market, and the reduction of transaction costs have been mostly discussed in terms of the efficient market economy. For instance, according to Article 2 of the Treaty of Rome (25th March 1957), the main goal of the Community was to achieve an efficient market economy with 'sustainable and non-inflationary growth':

The Community shall have as its task, **by establishing a common market and an economic and monetary union** and by implementing the common

policies or activities referred to in Articles 3 and 3a, to promote throughout the Community a harmonious and balanced development of economic activities, **sustainable and non-inflationary growth** respecting the environment, a high degree of convergence of economic performance, **a high level of employment and of social protection**, the raising of the standard of living and quality of life, and **economic and social cohesion and solidarity** among Member States (Article 2)

And this goal is to be realized according to the following policies:

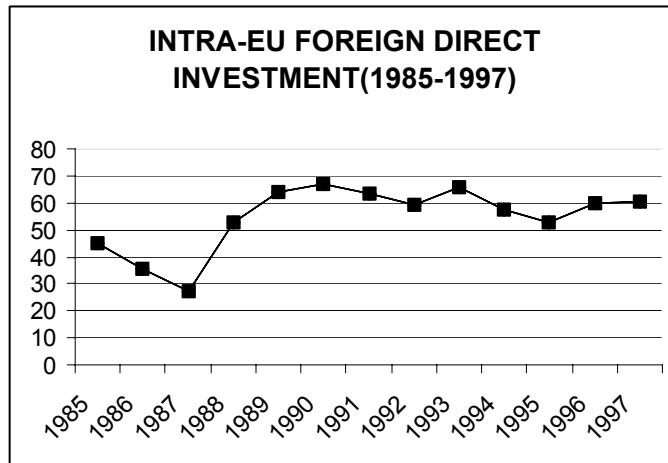
(a) **the elimination** as between Member States, **of customs duties and quantitative restrictions on the import and export of goods**, and of all other measures having equivalent effect; (b) a common commercial policy; (c) **an internal market characterized by the abolition**, as between Member States, **of obstacles to the free movement of goods, persons, services and capital**; (d) Measures concerning the entry and movement of persons in the internal market as provided for in Article 100C . . . (g) a system ensuring that competition in the common market is not distorted; (h) the approximation of the laws of the Member States to the extent required for the functioning of the common market . . . (l) **the strengthening of the competitiveness of Community industry**; (m) the promotion of research and technological development; (n) encouragement for the establishment and development of trans- European networks . . . (r) the association of the overseas countries and territories in order to increase trade and promote jointly economic and social development . . . (Article 3).

Hansen (2001:379) interprets the central concern of the Treaty of Rome to be achievement “the efficiency of price formation” concerning “the four freedoms” in the movement of goods, labor, capital and services. In transaction costs theory, economic efficiency is achieved by the economization of transaction costs and “transaction costs can be economized by assigning transactions (which differ in their attributes) to governance structures (the adaptive capacities and associated costs of which differ) in a discriminating way” (Williamson 1985:18).

Let me consider a more specific example in order to understand the logic of transaction costs theory. As we can see from Figure 3-1, from 1988 to 1991, intra-EU foreign direct investment rapidly increased. This fact can be explained by the competition policy represented by the Merger Control Regulation in force since the Single European Act. As Scholte (1997:429) points out, globalization has enforced capital to adopt a ‘supraterritorial mode of organization’ and to struggle for ‘world market position’. Generally, the merger movement of the late 1980s can be understood in this context. However, what we should note is that in the European context, this movement was encouraged by the transformation of governance related to the creation of the SEM (Single European Market) and the SEA (Single European Act). With the enforcement of the SEA in 1987 to seek the completion of the European Internal Market by 1992, the Commission facilitated the liberalization process designed to transform monopolies and state ownership toward competition, by actively employing Article 86 (Wallace and Wallace 2000). In fact, Article 86 was already addressed in the Treaty of Rome, but had not applied by 1987. The reason for this is that it originally focused on the privatization of large state-owned enterprises rather than concerned of the general corporate realignment and the transformation from monopolies to competition for ensuring global competitiveness.

In 1989, as an important instrument of the competition policy, the Commission introduced the Merger Control Regulation (MCR), a kind of ‘one-stop-shop system’ to regulate market-distorting

Figure 3-1 Intra-EU Foreign Direct Investment as % of Total Foreign Direct Investment (1985-1997)



Source: United Nations, *World Investment Report* (1999:154-156)

merger transactions. As Armstrong and Bulmer (1998) note, the MCR challenged “the existing balance of policy between the pursuit of domestic competition and the pursuit of international competitiveness” and enforced the transfer of regulatory authority from national governments to the European Commission, in other words, ‘the Europeanization of governance capacity’. The European Commission believed that the success of the single market depended on effective market competition. Thus, the Commission sought to control all merger transactions that may pursue a dominant position at the expense of market competition through its ‘exclusive’ powers of scrutinizing merger transactions (Morgan 1998).

The aim of the competition policy is to prevent the ‘misuse of market power’ across borders between EU member states and to discipline multinational firms’ behavior in the Internal Market (Hansen 2001). The control of mergers also has a direct effect on intra-firm restructuring as well as external conditions for firms. From the perspective of transaction costs theory, competition policy can be considered as the pursuit of ‘external safeguards in the form of an integrated governance

structure' to make the economization of trade and investment transaction costs possible by reducing opportunism from both firm-level and government-level (Mattli 1999:48).

Williamson (1985) argues that, when contracting is incomplete, the effect of asset specificity increases and, as a result, transaction costs also increase. His point can be applied to the relations between the creation of the Internal Market and the need for integrated European governance. The creation of the Internal Market is to exploit economies of scale in the comparison of the size of national markets. However, as the size of market increases, asset specificity (specialization) tends to increase, while firms' vulnerability to opportunism simultaneously becomes greater. An important point is that this increasing vulnerability creates a preference for institutional innovation, or, for assigning transactions to governance structure with the ability to enforce contracts more completely and effectively in markets. We can understand the creation of the Internal Market and the competition policy represented by the regulation of market concentration (mergers) in the light of transaction costs theory.

European Common Interest: A Social Europe and European Cohesion Policy

The proponents of European regulated capitalism provide a different interpretation of common interest among European states. They recognize a general tendency toward economic interdependence and globalization, but they disagree with the neoliberal prospect of European capitalism. They discuss the tension between neo-liberal capitalism and regulated capitalism concerning the future of European capitalism in various aspects. However, their common theme is that "markets have to be socially constructed via a set of agreed on or imposed rules of the game; there is no 'natural' or 'spontaneous' implementation of market mechanism" (Boyer and Drache 1996:5). The idea of the market as social construction is rooted in the criticism of the conventional economists' notion of a 'self-regulating market', based on an implacable economic determinism. For the proponents of European regulated capitalism, the history of European capitalism is about the

political decision to integrate the economic into the political. European integration can be considered in this perspective.

In fact, the prospect of European regulated capitalism has long been pursued through the idea of a 'social Europe', emphasizing the social dimension of European integration. According to Boyer (2000:280), at the heart of regulated capitalism is the political compromise between capital and labor based on 'mass consumption and the creation of social protection systems' by 'a wage-earner' state rather than simply a capital state. There are four mechanisms for a political economy to deal with social and political conflicts: the market, large firms, the balance between firms-wage earners, and the state. What we should note is that European capitalism has been developed on the basis of the third mechanism, that is, the pursuit of compromise between firms and wage earners. The vision of 'a social Europe' is therefore to preserve this tradition of European capitalism. As we read from the following statements, however, this vision of 'a social Europe' could never obtain dominance in the process of European integration.

The Fifties and Sixties were decades of unequalled economic growth, partly due to the economic cooperation within the European Community. In 1987, by establishing the Internal Market, the Single European Act gave fresh impetus to the economy. In 1992, the crowning event was the setting up of a monetary union as provided for in the Maastricht Treaty. The social dimension of European integration, however, was badly overlooked . . . Until the end of the Eighties, until the introduction of the Social Charter, the European Community merely created a prosperous economic climate by way of a common market. The European authorities gave absolute priority to economic co-operation without linking it with a sound social policy. In other words, there was a clear lack of balance. This does not mean that the founding fathers had not written social clauses into the Treaty of Rome - but the

procedure of decision making in that area, i.e. by unanimous vote, made it virtually impossible to draw up detailed "Provisions of a Social Treaty." (Cited from Speech in IGC by Mr. Derucke, Belgian Minister of Foreign Affairs, Egmont Palace, 23 January 1996)

As Mr. Derucke points out, the main reason for this failure can be found in the fact that it is not possible to achieve a common European social policy without overcoming the vicious effect of national veto implicit in the European decision-making rule of unanimity for a European social policy. In other words, the vision of a social Europe is not possible without the creation of a European polity based on European citizenship and European solidarity, capable of enforcing a new political compromise between the more affluent states and the poorer states, and between firms and wage-earners at the level of Europe as a whole. As Streeck (1996:305) very succinctly expresses, however, the vision of a social Europe was sacrificed by 'the alliance of nationalism and neo-liberalism'. Hay (2000) also raises the same point, that the vision of 'a social Europe' has been overwhelmed by the increasing neo-liberal idea. He wrote, "a project which was, from its inception, inherently social and political in nature has tended, through a slow process of attrition, to mute into little more than a charter of economic liberalization and marketization" (2000:521).

Of course, there has been some balanced effort to curb the neo-liberal tendency of European economic integration. One example of this is the 1988 cohesion policy reform -'a bedrock of the anti-neoliberal programme' (Hooghe 1998:459; Hooghe and Marks 2001). The European cohesion policy was introduced in the Single European Act (SEA) in 1985 in order to reduce regional disparities between richer and poorer member states and to induce a broader support among the poorer member states for the development of the single European market. The structural fund is one of the most important instruments for the implementation of the European cohesion policy.

According to the European Commission (2002), 94% of structural funding has been used for the following three objectives: 1) “Helping regions whose development is lagging behind to catch up, i.e. providing them with the basic infrastructure, which they continue to lack, or encouraging investment in business economic activity; 2) Supporting economic and social conversion in industrial, rural, urban or fisheries-dependent areas facing structural difficulties; 3) Modernizing systems of training and promoting employment”. A special solidarity fund, Cohesion Fund has been provided to four member states: Portugal, Greece, Ireland and Spain since 1993. Table 3-3 summarizes the historical development of European cohesion policy in the process of European integration.

The importance of cohesion policy was designated from the beginning of the process of European integration. Its main purpose, however, was ‘to facilitate broad Union agreement’ through providing structural funds as an instrument of enlargement, not to contribute to the creation a genius European governance to correct the destructive effect of a self-regulating market (Wallace and Wallace 2000:246). In this regard, the White Paper of 1993 can be seen as reflection of the increasing tension between the vision of ‘a social Europe’ and the vision of ‘a competitive Europe’:

we are faced with the immense responsibility, while remaining faithful to the ideals which have come to characterize and represent Europe, of finding a new synthesis of the aims pursued by society (work as a factor of social integration, equality of opportunity) and the requirements of the economy (competitiveness and job creation) (Cited from the Preamble of White Paper, the European Commission, 5 December, 1993).

Table 3-3 The Development of the European Cohesion Policy (1957-2002)

1957	The Treaty of Rome refers the need "to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favored regions".
1958	The European Social Fund (ESF) and the European Agricultural Guidance and Guarantee Fund (EAGGF).
1975	Creation of the European Regional Development Fund (ERDF) to redistribute part of the Member States' budget contributions to the poorest regions.
1986	The Single European Act introduces a cohesion policy in the consideration of the burden of the single market for southern countries and other less favored regions.
1989-93	The European Council in Brussels in February 1988 launches the Solidarity Funds (the Structural Funds).
1992	The Treaty on European Union emphasizes cohesion as one of the main objectives of the Union, alongside economic and monetary union and the single market with the creation of the Cohesion Fund.
1994-1999	Alongside the Structural Funds, a new Financial Instrument for Fisheries Guidance (FIFG) is created.
1997	The Treaty of Amsterdam emphasizes to reduce unemployment and to enhance cohesion.
2000-2006	The Berlin European Council (March 1999) reforms the Structural Funds and adjusts the operation of the Cohesion Fund.

Source: Author's adaptation from the document of the European Commission, "Working for the Regions" (2002).

Essentially, the White Paper is based on the Commission's idea of the compromise between economic efficiency (competitiveness) and social solidarity (unemployment). It was a plea that Europe should be an integrated economic entity in order to have 'competitive advantage to be centered on knowledge, intellectual capital and the management of information' as Competitiveness Advisory Group (CAP) within the European Commission stressed (the European Commission 1999). It was also a request for the 'Europeanization of economic governance' to be able to overcome the limitations of national economic governance (Rosemond 2002). Not surprisingly, all

of these discourses exactly reflect the logic of neo-liberalism, which assumes the decline of national economic governance and the importance of world competitiveness.

For some, the White Paper represents a justification of the belief that Europe should not be a simple application of neo-liberal common sense with the emphasis of the distinctiveness of European political economies based on the principle of social solidarity. Nevertheless, as Hooghe (1998) argues, the vision of a regulated European capitalism has weakened since 1988, even if the tension between two competing visions of European capitalism is reignited by the unemployment agenda. And the successful implementation of the unemployment agenda depends on the creation of a multi-level coalition among political actors such as the European Parliament, Christian Democratic parties and Social Democratic parties, and trade unions against national governments, business groups, and liberal political parties (Hooghe and Marks 2001).

The contrast between the European Competition policy and the European Cohesion policy suggests that European states define their interests in terms of the logic of the creation of a competitive Europe rather than in the logic of the creation of a social Europe. The European Commission has played its institutional role, as a driving force moving European states toward the Europeanization of economic governance. In contrast, the Europeanization of social solidarity has been undeveloped because social policy still lies at the hand of national states. This creates an institutional separation between European economic governance and national social policies. The crucial point is that it is impossible to implement social policies without the authority of economic governance. When European states delegate their authority of economic governance to European institutions, it also implies that they cannot implement effectively social policies in their societies. However, as Streeck (1996:303) points out, “defenders of the nation-state find it easy to convince citizens that supranational governance would detract from democracy”. In this situation, who has the ultimate authority to implement social policy-National States, or the European Union? This is a

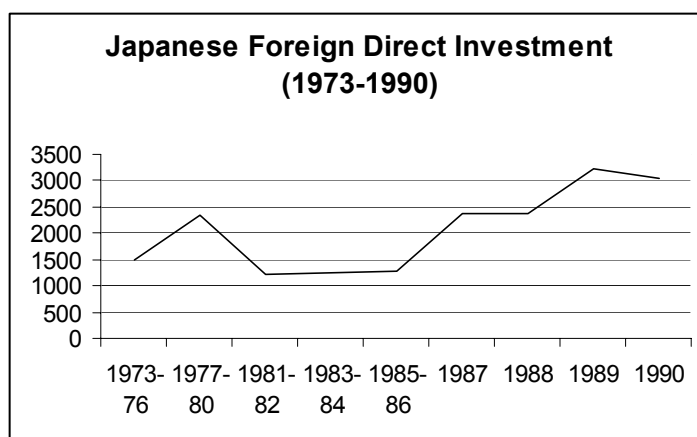
dilemma caused by the alliance between nationalism and neo-liberalism in the development of European integration.

Asian Common Interest: The Rise of a Yen Bloc?

To explain Asian states' common interests, let me again start our discussion with the issue of economic interdependence in terms of international trade and investment. Kwan (1994) and Pempel (2000) explain that economic interdependence among Asian states has been strengthened by the increasing value of currencies of Japan, Taiwan, South Korea, and Hong-Kong accompanied by the growth of foreign direct investment and intra-regional trade after the late 1980s. Stubbs (1994) also emphasizes the importance of the sequential expansion of Japanese foreign direct investment (FDI) into South Korea and Taiwan in 1970s, ASEAN region from the mid of 1980s, and finally China in the late 1980s for explaining the rise of Asia-Pacific regionalism. Figure 3-2 presents the radical change in the trend of Japanese FDI in Asia after 1987.

Behind the story of the expansion of Japanese FDI, is the economic conflict between the U.S and Japan. The most important factor causing the expansion of Japanese FDI into other Asian states beyond South Korea and Taiwan was the rapid appreciation of the Japanese yen after the Plaza Accord of 1985. The G-5 countries (Britain, France, West Germany, Japan and the United States) agreed to reduce the U.S current account deficit mostly caused by the Reagan government's expansionary policy, by the depreciation of the dollar. According to Helleiner (1994), despite this joint-effort to reduce the U.S current account deficit, it was not improved, as a result, Japanese investors continuously reduced their U.S investment. This situation explains

Figure 3-2 Japanese Manufacturing FDI in Asia (1973-1990)



Source: Adapted from *Network Power: Japan and Asia*, edited by Peter J. Katzenstein and Takashi Shiraishi (Ithaca: Cornell University Press, 1997), p.60.

the 1987 stock market crash as well as illustrating the growing financial power of Japan in the world stock market. With the increased influence of the Japanese yen in the world financial market, Japanese investors started to diversify their investments turning to Asian economies, particularly Southeast Asian states (Katzenstein 2000). Therefore, the appreciation of the yen against the dollar forced Japanese multinational companies to seek massive foreign direct investment in the Asia-Pacific region in order to relocate their firms and to offset their export deterioration (Stubbs 1994; Chua et al.1999). As Cohen (1996) notes, the situation of increased commercial and financial ties with Japan provided the opportunity for the formation of a yen bloc in the Asian-Pacific region. According to Holloway (1990), the terms yen bloc can be defined in two ways:

The broad definition. In this view, Japan become the centre of gravity of the West Pacific economy by virtue of its size-it comprises two-thirds of the region's annual output- and technological lead. As the region becomes increasingly integrated, more business activity enters the gravitational pull of Japan and its corporations. Trade and investment with the rest of the world

continue to grow, but at a slower rate than within the region. The narrower, monetary definition. The Japanese currency is used increasingly for regional trade and financial transactions, to the point where countries find it convenient to peg their currencies to the yen (Holloway 1990)

Some accepting the broad definition, argue that a yen bloc already exists (Smith 1995). That is, there is a general trend toward the formation of 'a trade-based yen bloc'. This point is supported by the fact that the ratio of reserves in yen in other Asian states increased from 17.5% in 1989 to over 20% in 1995 as they did not mind being paid in yen in the trade with Japan (Smith 1995). In fact, Table 3-4 shows Japan's growing trade with other Asian states increasing from 31.3% in 1980 to 38.1% in 1994. However, very interestingly, other Asian states' trade with Japan decreased from 21.95 % in 1980 to 18.5% in 1990. Instead, these states showed a tendency to increase their trade with non-Japan Asian states from 24% in 1980 to 34.6% in 1990. Also, Japanese imports from other Asian states decreased from 57.2% in 1980 to 41.9% in 1990. In this regard, Pempel (1997:64) argues that "Japan has hardly been an automatic market for Asian exports". However, his point is not meant to underestimate the economic preeminence of Japan in Asian region. Rather, it is related to another of his arguments that "Japan has demonstrated neither the desire nor the ability to become the major absorber of manufactured exports from the rest of Asia" (p.77). That is, Japan has no willingness to open its domestic market to exports from other Asian states, despite its massive trade surplus with these Asian states. At the same time, other Asian states also do not feel comfortable with the increasing dependence on Japanese trade and investment.

In Asian context, Japan might have an incentive to see that an Asian bloc is achieved. However, an important point, argued by Gilpin (2001) is that in the present world of open global economy, a leadership should have "larger political purpose that simply one nation's narrowly defined interest".

Table 3-4 Major Trading Partners in Japan and Other Asia as % of Total Trade

Japan	1980	1994	Other Asia	1980	1990
Europe	9.8	15	Europe	13.2	13.6
USA	20.8	27.1	USA	18.9	19.1
Other Asia	31.3	38.1	Japan	21.9	18.5
Latin America	16.3	3.8	Other Asia	24.0	34.6
Other	21.8	16.1	Other	22.0	14.2

Source: Adapted from T.J.Pempel, "Transpacific Torii: Japan and the Emerging Asian Regionalism" in *Network Power: Japan and Asia*, edited by Peter J. Katzenstein and Takashi Shiraishi (Ithaca: Cornell University Press, 1997), p.65; the original data source is IMF, Direction of Trade Statistics Yearbooks, 1980, 1991, and 1995(Washington, D.C.: IMF)

As is discussed above, it was just after the breakdown of the Bretton Woods monetary system in 1971 that Japan began to take intra-Asian relations seriously. Before then, the rest of Asia had simply been a source of raw materials for Japanese industry and an outlet for Japanese export. Japan had made no effort toward intra-regional economic integration. Basically, this tendency was the result of Japan's foreign policy which emphasized 'economic linkage to the United States and the West, not Asia' and 'a low military posture' (Pempel 1997:56). However, when Japan confronted the trade conflict with U.S and lost confidence in the U.S market for foreign investment after the depreciation of dollar, by contrast, the appreciation of yen after the Plaza Accord of 1985, Asia suddenly became important for Japan's economic interests (Hook 2002). The massive Japanese foreign direct investment into the rest of Asia in the middle of 1980s can be understood in this context.

The crucial point is that, although the economic preeminence of Japan in the rest of Asia is rapidly increasing economic interdependence between Japan and the other Asian states, Japan could not convince the other Asian states that Japan has the political willingness to bear the full burden of providing regional collective good and to play a legitimate leadership. Rather, the other Asian states have been more suspicious of the possibility that the increasing economic asymmetries with Japan might be transformed into a maturing power disparity (Grieco 1997). Their rejection of Japan as a legitimate leadership is deeply rooted in 'the bitter legacy of Japanese colonialism' (Ravenhill 2001).

It is interesting to note that, whereas European states have tried to incorporate Germany into the project of European integration despite their vivid collective memory of Germany's wartime aggression, Asian states have not accepted any initiative by Japan concerning the creation of a regional arrangement in Asia. According to Hurrell (1995:342), European integration can be considered as 'a means of managing German power' by seeking a strategy of 'regionalist entrapment'. On the contrary, in Asia, "the containment of Japanese power was achieved by undermining macro-regionalism and relying instead on extra-regional bilateral alliance with the USA" (Hurrell 1996:342). Compared Germany and Japan, Germany has concentrated on developing economic and political links to other European states and as Katzenstein argues that "Germany lives internationally inside a European cocoon" (Katzenstein 2000:365). In contrast, Japan has pursued 'global-scope interdependence' with a focus on its bilateral relationship with the US that ultimately constrains the development of an 'inward-looking Asian bloc'.

ASEAN states, in particular, have been very sensitive to any proposal that could put their regional institution at risk. For instance, ASEAN states showed their hesitation regarding the proposal of an Organization for Pacific Trade and Development (OPTAD), which Japan and Australia had suggested as a model for pacific economic cooperation at the first Pacific Trade and Development (PAFTAD) conference in 1968 (Ravenhill 2001). The ASEAN states shared a common fear that "the ASEAN identity would be lost within a broader regional arrangement" (Ravenhill 2001:57). More importantly, they thought that ASEAN itself should play a leadership role in developing a new regional institution. Therefore, they were highly critical of Japan who considered a non-Asian state - Australia rather than another Asian states, as the major partner in developing pacific economic cooperation.

Table 3-5 Regional Bias and Intra-Regional Trade (1986-1996)

	Asia (*)		EU		NAFTA	
	1986	1996	1986	1996	1986	1996
Total region's trade In world trade(a)	18%	25%	39%	38%	21%	19%
Intra-regional trade In total trade(b)	36%	49%	57%	61%	33%	43%
Intra-regional trade Bias(c= b/a)	2.0	1.9	1.5	1.6	1.6	2.3

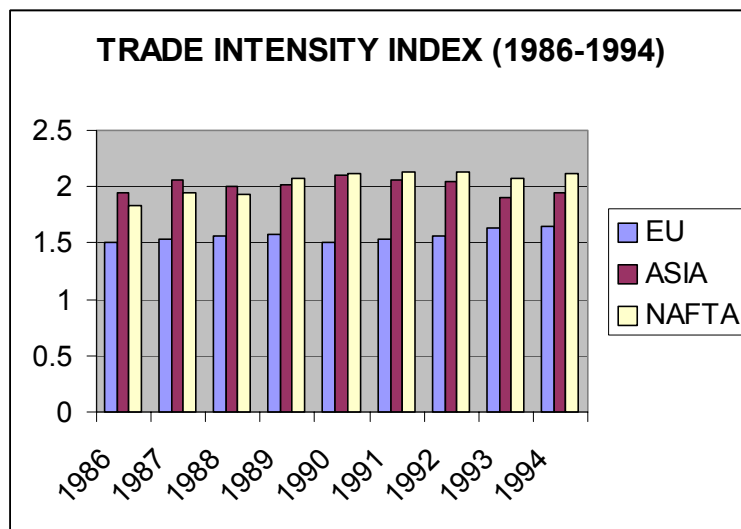
Source: Adapted from John Thornton and Alessandro Goglio. 2002. "Regional bias and intra-regional trade in South Asia" *Applied Economics Letter* 9:205-208.

Note: (*) includes Japan, China, Taiwan, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand

Asian Common Interest: Is a Natural Trading Bloc Good for Asian States?

For a more precise analysis of economic interdependence among Asian states, we can consider the concept of 'regional bias in intra-regional trade', as a measure of 'the degree of a relative geographic concentration of trade', namely, trade intensity (Thornton and Goglio 2002; Goto and Hamada 1998). From both Table 3-5 and Figure 3-3, we know that comparatively, the intra-Asian trade share is lower than intra-European trade. However, we cannot simply conclude from this that Asian states show a relatively lower economic interdependence than European states in terms of the intra-regional share of trade. In fact, Asia has a relatively higher geographic concentration of trade than Europe, in with an intra-regional trade bias was 2.0 in 1986, contrast to Europe's intra-regional bias of 1.5 in the same year. Nonetheless, while intra-regional trade bias in Asia decreased from 2.0 in 1986 to 1.9 in 1996, it significantly increased in the other regions during the same period. In particular, a general tendency toward the increased intra-EU trade bias since the creation of the European Community has been discussed by many

Figure 3-3 Intra-Regional Trade Intensity in EU, Asia, and NAFTA

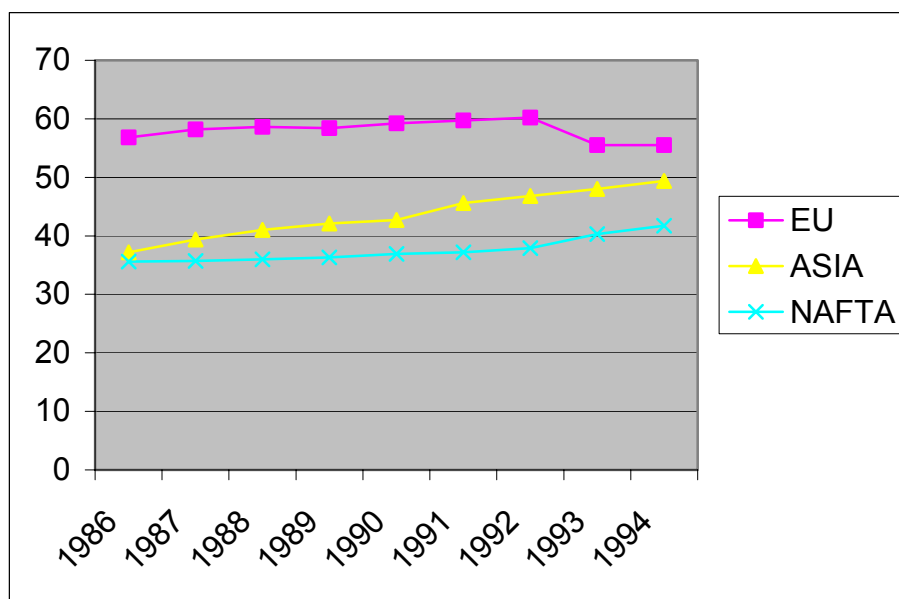


Source: Junichi Goto and Koichi Hamada. 1998. "Economic Integration and the Welfare of those who are left behind: An incentive-Theoretic Approach" *Journal of the Japanese and International Economies* 12:25-48.

economists (Frankel et al. 1998b; Soloaga and Winters 2001). Figure 3-3 shows this fact graphically.

How can we explain the fact that, despite the share of intra-Asia trade increases, the intra-trade intensity among Asian states decreases during this period? One possible explanation is the effect of APEC, an organization based on 'open regionalism' rather than the EU's 'preferential trade agreements' (PTAs). Remember that APEC was organized in 1989, and the SEA and SEM was launched in 1987. As we can see from Figure 3-4, since 1989, the share of intra-Asian trade has increased very significantly. On the contrary, the share of intra-European trade has not changed very much since 1987. Of course, this difference can be explained by the fact that, while the share of Asian trade in the total world trade also increased from 18% in 1986 to 25% in 1996, the share of European trade in the total world trade was decreased from 39% in 1986 to 38% in 1996.

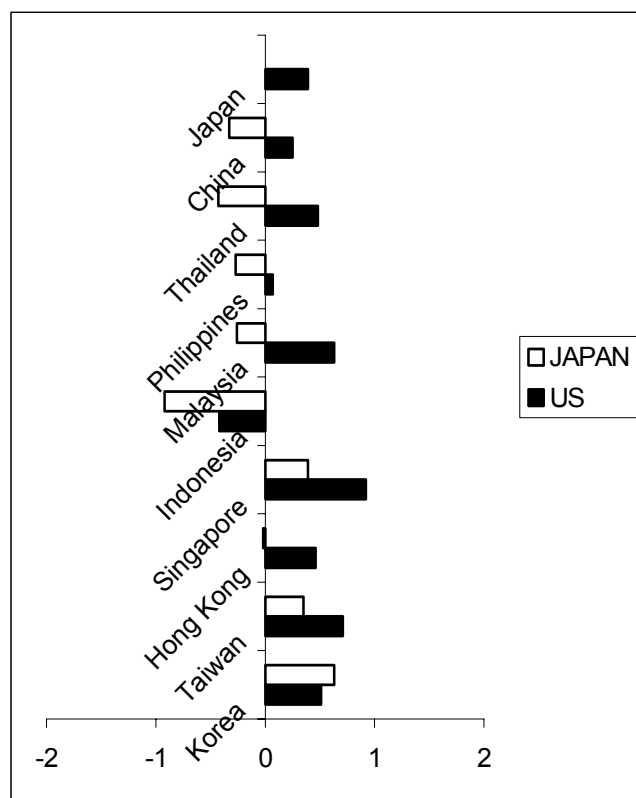
Figure 3-4 The Share of Intra-Regional Trade in EU, Asia and NAFTA (1986-1994)



Source: Junichi Goto and Koichi Hamada. 1998. "Economic Integration and the Welfare of those who are left behind: An incentive-Theoretic Approach" *Journal of the Japanese and International Economies* 12:25-48.

More importantly, this period from the mid-1980 to the mid-1990s was the time when Asian states experienced their rapid economic growth. Thus, growing intra-regional trade volume as well as Asia's increased share in the total world trade during this period reflects their rapid economic growth. Interestingly, the inter-regional trade in the EU toward 1992 and that of NAFTA toward 1994 showed a general tendency to decrease (Goto and Hamada 1998). In this respect, Asia was an exception. That is, while the effect of the EU and NAFTA was to increase intra-bloc trade, but decrease inter-bloc, APEC did not have the same effect. This fact may explain the decline of intra-Asian trade intensity. In essence, as Asian economies are growing, they are unlikely to limit their trade to 'natural trading blocs' based on 'the proximity of a pair of countries, their economic size and GNP, and a common border and common language', contrary to Krugman's argument to

Figure 3-5 The Correlation of Trade Structure between Asian States, U.S.A., and Japan (1993)



Source: For this figure, the data are collected from C.H.Kwan. 2001. *Yen Bloc: Toward Economic Integration in Asia*. Washington D.C.: Brookings Institutions Press. p.164; the data originally compiled by Nomura research Institute based on World Bank, World Development Report, 1995.

emphasize the advantages of natural trading blocs in terms of transportation and communication costs (Krugman 1993; Frankel, Stein, and Wei: 1998a). The reason for this is that, as Pempel asserts, “the developmental states of Asia are simply too dependent on outside market” of their geographical region (Pempel 1997:81). More important, these states, Japan, Taiwan, and the South Korea are heavily dependent on trade with the United States. Figure 3-5 presents the degree of the similarity in the trade structure and trade competition between Asian states, the U.S.A., and Japan. The closer to plus 1, the more similar trade structure and therefore the higher competitive trade relationship. In contrast, the closer to minus 1, the more different trade structure and therefore the more divergent and complementary the trade relationship (Kwan 2001).

Alternatively, we can interpret the degree of trade competition as the degree of contingency in economic relations, namely, 'economic sensitivity,' which is one aspect of economic interdependence. As we can see, all Asian states have their economic sensitivity in terms of trade with the U.S, with the exception of Indonesia who has a complementary trade relationship with U.S. What is an important consequence of the economic sensitivity? Whenever Asian states are in the situation of a weaker U.S dollar, Asian products become less competitive against US products in international trade, because a weaker dollar makes US exports relative less expensive relative to Asian exports. The decline of Asian export results in the decline of Asian economic growth. The same logic can be applied to trade relations with Japan. The South Korea, Singapore, and Taiwan have a more competitive trade relationship with Japan. As a result, a weaker yen directly influences their trade performance and economic growth in both a positive and negative direction. In this respect, some economists claim a positive effect of the creation of a yen bloc (Kwan 2001).

However, the point is that unlike their 'competitive' trade relationship with the U.S, most Asian states have a 'complementary' relationship with Japan, with exceptions of Korea, Singapore and Taiwan. This fact implies that Asian states are more sensitive to trade relations with the U.S than Japan. It is the very reason why Asian states do not want to exclude the U.S from their regional economic bloc. On this point, Katzenstein (2000:360) notes that "the United States is the economic anchor for national strategies of export-led growth" as all Asian states run large trade surplus with the US.

ASEAN, APEC, and EAEC and APT: The Diversity of Asian Regionalism

If we focus on the comparison of different regional arrangements within Asia, we find an interesting point, presented in Table 3-6 presents. The more open and the less institutionalized the sub-regional arrangement, the larger the size of intra-regional trade. In fact, APEC is less

Table 3-6 Intra-Regional Trade as % of All Trade in APEC, ASEAN and APT

Sub-Regional Arrangement	1970	1980	1990
APEC	54	55	66
ASEAN	21	18	19
EAEC	31	36	40

Source: Modified from Joseph M. Grieco. 1997. "Sources of Variation in Regional Institutionalization" in *The Political Economy of Regionalism*, edited by Edward D. Mansfield and Helen V. Miner. New York: Columbia University Press. pp.164-187; the original data source is International Monetary Fund, *Direction of Trade Yearbook*, various years.

institutionalize than ASEAN in terms of the scope of regional cooperation, but it provides higher trade creation to member states than ASEAN. To be specific, ASEAN member states have long pursued comprehensive regional cooperation by launching ambitious regional projects such as ASEAN Preferential Trading Arrangements (PTAs) in 1977, the ASEAN Industrial Projects (AIPs) in 1976, the ASEAN Industrial Complementation (AIC), the ASEAN Industrial Joint Ventures (AIJV) in 1983, and the Asian Free Trade Area (AFTA) in 1992. However, their efforts did not significantly improve intra-member economic gains as shown by table 3-9. Intra-ASEAN exports was accounted for only 5% of total ASEAN trade in 1990 and intra-member investment was 10% of total FDI in ASEAN states, not including Singapore despite their long history of cooperation since 1976 (Grieco 1997; Mattli 1999).

Recently, ASEAN states have pursued institutional change from 'a loose grouping based on consensus and mutual consultation' toward 'a more institutionalized community building based on commitment and timetable' even if their effort is far from 'pooling of sovereignty' (Langhammer 2001; Hund 2002). Kahler (2000) also points out the same point that ASEAN states have shown their willingness to change consensus decision-making into a more legalized, non-consensual decision-making in order to enhance AFTA's trade liberalization.

In contrast, APEC member states have consistently resisted to any effort of legalization with their emphasis of 'voluntary mediation' and 'no duplication of the WTO dispute-mediation

mechanism' since the creation of APEC of 1989. This tendency was confirmed again by the adoption of Borgor Declaration in 1994. According to Borgor Declaration:

Trade and other economic disputes among APEC economies have negative implications for the implementation of agreed cooperative arrangements as well as for the spirit of cooperating. To assist in resolving such disputes and in avoiding its recurrent, we agree to examine the possibility of **a voluntary consultative dispute mediation service**, to supplement the WTO dispute settlement mechanism, which should continue to be the primary channel for resolving disputes. (APEC Economic Leaders' Declaration of Common Resolve, Borgor, Indonesia November 15, 1994a)

It was trade liberalization that motivated Asian states to participate in the project of Asia-Pacific regional cooperation originally proposed by Japan and Australia. More correctly described, however, it was 'trade facilitation' and 'economic and technological cooperation' and different from trade liberalization based on multilateralism and reciprocity (Ravenhill 2000:321). Asian states did not want any legally binding requirement that might constrain their national economic governance. In the absence and legally binding requirement, an important mechanism of collective action within APEC has become 'peer pressure' based on voluntarism and consensus formation among member states (Drysdale and Elek 1996a and 1996b; Ravenhill 2000). According to Petri (1997:3), APEC's important institutional strength is its "repeated game" structure which enable member states "to make regular (albeit smaller) concession each year, partly to avoid peer approbation, and partly to obtain support for their own priorities in future years".

The EAEC lies between ASEAN and APEC in terms of its institutionalization of regionalism. In terms of the locus of institutionalization, it is a 'grouping' composed of some but not all states in Asia, rather than a regional community. It was organized beyond ASEAN states, but excluded non-

Asian states, unlike APEC. In terms of the scope of activity, it focuses on limited issues such as trade liberalization among Asian states. This is in contrast to ASEAN which has shown a comprehensive scope of activity from industry policy to security policy. At the same time, however, it differs from APEC as a non-discriminatory association based on a concept of open regionalism in that it can be defined as “a more discriminatory outlook favoring intra-Asian trade as a counterpart to the European Union or the proposed Free Trade Area of the Americas (FTAA)” (Pomfret 1998:56).

In fact, the EAEC was proposed by Prime Minister Mahathir Mohamed of Malaysia in 1989 as a competing project with APEC. His main idea to underlie the proposal of an exclusive Asian trading bloc was ‘an Asian renaissance and the pan-Asian-vision’ based on the distinction between Asia (Asians) and West (Westerners)’ (Berger 1999:1020). However, the project did not obtain broad support from other Asian states. In particular, Japan did not want to exclude the North American market from their regional trading bloc. More importantly, other Asian states also considered that it would be better to incorporate the United States into their regional bloc for ‘the increased leverage over US behavior’, rather than to discriminate against the United States (Ravenhill 2001: 61). Therefore, APEC was finally recognized as a model of regional economic cooperation by most Asian states. As discussed earlier, however, after the Asian financial crisis, the prominence of APEC seems to decline as a common perception that “APEC failed to generate any sort of constructive response to the financial crisis that struck East Asia in 1997-98” grew (Rapkin and De Long 2001:374). As a result, once, the idea of a pan-Asian vision based on Asian values and an Asian model of development began to inspire Asian states. This may be the origin of the rapid rise of APT. More importantly, the rise of APT implicated that Asian states started to think that regional cooperation should provide protection against financial crises by increasing the monetary and financial linkages between participating economies (Dieter 2000). This kind of perceptual change

among Asian states can be called, in Dieter and Higgott's (2000) phrase, 'the beginning of a new era of regionalism', based on monetary regionalism rather than trade regionalism.

An Unsolved Question: Why Do States Choose Different Regional Institutions in Different Regions?

This chapter addresses two main questions: 1) why do states cooperate on the basis of 'geographical proximity' and 2) why do states choose different regional institutions in different regions? Up to this point, we have discussed the validity of two conventional logics of regional cooperation - common identity and common interest among states, in order to answer to the first question. The two logic of regionalism is based on the self-evident idea that commonalities (homogeneity) facilitate collective action among states in terms of identity and interest. Following this idea, there is a pervasive argument that the more homogeneous the actors are who participate in collective action, the more institutionalized and successful their collective action will be. In the context of the study of regionalism, the argument can be translated as follow: the more homogeneous the states in a given region in terms of identity and interest, the more institutionalized and successful their regional cooperation.

But, in this chapter, we have critically discussed this self-evident idea, asking the following questions:

Q1. What is a regional identity and does it really exist as precondition of collective action among states in Europe and Asia?

Q2. What are common interests among regional states? Why do states interpret differently the same situation of economic interdependence, as we know from the comparison between the competing visions of a competitive Europe and the vision of a social Europe?

Q3. Can we say that Europe is more homogeneous than Asian states in terms of identity and interest? If the answer is yes, is there an optimal level of homogeneity to determine different institutional outcomes of regionalism? If so, how can we determine the optimal level?

For the first question, this study argues that regional identity is not a cultural phenomenon to be simply reduced to some common cultural foundations among the states of a given region. Rather, it is the product of collective action among the states of a given region. That is, the formation of regional identity per se is the part of collective action accompanied by the cultural project of myth-making and imaging a new community. Thus, a regional identity is not exogenously given but endogenously constructed through the process of regionalization. In this regard, the formation of regional identity can be understood as analogous with concepts such as 'national identity' and 'nation-building'.

The second question concerned the causal effects of common interests mostly defined in terms of economic interdependence on the variation of regional institutions. However, there is no consensus regarding what is common interest in states in a given region. There are always the competing visions of regionalism in both Europe and Asia. It is also hard to say that European states are more interdependent than Asian states. Rather, we can claim that there is a significant difference between European states and Asian states in the natures of the interdependence and interaction among them. Finally, therefore, we cannot specify the optimal level of homogeneity to determine different institutional outcomes of regionalism in terms of identity and interest. If so, what can explain the difference between European regionalism and Asian regionalism in terms of institutional outcomes of regional cooperation? I suggest the concept of situation as an explanatory alternative to identity and interest in the following section.

**BEYOND IDENTITY AND INTEREST: A CONTEXT-BOUNDED RATIONALITY
APPROACH TO REGIONALISM**

A Context-Bounded Rationality Approach

The primary interest of new institutionalists in the social sciences is to account for the formation and change of institutions in terms of the interaction between structure and purposive action. The idea of the interaction between structure and purposive action rejects a dominant sociological approach, that is, ‘methodological holism’ which does not consider that similar social situations do not dictate the same individual actions because individuals act in their choice. It also rejects the basic assumption of neoclassical economies of rationality, which disregards the effect of social relationships and institutions on individuals’ purposive action. Therefore, the focal point of the context-bounded rationality approach is “the reciprocal interaction between purposive action and social structure” (Nee 1998:4).

Both methodological holism and methodological individualism represent two seemingly competing but substantially common mechanical views of how social structure and purposive action interact. According to Granovetter (1985), there are two dominant conceptualizations of human action. One is ‘the oversocialized conception’ of the relations between social structure and human action, while the other is ‘the undersocialized conception’. The former assumes that actors’ behavior is determined by their social role positions, regardless individualized content of social relations, whereas the latter assumes that actors’ behavior is determined by their self-interest in a vacuum of social relations. Interestingly, however, both conceptualizations share the common assumption of ‘the atomization of actors’, that is a belief that actors act mechanically and automatically according to their social role positions or their self-interest. Criticizing both conceptualization of human action, Granovetter argues that

Actors do not behave or decide as atoms outside a social context, nor do they adhere slavishly to a script written for them by the particular intersection of social categories that they happen to occupy. Their attempts at purposive action are instead embedded in concrete, ongoing systems of social relations (1985:487).

In a similar vein, French sociologist Raymond Boudon (1987) identifies the notion of context-bounded rationality as the main idea of the ‘individualistic sociological tradition’. According to his argument, social action is essentially rational action, but the rationality is bounded by the context:

In the individualistic sociological tradition individual action is considered rational, but this rationality can take various form as a function of the context. The actions of the social actors are always in principle understandable, provided we are sufficiently informed about their situation (1987:64).

Simon Herbert, the 1978 Nobel laureate in economics, also asserts a similar point:

To deduce the procedurally or boundedly rational choice in a situation, we must know the choosing organism’s goals, the information and conceptualization it has of the situation, and its abilities to draw inferences from the information it possesses. We need know nothing about the objective situation in which the organism finds itself, except insofar as that situation influences the subjective representation (1985:294).

His point is that to understand rational choice in a situation is to understand the conceptualization of the situation, information concerning the situation, and abilities to interpret the situation and to process information. Therefore, as Boudon argues, the rationality is ‘a function of the context’.

At the theoretical center of this context-bounded rationality approach is the concept of institutions as social situations that shape actors' structure of opportunity and possible sets of choice. This study defines the concept of social situation as 'the institutionalized solution of the previous collective action'. At time $t-1$, actors chose a particular solution for solving a specific collective action problem in their society. Once institutionalized, this solution tends to become a social situation and context in which actors are expected to make their new choice concerning collective action at time t . Therefore, the concept of a social situation as the institutionalized collective action cannot be understood without considering the concept of path dependency.

This conceptualization of social situation implies three important points: 1) actors' action cannot be motivated exclusively by self-interests because their social situation has been constructed by interaction with other and it also specifies 'institutionalized expectations' of what to expect of each other; 2) there is no convergence toward one best and universal solution because there is no universal situation beyond time and place. The solutions of collective action at a particular time are not free from the shadow of the past (Scharpf 1997:41); 3) a shared social situation does not refer automatically to a collective identity and interest because different actors can interpret the same situation differently. Furthermore, collective identities and interests are created through the process of mutual understanding of social situations and collective actions among actors. That is, collective identity and interest are, in Calhoun's phrase, a 'changeable product of collective action', if we express, rather than it is a cause of collective action per se (Calhoun 1991).

We need at this point to define more clearly the relationship between social situation and interest or identity. The concept of interest and identity can be considered as a 'short cut' to understanding the complexity of reality because these concepts can help us simplify actors' motivations in a specific choice situation. Furthermore, there is a pervasive view that we can predict actors' choices if we know their interest and identity. This theoretical emphasis on the importance of prediction and simplification of reality, assumes that actors' interest and identity are relatively stable

over time. As Scharpf (1997) notes, stability of interest and identity can reduce the uncertainty, information costs, and transaction costs in real interactions among different actors. As a result, we can predict real outcomes effectively. But the problem is that interest and identity depend on actors' social situation. That is, the stability of social situation determines the stability of interest and identity and the stability of social situation depends on a particular, institutionalized pattern of interactions among actors.

Following this argument, we can reconsider the three points above. First, the concept of social situation assumes interdependence among actors. This assumption implies that any unilateral action based solely on the reference to self-interest comes at a price as their social situation tends to specify 'institutionalized expectations' of each other. Whenever actors try to act unilaterally, their transaction costs would be higher and the production of collective goods would also be difficult. Nevertheless, what we should remember is the fact that interdependence neither automatically motivates the need of collective action among actors nor prevents actors from seeking unilateral actions. Rather, interdependence may discourage collective action since it can generate higher transaction costs if there exists a possibility of victimization. The presence of vertical interdependence and redistribution problems can make collective action difficult, as powerful actors can exploit the vulnerability of the other (Keohane and Nye 1977).

Second, the concept of social situation should also be understood through the idea of path dependence. What is the source of path dependence? Put simply, social situations create institutions that are 'the humanly devised constraints', which shape human interaction (North 1990). We can distinguish formal institutions from informal institutions, with social situation as a broader concept referring to both formal and informal institutions. Formal institutions such as constitutions, regulations, property rights, and contracts can be changed over time or may be implemented externally. As North argues, however, without considering indigenous and informal constraints such as normative ideas, customs and conventions, various social ties and norms basically considered as a

part of cultural and cognitive heritage, borrowing a formal institution is neither effective and desirable. He wrote:

The long-run implication of the cultural processing of information that underlies informal constraints is that it plays an important role in the incremental way by which institutions evolve and hence is a source of path dependence (North 1990:44).

The importance of informal institutions lies in their influence on the formation of perceptions as the mental constructs or subjective models actors use to explain and interpret the world around them (North 1995). And, perceptions are the key to processing information and making choices. From this understanding of informal institutions, the present study will stress the importance of different perceptions of the state-society relations in Europe and Asia in explaining different institutional choices of regionalism. More importantly, the perceptions of state-society relations should be understood within a broader historical context.

Finally, the concept of social situation should be understood as 'a pattern of interaction' among actors. Conceptualizing social situation as a pattern of interaction underscores the existence of shared beliefs about a particular way in which interaction among actors is repeatedly occurred. Sometimes, changes in actors' interest and identity can generate a condition in which shared beliefs about the present pattern of interaction are challenged. The possibility of a new pattern of interaction would be influenced by the degree to which actors' interest and identity can be harmonized with shared beliefs about the present pattern of interaction. When it is not possible for actors to incorporate their new interest and identity into shared beliefs about the present pattern of interaction, they will seek a radical change toward a new pattern of interaction. To achieve this goal, however, their interest and identity should be recognized as common to that of the other actors.

Therefore, the process of recognition per se will influence the possibility of a new pattern of interaction. That is to say, it is a process of collective action.

The main goal of this chapter is to explain the states' rational action in terms of the governance of capitalist economies in Europe and Asian region after the World War II. I argue that the historical path of regional capitalism constitutes social situations where states make their collective choice of regional economic cooperation, defining the economic role of the states and state capacity in governing national economy in a given region (Wittrock and Wagner 1996:104). More specifically, Western European states have developed as 'welfare' states to limit "the range of feasible market strategies by strengthen society and setting social limits to market action" whereas Asian states are defined as 'developmental' states to shape market per se "by aggressively mobilizing society to compete in international markets" (ORiain 2000:196-197). I argues that the differences in the economic role of the state and the state capacity between European welfare state and Asian developmental state generate the institutional variations in European regionalism and Asian regionalism.

Understanding States' Social Situation

Different Interaction Modes between State and the Society in Europe and Asia

The main actor analyzed in the present study is the state. As we discussed in Chapter 1 and 2, the concept of the state is defined as a political community based on 'the shared understanding of a legitimate order', the organizational structure of public authority, and corporate social relationships from a Weberian perspective of the state. This definition emphasizes mixed nature of the state - as a collective actor as well as a corporate actor. States are collective actors in the sense that they not "autonomous in the choice of the preferences that guide their actions but rather are dependent on the preferences of their members" (Scharpt 1997:54). At the same time, however, states are corporate actors whose "strategic choices are decoupled from the private preferences of the

membership” and “from the private preferences of bureaucratic staff that participates in preparing these choices and that must implement them” (Scharpt 1997: 56). Thus, they are “autonomous from the interests and preferences of the populations they affect and are supposed to serve” (Scharpt 1997: 57). Consequently, as collective actors states seek to optimize democratic legitimacy and accountability, at the same time, as corporate actors states’ key concerns are policy effectiveness and efficiency. In this respect, states are situated between ‘embeddedness’ and ‘autonomy’ in terms of the relation to the society.

What defines a state’s social situation? It is the relations between the state and society. The relation between the state and society is the most important social situation determining the states’ preferences and their capacity for strategic action. If there is a significant divergence in the formation of preferences between the state and society or among different societal actors, then states’ capacity for strategic actions will be weakened. More importantly, the degree of divergence or convergence of preference depends on the collective action mechanism, or, conflict resolution mechanism, developed and institutionalized between the state and the society. The nature of the collective action mechanism also depends on ‘the mode of interaction’ between the state and the society.

According to Scharpf (1997), there are four analytical modes of interaction: *unilateral action*, *negotiated agreement*, *majority voting*, and *hierarchical direction*. All four modes are characterized by a particular institutional setting. For instance, unilateral action is characterized by the absence of formal rules, or an institution-free setting and spontaneous social order such as is seen in the market. The mode of hierarchical directions, on the other hand, can be found in institutional settings where ‘the exercises of hierarchical authority’ and ‘hierarchical coordination’ exist. Between these two modes, both negotiated agreement and majority voting mode are distinguished by their specific means of reaching collective agreement among actors, Table 4-1 summarizes the central features of each interaction mode.

Table 4-1 Four Ideal Types of Interaction Modes

<i>Unilateral Action</i>	Self interested individuals' interactions in an institution-free setting and spontaneous social order such as the market. Under this interaction mode, there are the minimal institutions of negative coordination to protect property rights and exchange rule through market price system. In terms of the relations between the state and the society, this interaction mode implies a minimization of the state authority.
<i>Negotiated Agreement</i>	This interaction mode is dominant when the production of a common good implemented by negotiated agreement (contract) is more attractive than the outcome from nonagreement for the both party of negotiation. However, more importantly, in this interaction mode, there still exists the possibility of unilateral action, in other words, opportunistic action by each party of negotiations. This possibility also increases the difficulty of reaching agreement per se; accordingly, the possibility of unilateral action is more likely to increase unless the problem of distributive conflict in sharing common goods can be solved.
<i>Majority Voting</i>	While the negotiated agreement interaction mode tends to rapidly increase transaction costs as the number of actors involved in a negotiation increases, this interaction mode can moderate transaction costs if a collectively binding decision is imposed by majority rule. However, unless there is no cohesive majority and collective interest oriented voters, this interaction mode generates cyclical instability and the exclusion of the minority in collective decision-making. These problems will raise an issue of legitimacy.
<i>Hierarchical Direction</i>	This interaction mode can be defined as "an exercise of unilateral power that reduces or eliminates others' freedom of choice."(Scharpf 1997:172). It reflects the fact that there is no critical difference between modern constitutional democracies and their nondemocratic predecessors in that collectively binding decisions (public policy) are imposed by the hierarchical state authority rather than chosen by individual citizens' consent. In this sense, modern democracy is not about effective policy making but about the control of hierarchical state authority. Therefore, this interaction mode can be considered as the most effective mode in terms of transaction costs in policy making. In contrast, this mode can be regarded as illegitimate in terms of normative individualism.

that is, negotiation or voting.

These analytical distinctions between interaction modes are very useful for capturing different interaction modes between the state and society in European Welfare states and Asian developmental states. From the theoretical perspective of the state as an autonomous and rational institutional actor charged with the provision of collective goods for its society, both European welfare states and Asian developmental states can be considered as "the external state," intervening in the market for the propose of the maximization of common good (Stoper and Salais 1997:211). Essentially, this implies that both European welfare states and Asian developmental states have developed the hierarchical interaction mode of the state-society relation. The hierarchical direction mode is distinctive in terms of its reduction of transaction costs in collective decision-making, much

possible by its capacity to enforce externally a particular preference on others. Accordingly, under the hierarchical direction mode, there is always the question of legitimization of hierarchical authority. It follows that one of the most critical differences between European welfare states and Asian developmental states is the different nature of legitimacy of hierarchical state authority.

The hierarchical interaction between the state and society has been developed in different ways in Europe and Asia since World War II. The nature of international economic order in the post war era can be characterized as 'liberal multilateralism' - the projection of American idea of the New Deal in domestic order and multilateral designs in postwar world economy (Ruggie 1982; Ikenberry 1989; Epstein and Schor 1992; Burley 1993). While the idea of liberal multilateralism in Western European states was modified into "welfare state liberalism", in other words, "embedded liberalism" (Ruggie 1982; Ikenberry 1989:376), it was incorporated into Asian state's as "embedded autonomy" at the expense of political liberalism (Evans 1995).

Using Scharpf's analytical distinctions of interaction modes between the state and society, this study reinterprets conventional interpretations of European welfare states and Asian developmental states. It suggests that the dominant interaction mode in European welfare states can be characterized as a mixed mode between negotiated agreement and hierarchical direction, whereas the dominant interaction mode in Asian developmental states can be characterized as a mixed mode between majority voting and hierarchical direction.

The European Welfare State: A Mix between Hierarchical Direction, Negotiated Agreement and Input-oriented Legitimacy

In European welfare states, the interaction between the state and society is influenced heavily by the path dependent effects of collective action between the state and society as well as among competing social actors in the process of political and economic modernization. The historical process of political and economic modernization was the very process of balancing power between

the declining social classes, such as the rural class and peasants, and the rising classes such as bourgeois and working class (Luebbert 1991; Rueschmeyer et al. 1992). The historical tradition of balancing power among competing social actors was directly related to the development of European liberalism based on mutual recognition of other interest positions and a sense of a community. In addition, the collective experience of war and Fascism in the 19th and 20th century made European people take the danger of a 'politics of exclusion' seriously.

The historical tradition of balancing power among competing social actors has been institutionalized into two fields of negotiated agreement among all major factions in a society: *distribution and production*. For the first field of distribution, European welfare states developed coalition government based on a parliamentary party system. With the exception of Britain, Spain and Greece, coalition politics has been a normal phenomenon in the majority of Western European states since 1945. European coalition governments work on the basis of bargaining among coalition parties.

As Muller and Strom (2000) point out, the nature of coalition bargaining can be explained better by the existence of *coalition agreement* among coalition parties prior to forming a coalition, rather than by competition among individual coalition parties or cabinet ministers who cannot support any policy other than their ideal policy position, as Laver and Shepsle (1994) argue. Coalition agreement plays the role of a collectively binding contract to define "the rules of games within a government coalition" (Muller and Strom 2000:18). This mechanism of collective action among coalition parties implies that European coalition government is a kind of *joint-decision system* in which "parties are either physically or legally unable to reach their purposes through unilateral action and in which joint action depends on the (nearly) unanimous agreement of all parties involved" (Scharpf 1997:143). And, in the sense that it is not possible to act unilaterally, this system can be understood as a compulsory negotiation system based on unanimity or consensus.

Second, with the development of coalition government as a negotiated agreement mode in the field of distribution, European welfare states also institutionalized a negotiated agreement system in the field of production. It is a corporatist system of interest representation for the organization of economic cooperation between trade unions, employers' organization and government. Corporatism is 'the closed tripartite policy network' in which the state is a proactive actor whose role is to "recognize, license and grant representational monopolies to both sides of labor and business in the name of social partners", (Hix 1999:190; Schmitter 1974; Schmitter and Lambruch 1979). In this regard, corporatism can be considered as a good example of a mixed mode between hierarchical direction and negotiated agreement in terms of the state-society relations in the field of production. An important point to note is that the development of corporatism can be regarded as "the outcome of parliamentary class conflict" in the field of distribution, in as much as corporatist development is positively related to social democratic governments (Western 1991:283). Thus, in European welfare states the interaction mode in the field of distribution influenced the interaction mode in the field of production.

Considering the development of a joint-decision system or compulsory negotiation system at the fields of both distribution and production, European welfare states increased the input-oriented legitimacy of policy making. According to Scharpf's (1999:6) distinction,

Input-oriented democratic thought emphasizes 'government *by the people*'.

Political choices are legitimate if and because they reflect the 'will of the people'---- that is, if they can be derived from the authentic preferences of the members of a community. By contrast, the output perspective emphasizes 'government *for the people*' here, political choices are legitimate if and because they effectively promote the common welfare of the constituency in question

More importantly, this input-oriented legitimacy assumes the existence of a political community based on a collective identity and the idea of public interest. Therefore, the concept of input-oriented legitimacy is more conducive to the idea of deliberative democracy as discussed in the second section.

The Asian Developmental State: A Mix between Hierarchical Direction and Majority Voting and Output-oriented Legitimacy

On the other hand, Asian developmental states have developed a mixed model between hierarchical direction and majoritarian voting for situations where the state desires to minimize transaction costs in relation to their societies, which simultaneously, maximizing aggregated utility or social welfare by seeking rapid economic modernization. For Asian developmental states, the hierarchical interaction mode was considered the most effective in realizing these two primary goals because the mode is defined as an interaction mode in which the state can *stipulate* the society's preferences and choices by providing selective incentives and punishing defections. Furthermore, the effectiveness of hierarchical direction mode was reinforced by mixing it with a majoritarian voting mode for public policy making.

Weiss (2000:23) argues that Asian developmental states can be distinguished by the following three criteria:

1. Their priorities (aimed at enhancing the productive powers of the nation, raising the investible surplus, and ultimately closing the technology gap between themselves and the industrialized countries)
2. Their organizational arrangements (embodying a relatively insulated pilot agency in charge of that transformative project, which in turn presupposes both an elite bureaucracy staffed by the best managerial talent available,

who are highly committed to the organization's objectives, and a supportive political system); and

3. Their institutional links with organized economic actors (privileging associations rather than individual firms) as the locus of policy input, negotiation and implementation.

In Asian development states, the issue of production was more salient than that of distribution in the condition of absolute poverty. The issue salience of production made it possible for the state to project its image as the planner of national production through manner of problem solving and as a disinterested actor surrounded by 'a relatively insulated pilot agency' and 'elite bureaucracy with the best managerial talent' as Weiss describes. Rodrick also recognizes the issue salience of production and the efficiency of state bureaucracy in Asian developmental states, arguing that "what was required was a competent, honest, and efficient bureaucracy to administer the interventions, and a clear-sighted political leadership that consistently placed high priority on economic performance" (1995:91). This kind of description of Asian developmental states, particularly, the Northeast Asian states such as Japan, Korea and Taiwan has become a conventional interpretation since Chalmers Johnson's (1982) work, *MITI and the Japanese Miracle*.

However, as Evans (1995:50) emphasizes in *Embedded Autonomy*, we can fully explain the nature of Asian developmental states only when we connect the state's internal policy network, characterized as "Weberian bureaucratic insulation", with their external policy network characterized by the mutual interdependence between the state and the private economic actors, particularly organized business groups. In more recent study of Asian developmental states, Kang (2002a and 2002b:3) characterizes the mutual interdependence of government-business relations as "a situation of mutual hostages among a small and stable number of government and business actors." More interestingly, he relates this situation to the effect of crony capitalism in reducing transaction costs.

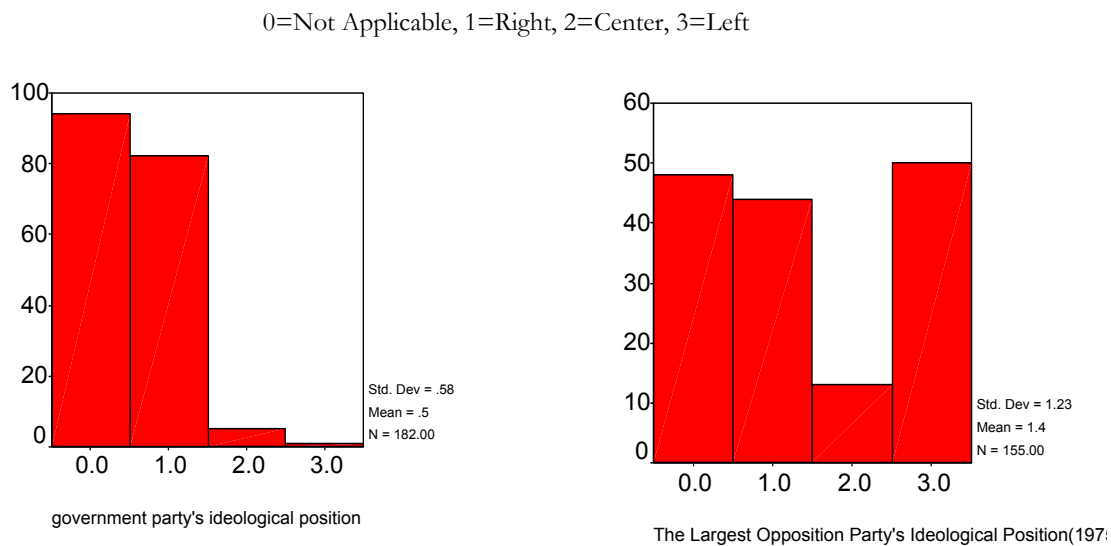
His main argument is that a situation of mutual hostage between government and a small group of business based on a long-term personal relationship and informal network, can reduce transaction costs by minimizing monitoring costs and making enforcement of agreement easier. In the later part of this chapter, we shall come back to this argument in more detail, discussing the neoliberal critics of crony capitalism as the nature of Asian developmental state.

With the issue salience of production, the interaction mode between the state and society in the field of distribution was institutionalized in the direction that the stability of political exchange depends on the stability of economic exchange. For this direction, Asian developmental states preferred a majoritarian vision of politics in which “democratic elections are designed to create strong single-party majority governments that are essentially unconstrained by other parties in the policy-making process” (Huber and Powell 1994:291). This vision of politics is also favorable to the disembedded Asian political parties.

One of the most crucial differences between European and Asian political parties is that Asian politicians and political parties were not embedded in their specific social interests unlike their European counterparts. Rather, the Asian situation is more similar American pluralism in which “social preferences are still expressed through the intermediation of political actors, such as local party organizations, interest groups, and individual politicians”, but “these preferences are not channeled via *coherent* political parties and *decisive* elections to the supersystemic level”(Coultrap 1999:117).

This disembeddedness of political parties is also demonstrated by the fact that most Asian political parties cannot be located on an ideological continuum from left to right. Figure 4-1 represents the ideological positions of both the government party and the largest opposition party in seven Asian states from 1975 to 2000. In this figure, parties’ ideological position is classified by four categories: right=1, central=2, left=3, and not applicable=0.

Figure 4-1 Ideological Position of Political Parties in Asian States (1975-2000)



Data Source: Thorstein Beck, George Clarke, Alberto Groff, Philip Keefer and Patrick Waish. 2001. "New Tools and New Tests in Comparing Political Economy: The Database of Political Institutions" *World Bank Economic Review*.
<http://www.worldbank.org/wbi/governance/pubs/wps2283.html>

Note: Countries included are Indonesia, Japan, Korea, Malaysia, Philippine, Singapore, and Thailand.

A political party's ideological position is the most effective short-cut by which to explain and predict its identity, behaviors, policy, and support groups. However, this conventional wisdom is not applicable for Asian political parties because, as Figure 4-1 shows, most Asian political parties can not be located on a continuum left - right. In particular, for government parties, the distinction between left and right is not useful. It is more precise to say that most of them do not have coherent and substantive platforms based on party ideology rather than simply saying that they are skewed toward the Right.

Generally, there are three goals pursued by political parties: office, policy, and ideology. For the disembedded politicians and political parties, the most important goal will to win elections and thus gain office. Of course, to be reelected the incumbent parties need to be concerned with their policy

performance. However, considering the Asian context where there is no tradition of organized interest groups or organizational connections between political parties and organized interest groups, politicians and political parties' policy accountability does not constrain their political life. In other words, they have no long-term commitment to any policy position and can change their policy positions and electoral alliances rapidly according to the rational calculation of winning elections. This situation increases political uncertainty. An important consequence of this nature is high-transaction costs in executive-legislative relations. Consequently, the legislative power of policy making is relatively weak and control of the legislature by the executive is guaranteed.

An ironic point is that, while according to classical theories of democracy the idea of legitimacy in majoritarian politics is rooted in in-put oriented arguments, the nature of majoritarian politics in Asian developmental states is transformed into an instrument of out-put oriented legitimization in the absence of organized interest groups. In this point, we find a possibility of empirical application of Olson's (1982) argument that there is a positive relationship between economic growth and encompassing distributional coalitions or a negative relationship between economic growth and the power of special interest groups. Olson (1982) wrote,

. . . . then the great majority of special-interest organization redistribute income rather than create it, and in ways that reduce social efficiency and output. In addition, this focus on distribution makes the significance of distributional issues in political life relatively greater and the significance of widespread common interest in political life relatively smaller In distributional struggle, by contrast, none can gain without others losing as much or (normally) more, and this can generate resentment. Thus when special interest groups become more important and distributional issues accordingly more significant, political life tends to be more decisive.

Olson's point should not be misunderstood as a normative rejection of interest group pluralism. His point concerns "non-parochial solution to collective good problems" and the importance of inclusive organization in promoting national economic performance (Schmidt 2002:150). Concerning of the formation of encompassing distributional coalitions in Asian developmental states, Singapore provides a good example. In his study of the political leadership in Singapore, Cho-oon Khong (1995:114) wrote:

Most obviously, of course, Singapore no longer has open negotiation between competing groups, the hallmark of a pluralist liberal democracy. But this is not to suggest that because social groups no longer compete, they have therefore been thoroughly repressed, though an element of repression cannot be ruled out. We have a situation in which ordinary people as members of society no longer have ---- or, perhaps more important, no longer feel they have ---- access, however, imperfect, to state power and therefore have no ability to influence the actions of government in any meaningful way. Although this statement must be qualified in the light of developments in the 1980s ----- the government's response to the loss of its parliamentary monopoly in 1981, for example, and the shift in its economic strategy after the 1985 recession ---- it remains essentially true.

A fact we should note is that in most Asian developmental states, the formation of encompassing distributional coalitions as a favorable condition of rapid economic growth was also the consequence of the depoliticizing process, in other words, the minimization of distributional issues. Furthermore, in the absence of organized interest groups in society, the state itself played the role of an inclusive and non-parochial interest group.

In sum, Asian developmental states benefited from two favorable conditions in implementing their project of economic development, the disembeddedness of politicians and political parties and the absences of organized special interest groups. While the former condition reduced “the significance of the distributional issue” in the field of distribution, the later condition produced “the state-dominated growth alliance” in the field of production (Haung 2001:7). In these favorable conditions, the legitimacy of hierarchical state authority depended on its capacity and effectiveness in providing a pie large enough to minimize distributional struggles.

Market Stability vs. Market Formation: Different Stages of Market Development in Europe and Asia

Up to this point, I have discussed different interaction modes of state-society relations in European welfare states and Asian developmental states. The next question is what caused this difference between European and Asian states? This section develops an argument that different interaction modes of state-society relations in European and Asian states were the historical product of different stages of market development.

According to Calleo (2001:68), European states have been continuously confronted with “the tension between nationalist communitarianism and capitalist efficiency” by the conflictual logic between capitalism, based on “free trade and the global mobility of factors of production”, and the nation-state, based on “national-self determination and social solidarity”. The development of welfare state was a European solution of this tension. In contrast, Asian states were in a different situation, one of mutual encouragement between neo-mercantilist nationalism and capital accumulation at the expense of political liberalism. This difference can be understood in terms of different stages of market development. Of course, different stages of market development can be understood in terms of different historical trajectories of nation-state formation, modernization, and industrialization in the two regions with insights from political and historical sociology. However,

there is not the space to deal with this issue at any length here. This section focuses instead on an analysis of the political process of market development in European welfare state and Asian developmental state since 1945 relying on Fligstein's (1996) theory of "Market as Politics".

According to Fligstein (1996), market institutions are social institutions in which actors take each other into account their actions. And, the production of market institutions is a political project implemented by the state. What is the role of the state in constructing market institutions? Fligstein (1996: 66) wrote:

Property rights, governance structures, and rules of exchange are arenas in which modern states provide stable and reliable conditions under which firms organize, compete, cooperate, and exchange, the enforcement of these laws affects what conceptions of control can produce stable market. There are political contests over the content of laws, their applicability to given firms and markets, and the extent and direction of state intervention into the economy. Such laws are never neutral. They favor certain groups of firms.

However, a more specific role for the state in the construction of market institutions depends on different stages of market development, such as market formation, market stability, and market transformation. First, in the stage of market formation the state specifies the boundaries of appropriate economic action by establishing property rights, governance structures, and the rules of exchange. More importantly, by doing this, the state creates "stable conceptions of control" as "understandings that structure perceptions of how a market works and that allow actors to interpret their world and act to control situation" (Fligstein 1996:658). Second, in the stage of market stability the main role of the state is to protect the established actors and to reproduce the hierarchical structure among them by controlling competition in the market. For market stability, it is crucial to construct a concept of control to "operate as a kind of collective identity" that all can accept

(Fligstein 1996:664). This can be achieved through the formation of political coalition and political compromises among the main actors. Finally, the stage of market transformation refers a situation where market stability is declining and the established conceptions of control are challenged by new conceptions.

Market Stability and European Welfare State

After the World War II, the crucial task for European states was the establishment of stable markets. In contrast, the task for Asian states, was the formation of a market per se. Different stages of market development mean different 'political' processes for the construction of social institutions and social relations such as property rights, governance structure, and the rule of exchange. Therefore, European and Asian differ with regard to the role of the state in constructing social institutions and social relations as preconditions of economic action in the market.

European welfare states intervened in order to restrict 'competition' for market stability. A stable market can be interpreted, if we borrow Williamson's terminology, as the pursuit of 'higher asset specificity' that refers "a characteristic of a specialized investment, whereby it cannot be redeployed to alternative uses or by alternative users excepts at a loss of productive values" (Williamson 1994:101). That is, a stable market is a social situation where economic actions are based on well established identities and mutual dependence, and specialized investment through state intervention as 'contractual safeguard' to reduce opportunism. At the simplest level, economic actions as social actions can be either competitive or cooperative. Therefore, European welfare states aimed at developing a model of 'cooperative' economic actions to be able to control competitions in the market.

There are competing theories to explain the development of the European welfare state after World War II. First, there is the "working-class-strength" approach which suggest that the development of European welfare state was, as Stephen claims, "a product of labour organization

and political rule by labour parties and thus represents a first step towards socialism” (Stephen 1979:72; Esping-Anderson 1990 and 1994; Korpi 1987; Gourevitch 1986). In this approach, the crucial forces in the historical development of welfare state were organized labor and left political parties on the left.

However, there is much historical evidence to suggest that the development of the European welfare state was also the product of social policy reform by conservative or liberal political forces. For instance, in his interpretative study of the origins of the Scandinavian welfare state, Baldwin (1989:8) argues that the Scandinavian welfare state’s unique features - universalism and tax financed social policy - can be explained as “the result of narrow interest disputes fought out between the rising rural middle class and the entrenched bureaucratic and urban elites”, rather than between the rising working-class and the left parties, on the one side and conservative and liberal forces, on the other side in the late nineteenth century.

For the rising rural middle class (farmers) and the agrarian liberals, social policy reform was an important way to compensate for the increasing production costs and the burden of poor-relief. State-subsidized social policy shifted their burden to the urban and laboring classes through tax financed social policy. In particular, the connection between social policy reform and tax reform is very important in understanding the reason why the tax structure of most European states is based on indirect taxation. I will return to this point later.

Baldwin’s historical analysis of the origins of Scandinavian welfare states enables us to avoid a simple linear interpretation of the relationship between democratization based on the working-class thesis and welfare state development. Esping-Anderson (1990) further advanced this point by theorizing different welfare policy regimes, according to the degree of de-commodification. According to him, the type of welfare policy regime rather than simply the level of welfare expenditure is determined by the political strength of the left parties and labor organization

determines. Thus, his study suggests that we need to understand the national diversities among European welfare state.

Second, there is another type of analysis based on class conflicts, but one which holds a more pessimistic assumption of the social democratic welfare state. It is a social control approach argues that “ the welfare state, *even under social democratic auspices*, continues to be, in essence, an instrument of social control of the working population in the interest of capital” (Pierson 1998:37). The theoretical root of this approach can be found in the neo- Marxist theories of the welfare state developed at the end of the 1960s. Ginsburg (1979:2) claims:

From the capitalist point of view state welfare has contributed to the continual struggle to accumulate capital by materially assisting in bringing labour and capital together profitably and containing the inevitable resistance and revolutionary potential of the working class . . . the social security system is concerned with reproducing a reserve army of labor, the patriarchal family and the disciplining of the labor force.

According to this view, the welfare state is ‘a particular form of the developed capitalist state’ designed to secure the long-term accumulation of capital rather than ‘a first step towards socialism’ (Pierson 1998:50). Considered as a whole, this approach has also been criticized by another view within the neo-Marxists theories to reject orthodox interpretation of Marxist theory of the capitalist state.

The third approach to the welfare state defines its nature of the welfare state as the institutional product of ‘market reconstruction’ pursued by the state in the postwar period, providing a reinterpretation of the capitalist state. Unlike the working-class strength approach, according to ‘market reconstruction’ approach, the state and capitalists’ natural hostility toward the provision of social protection is an oversimplification of reality. Rather, there exists a complexity between welfare

policy, labor market policy, and production regimes through state intervention and coordination (Pierson 2000).

The welfare state is ‘a precondition for optimal economic performance’, not the provision of social protection under the pressure from the organized labor and social democratic political parties against a self-regulating market at the expense of economic efficiency (Esping-Anderson 1994, 1996, and 1999; Mares 1997; Iverson and Wren 1998 Soskice 1999). At the same time, unlike the social control approach, this approach understands the nature of the capitalist state as the manager of systemic crisis caused by the contradiction between ‘the privately regulated capitalist economy’ and ‘the process of socialization this economy triggers’ (Offe 1984:51; Jessop 2002a; Pierson 1998).

In fact, many studies have analyzed the role of the state in harmonizing this contradiction in contemporary advanced capitalist society. For example, in his most influential work, *The Extension of the Public Economy*, Cameron (1978:1243) writes:

In spite of the traditional legitimacy accorded the market mechanism of the private sector in advanced capitalist nations, governments in those nations have become more influential as providers of social services and income supplements, producers of goods, managers of the economy and investors of capital. And in order to finance these various activities the revenues of public authorities have increased dramatically . . .

In particular, he argues that the openness of the economy directly influenced the extension of the public economy in Europe between 1960 and 1975. Small and open European economies had structural conditions characterized by a high degree of industrial concentration by oligopolistic and non-competitive sectors and a high degree of labor unionization. Given the fact that economic openness of the economy increases the risks caused the external shocks of international business

cycle, consequently, the state in those small and open economies extended public expenditure for aggregate demand management and political stability (Rodrik 1998; Adsera and Boix 2002).

The idea of aggregate demand management was essential for market stability in the post-war European economies. Aggregate demand management is a strategy employed by the state in order to control fluctuations of the private economy. As Fligstein (1996) points out, market stability depends on the formation of a conception of control legitimated by all members in the society. He defines it as a kind of collective identity providing “understandings that structure perceptions of how a market works and that allow actors to interpret their world and act to control situation” (Fligstein 1996:658). An important point is that the ideas of aggregate demand management reflect a dominant concept of control in the postwar European economies - the Keynesianism. Two main ideas of Keynesian economic theory are 1) “the state has a responsibility to intervene regularly in the operation of the economy”; and 2) “investment responds to many factors and governments might be best deal with economic depression by raising the level of aggregate demand for goods” (Hall 1983:6). One of the important policy prescriptions arising from these economic ideas is the extension of the public economy and the rejection of the idea of the balanced budget.

It is true that the extension of the public economy as a Keynesian policy prescription paved the way for the development of European welfare states, even if Keynesianism itself did not dictate it (Winch 1983). However, we need consider the nature of accumulation and the mode of regulation in the postwar European economies in order to understand how Keynesian economic policy had been integrated with social welfare policy. Jessop (2002a) defines the nature of accumulation and the mode of regulation in the postwar European economies as “Atlantic Fordism”. According his definition, Atlantic Fordism is “an accumulation regime based on a virtuous autocentric circle of mass production and mass consumption secured through a distinctive mode of regulation that was discursively, institutionally and practically materialized in the Keynesian welfare national state” (Jessop 2002a: 55).

Under a Fordist regime, the main task of the state was to maintain the virtuous circle of mass production and mass consumption. For this task, the objective of full employment was essential. Therefore, European states institutionalized rules of employment, working time, wage and social protection with the management of the conflicts between capital and labor. Furthermore, as the state constrains the competition among firms and concentrates capital into small number of large firms, private sector-wage bargaining was also concentrated and centralized. More importantly, the state became employer itself through the expansion of public sector employment and nationalized enterprises. Finally, all of these policies were supported by the public finance and collective consumption. In particular, collective consumption or 'nationalized consumption' meant the extension of social policy such as unemployment benefits, sickness benefits and pensions.

Considered as a whole, this market reconstruction approach provides a more systemic explanation of the welfare state as a capitalist state in the age of mass production and mass consumption. More importantly, it views the welfare state as a "spatio-temporal fix" of the contradictions and dilemmas caused by a pure capital relation. Consequently, this approach also implies the possibility of transformation toward a new model of the capitalist state, as the nature of accumulation and the mode of regulation is changed.

Market Formation and the Asian Developmental State

After the World War II most Asian developmental states, with the exception of Japan were confronted with the task of market formation. The developmental state is not a genius invention of Asian states. As Gerschenkron's seminal work shows us, *Economic Backwardness in Historical Perspective* (1962), the developmental state is a general phenomenon of 'state entrepreneurship' or 'politically oriented capitalism' (Weber 1978:164-166; Swedberg 1998a and 1998b; Schneider 1999) to replace private entrepreneur in the condition of late development. Loriaux (1999a: 235) defines the concept of developmental states in the same vein:

The term of “developmental state” refers a kind of capitalist political economy that is characterized by the preponderance of a certain kind of actor, which pursues a certain kind of ambition using a certain kind of power. The actor is the state bureaucracy the ambition is not only one of economic growth but also one of protection and promotion of national interests, as perceived or determined by the administrative elite. . . . That power is, first, the power to intervene in economic life by regulating international transactions and domestic prices and, more typically, by controlling or guiding industrial investment. But not less important to the state elite is the power that comes from being “well connected” to powerful actors in politics and business.

This conceptualization of the developmental state suggests that it is not simply an interventional state. All state intervenes in their domestic economy even though there are significant differences in terms of the scale and scope of economic intervention. However, the developmental state requests a certain kind of economic discourse, moral ambitions and policy orientation. Cumings (1999:79) expresses the same point in the idea of ‘the bias toward *National \bar{k} onomie*’:

National \bar{k} onomie is not just for Germany but for everyone; the state should regulate competition by opening and closing within the grand terrain of the world market ---- in other words, Karl Polanyi’s theory of the state. The state in the milieu of the world becomes a guarantor of Polanyi’s “principle of social protection” the backwash and the ravages of world market competition.

As Cumings points out, however, the bias toward a national economy is not an Asian innovation. Rather, it is a general phenomenon among ‘late developer’ states. If so, what makes the Asian developmental state distinctive? Given the conditions of severe international competition,

vulnerability to external shocks, and the legacy of colonialism, the bias toward national economy - neomercantilist nationalism - provided a particular legitimacy to Asian developmental states. It was a kind of “revolutionary legitimacy” based on “the authority of a people committed to the transformation of their social, political, or economic order” (Johnson 1999:53; Alagappa 1995; Castells 1992). In this regard, as Fligstein rightly expresses, the politics apparent in the phases of market formation resemble a social movement in which powerful actors mobilize their society in order to force their worldview. In this analogy, the most powerful actor was the state, who forced society into fundamental transformations of the social and economic order. An important point to remember is that when the state aims for fundamental change of social and economic order itself, it does not consider that the source of legitimacy is the consensus of the society or the democratic representation of the society. Castells (2000:283) writes:

Many political scientists remain prisoners to an ethnocentric conception of legitimacy, related to the democratic state. Under this conception, the state is legitimate when it establishes hegemony or consensus *vis-a-vis* the civil society. Yet, this particular form of legitimacy presupposes acceptance by the state itself of its submission to the principle of representation of society as it is. But we know that states that have tried over history to break away from the existing order did not recognize civil-society-as-it-was the source of their legitimacy

Based on this kind of revolutionary legitimacy, the process of market formation for Asian developmental states is not the process of political compromise among competing economic elites in which the state acts as a third party to enforce property rights. Rather, Asian developmental states dictate property rights and therefore directly define the relations between economic elites and the state.

Yusuf and Stiglitz (2001:230) claim that efficient property rights are “the lifeblood of an efficient free-market economy”, but in most developing states property rights are informally defined and weakly enforced. According to this logic, rapid economic growth combined with inefficient property rights becomes a puzzle. An efficient property rights depend on an efficient political market, in order words, democratic political system. However, efficient political market does not always assure efficient economic market. This distinction is important to our understanding of why inefficient property rights can persist, when accompanied by a rapid economic growth. North (1990:51) provides some theoretical clue on this point and it is worth quoting his argument in a length here.

The evolution of polities from single absolute rulers to democratic governments is typically conceived as a move toward greater political efficiency. . . . But it would be wrong to assert that the result is efficient political markets in the same sense as we mean efficient economic market. . . . but not only will the number of exchanges increase so that the size of the total political transaction sector will grow, the agency costs between constituent and legislator and legislator and bureaucrat will be substantial. . . . The point is that formal political rules, like formal economic rules, are designed to facilitate exchange but **democracy in the polity is not to be equated with competitive market in the economy**. The distinction is important with respect to the efficiency of property rights.

From North’s insight, what we should note is the possibility of incongruence between political efficiency (democratic political system) and economic efficiency. In Asian developmental states, the incongruence between political efficiency and economic efficiency generated a contradictory situation where less efficient property rights coexist with high economic growth. According to neoliberal critics, the absence of efficient property rights results in crony capitalism and corruption,

based on a mutual dependence between political elites and economic elites, at the expense of efficient resource allocation by a competitive market system. As a result, it increases the transaction costs associated with making, monitoring, and enforcing contracts in market exchange. Ultimately, it reduces economic efficiency by its distortion of the market.

If so, how is it possible that less efficient property rights have induced a high economic growth in Asian developmental states? Before directly answering this question, it is interesting to consider a neoclassical economist, Krugman's (2000:100) perspective on Asian crony capitalism. Analyzing the Asian financial crisis of 1997, he questions that "it was not a pretty system by Western standard; but it did function very well for thirty-five years. The same may be said, to a lesser extent, of all the countries caught up in the crisis. Why did their flaws become crucial only in 1997?" His answer was that "the only answer that makes sense to me, at least, is that the crisis was not (mainly) a punishment for sins [cronyism and corruption] there were real failings in these economies, but the main failing was a vulnerability of self-fulfilling panic" (Krugman 2000:100). More importantly, the vulnerability of self-fulfilling panic was an inevitable outcome of the choice of development path made by Asian states in order to achieve rapid growth and a better free-market system.

Again, how is it possible that less efficient property rights induce high economic growth? To answer this question more appropriately, we first need to understand the concept of property rights as the expression of "relationships among people" (Campbell and Lindberg 1990:635). If we define property rights from this perspective, we can also interpret them as "the institutional basis of power relations in the process of production, exchange, and accumulation" (Campbell and Lindberg 1990:635). The point is, that under this kind of understanding property rights, they are no longer considered as something neutral. In other words, they cannot be discussed solely from the perspective of economic efficiency because it does not make sense to say that types of power relations are efficient or less efficient. Instead, we can describe the nature of power relations in terms of configuration and pattern.

The essence of property rights is the power relation between the state and economic elites. The power relation between the state and economic elites can be competitive or cooperate, hierarchical or horizontal. Thus, we can define the nature of power relations between the state and economic elites in most Asian states as one of 'hierarchical cooperation'. Evans's famous concept of embedded autonomy can be understood in this term. Evans argues, "for developmental states, connection with society are connection to industrial capital"(1995; 234). That is, the formation of an informal network between the state and economic elites makes the relationship between the state and economic elites cooperative. However, the network is hierarchical because the state decides who can enter the network and controls financial flows through the network. As many of studies of developmental states in East Asia point out, the state disciplined economic elites by its control of finance and credit market (Johnson 1987;Woo-Cumings 1991). This hierarchical network is similar to Zysman's (1983) credit-based system of industrial adjustment in which market relations are dominated by the state's price control and the state thus leads the industrial adjustment.

Under this relation, the crucial question becomes that who pays for the costs of industrial adjustment in times of adversity and how? Katzenstein (1985) classifies three types of capitalism according to the way they manage industrial adjustment: liberal capitalism, statist capitalism and welfare capitalism. In liberal capitalism like the United States, it is possible to externalize the costs of industrial adjustment through the protectionist trade policy. In contrast, in small and open economies, like small European states, their choice is to compensate costs domestically by extending welfare or by indirect policy instruments such as taxation. On the other hand, the statist capitalism, like Japan, can 'preempt' the costs of industrial adjustment by the way that "the state helps industry to prepare for international competition" with various policy instruments of long-term market development (Katzenstein 1985:26).

How about small, open and less developed Asian states? Their way of industrial adjustment is basically similar to the Japanese way, but there is a significant difference between them because

small Asian states can exploit their situation where there is no need to balance vested interests. On this point, more recent studies of the Japanese developmental state in the post-war period argue that, unlike the conventional interpretation of the statist school, the Japanese developmental state has not been the case of strong state-weak society (private sector) that is generally found in most Asian states (Khosla 2000). Rather, it has been confronted with the situation of a strong state-strong society in which “policies for this or that industry, sector, or technology are not simply *imposed* by bureaucrats or politicians, but are the result of regular and extensive consultation and coordination with the private sector”(Weiss 1998:39). In Weiss’ terminology, this kind of “governed interdependence”, was projected into the very nature of Japanese party politics, represented by party factional competitions between the Hatoyama and Kishi policy line of “domestic development orientation” and the Yoshida and Ikeda policy line of “export-led liberal market orientation” within the conservative Liberal Democratic Party (LDP) in the 1950s and 1960s (Kume 2000). What is absent in other Asian developmental states is something like Hatoyama and Kishi policy line of domestic development orientation to be able to balance export-led liberal market orientation. Consequently, ‘accumulation without legitimization’ under the guidance of strong states and authoritarian political systems become possible. This is the key to the coexistence between inefficient political market and efficient economic market in most Asian developmental states.

Conceptualizing the Economic Role of the State

Two Dimensions of the State’s Economic Role: Economic Policy Priority and the Pattern of Economic Policy Making

Following my discussion of different relations between the state and the society and different economic development paths in Europe and Asia in the post-war period, this section provides a more general conceptualization of the state’s economic role, as a tool for the comparative analysis of European Welfare states and Asian developmental states. The role of the state in achieving national

wealth and prosperity and enforcing economic transformation has been recognized as a classic question for political economy from Weber through Polanyi to Moore, Gerschencron, North and Olson, across different theoretical perspectives. As we discussed in section 2, in this study, the state is defined as an institutional actor whose primary interest is to provide public goods and a political community based on a shared understanding of a legitimate order.

Under this definition of the state, we can then say that the state' legitimacy, capacity and effectiveness in providing public goods to domestic political economy will shape its preferences and choices concerning regional economic cooperation. That is, regional economic cooperation cannot be explained without understanding the economic role played by the state. We need, therefore to specify some variable in order to capture significant differences in economic role between European welfare states and Asian developmental states. This study suggests two dimensions of the economic role of the state: 1) economic policy priority: public power vs. market governability; 2) the pattern of economic policy making: social concertation vs. encompassing distributional coalition.

The state always stands on a difficult balance between equality and efficiency and between distribution and development (Okun 1975), and each state has a particular pattern of balance between these two priorities. We can identify the pattern between two priorities in a society by using the conceptual distinction between public power and market governability of the state. We can also consider each state as having its own particular model of economic policy making, between social concertation and encompassing distributional coalition. In reality, no state shows its extreme feature in terms of public power, market governability, social concertation, and encompassing distributional coalition. Rather, each state chooses its unique balance and combination of these four factors. Nevertheless, the underlying rationale of this study is that we can find a common regional pattern in the economic role of the state in a given region. Then, the most important task is to develop a general conceptual model capable of explaining both national divergence and regional convergence of the economic role of the state in governing national economy.

To begin with, public power refers to the aspect of political exchange between political loyalty and the provision of social protection from the self-regulating market, through the extension of public economy (Streek 1996). Public power is about social rights, citizenship, and social solidarity in a political community. Market governability is the capacity of the state to manage the private market through various interventions and regulations designed to develop stable and efficient institutional settings, such as property rights, governance structure, and the rules of exchange in the market (Williamson 1994; Fligstein 1996). A state may change its subtle balance between two priorities over their changing political and economic environments. However, it does not always generate intentional outcomes because a particular balance between two priorities at a particular time has path dependent effects on a new balance at other times.

There are also two competing patterns of economic policy making: social concertation and encompassing distributional coalition. Essentially, the difference between these two patterns is the result of two competing ideas of politics. The social concertation model assumes politics to be as a process of “collective deliberation about public values and the good life”. An encompassing distributional coalition model assumes politics to be a process of “aggregating prepolitical desires” (Sunstein 1991). This difference stems from a different assumption regarding the nature of organized interests. Social concertation assumes that organized interest groups can cooperate beyond their narrow sectional interests, as Katzenstein (1985) assures. The encompassing distributional coalition approach assumes that interest groups have no incentive of collective action for achieving national economic growth as Olson (1982) claims.

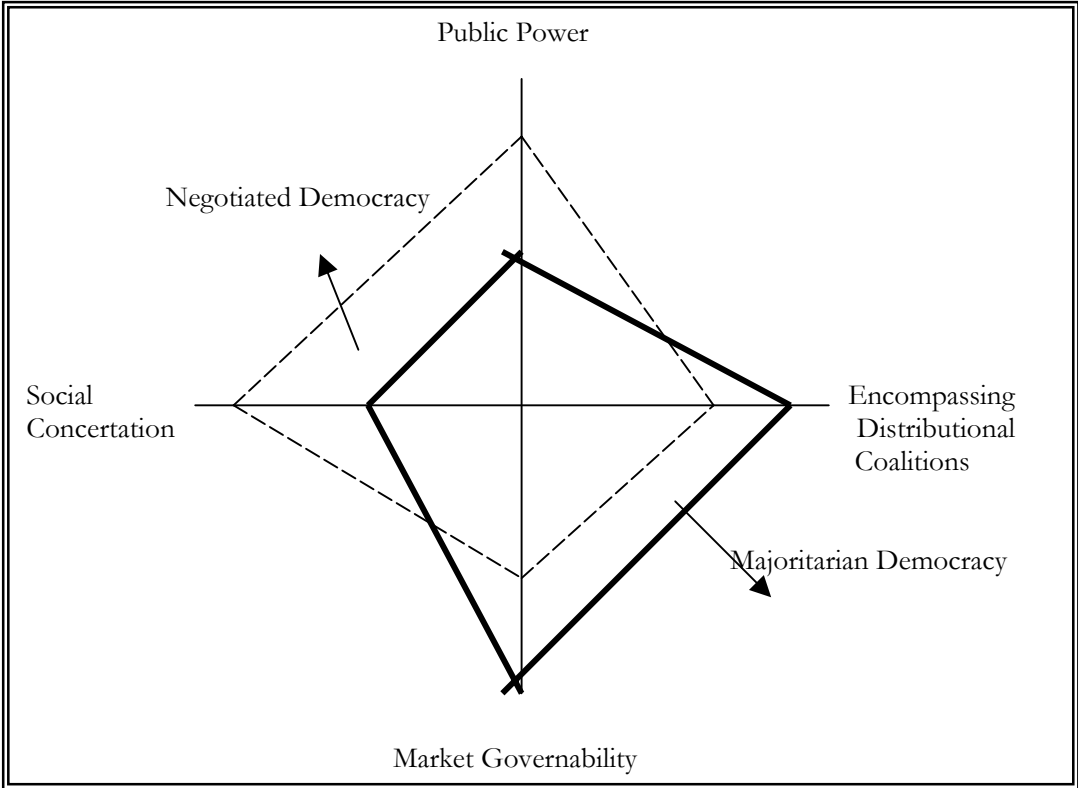
According to the logic of social concertation, if individual preferences become homogeneous through the process of political consensus formation, the likelihood of the paradox of voting will be reduced, as we discussed in the second section. Therefore, this pattern of economic policy making considers it is legitimate for different social economic interests to compete for political authority over policy making in order to realize their organized interests. At the same time, it emphasizes the

importance of the deliberative process for the formation of a shared understanding and common view of what is the best for all in a society where consists of heterogeneous individuals. This pattern is found mostly in the negotiated agreement interaction mode between the state and the society. Social concertation means the incorporation of different social interests into the process of economic policy formation. This is achieved through institutionalized policy coordination and comprehensive bargaining among major economic actors business and labor concerning production as well as distribution (Schmitter 1982; Swanson 1989; Soskice 1990; Hicks and Kenworth 1998).

In contrast, according to the logic of encompassing distributional coalition, there is always a dilemma between individual rationality and collective rationality. Therefore, it is difficult for vested interests to contribute voluntarily to the creation of public goods. The concept of encompassing distributional coalition originally comes from Olson's theory, which assume interest groups to be rent-seeking groups and monopolists to undermine market efficiency. He argues that non-encompassing and self-interested "distributional coalitions slow down a society capacity to adopt new technologies and to reallocate resources in response to changing conditions, and thereby reduce the rate of economic growth" (Olson 1982:74). From Olson's perspective, political authority is always in a danger of being captured by powerful interest groups at the expense of public interests. Therefore, his important insight is that economic policy should be insulated from political process since politics will always distort market rationality.

In fact, his argument of the negative relationship between interest group politics and economic performance share North's point of the incongruence between efficient political market and inefficient economic market. That is, democratic political system can increase transaction costs in economic market. Olson (1982:77) exactly argues the same point that "countries that have democracies freedom of organization without upheaval or invasion the longest will suffer the most from growth-repressing organization and combinations." In conclusion, the crucial difference between social concertation and encompassing distributional coalition is their different ideas of

Figure 4-2 A Conceptual Map of the State’s Economic Role



interest group politics in democratic political systems. For the social concertation pattern of economic policy making, interest groups such as trade unions are part of politics. For encompassing distributional coalitions, however, they are considered as ‘frictions’ against economic efficiency.

A conceptual Map of the Economic Role of the State and State Capacity

On the basis of two-dimensional definitions of the economic role of the state (public power vs. market governability and social concertation vs. encompassing distributional coalitions), this section introduces a conceptual map able to position different combinations of these four factors. Figure 4-2 represents the conceptual map of the states’ economic role in governing national political economy. This conceptual map distinguishes two basic models of national political economy,

Table 4-2 Two Models of National Political Economy

	Public Power and Social Concertation	Market Governability and Encompassing Distributional Coalitions
State-society relations	Negotiated agreement	Majoritarian voting
Economic Policy Priority	Equality and social welfare	Efficiency and growth
Economic Policy Making	Deliberation and participation of social interests	Aggregation and insulation from social interests

negotiated (consensus) democracy and majoritarian democracy, according to the states' economic role. As we see from Figure 4-2, the combination between public power and social concertation can be characterized by the negotiated agreement mode of the state-society relations, the economic policy priority of equality and the provision of social welfare and the subsequent economic policymaking pattern based on social concertation. In contrast, the combination of market governability and encompassing distributional coalitions represents can be characterized by the majoritarian voting mode of state-society relations, the economic policy priority of efficiency and growth and economic policy making pattern based on encompassing distributional coalitions.

Table 4-2 summarizes main differences between two models of political economy. Using these two models of national political economy, this study aims to develop quantitative measures able to capture the nature of national political economy by measuring national variations across each dimension. This study suggests two measures: total tax revenue for the dimension of economic policy priority (public power vs. market governability) and direct taxation for the dimension of economic policy making (social concertation vs. encompassing distributional coalitions). That is, in each national economy we can capture a particular pattern of the combination of these four factors by measuring total revenue as the ratio of GDP, and direct taxation as the ratio of total tax revenue. The underlying logic of these measures is that the higher public power, the higher total tax revenue, while the lower market governability. Conversely, the higher direct taxation, the lower social

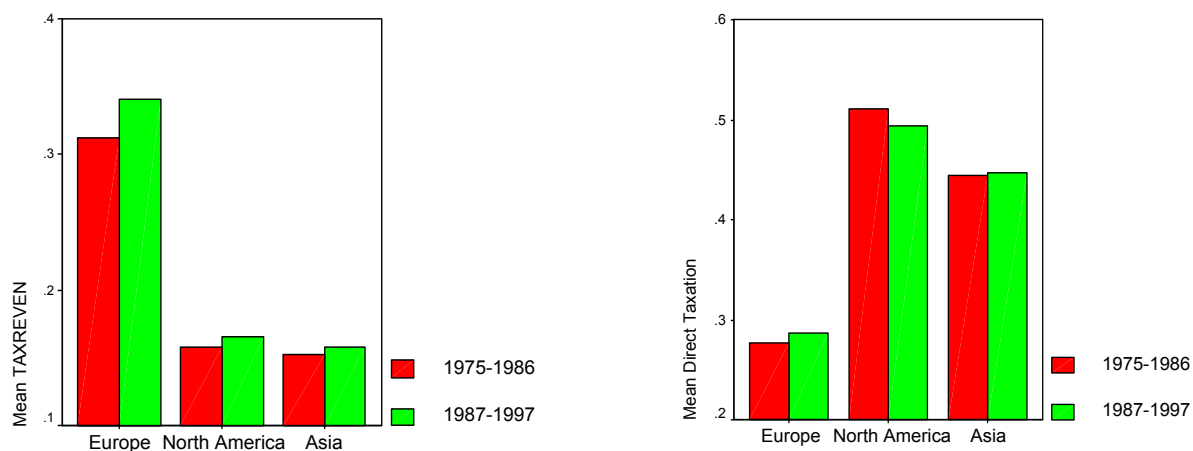
concertation but the higher encompassing distributional coalitions. The remaining part of this section will focus on the theoretical significance of taxation for analyzing the nature of national political economy and the state's economic role.

Taxation concerns how the state raises the money to cover the costs of governing (Steinmo 1998). Alt (1983:185), discussing the evolution of tax structure, provides an excellent interpretation of the nature of taxation as following:

First, as historians are fond of pointing out, taxation is inseparable from the existence of a state. Indeed, it is the price of having a state, whether the resulting society is civilized or not. The legitimacy of a tax is that of the state that levies and collects it. A tribute is not a tax because it is not legitimated. Does this mean that no tax can be illegitimated? Not exactly: it means that the answer to the question "Why have a tax?" is the same as that to the question "Why has a state?" the answer lies in a cost and benefits received by citizens. This is the second important point about tax. Taxation is a cost and benefits received.

As Alt mentions, it is obvious that we cannot consider a tax without thinking of a state. Thus, to analyze taxation is to analyze the state per se. In the study of taxation, two fundamental questions exist: 1) what determines how much and from whom the state should be taken taxes; 2) what are the political and economic consequences of different tax systems? For the first question, let's start by considering an interesting fact. As Figure 4-3 shows, there is a very significant difference between European states, and Asian states and North American states in terms of their total revenue as a ratio of GDP from 1975 to 1997. How can we explain this regional difference? How could European states take relatively higher taxes than Asian states and North American states?

Figure 4-3 Total Tax Revenue and Direct Taxation in Europe, Asia and North America (1975-1997)



Source: IMF, Government Finance Statistics, selected years. Washington, D.C: International Monetary Fund
 Note: Europe includes 18 Western European states. Asia included Indonesia, South Korea, Japan, Malaysia, Philippine, Singapore, and Thailand. And North America includes the United States, Canada, and Mexico

Before answering this question, another fact needs consideration. Figure 4-3 also represents the regional differences in terms of direct taxation between the three regions. Direct taxation is defined as taxes raised from the income or wealth of an individual or business, whereas indirect taxation refers consumption and value-added taxes (VAT) collected not from individual incomes, assets, and company profit. As we see from Figure 4-3, in contrast to the case of total tax revenue, European states show relatively lower direct taxation than Asian and North American states during the same period. That is, while indirect taxation is more significant in European states, direct taxation represent as an important part of tax revenue in Asian and North American states. What explains this regional difference? This study will show how the conceptual map of the state's economic role can be used. This analysis will, at the same time, explain why two measures (total tax revenue and direct taxation) can capture the nature of national political economy in terms of two dimensions (economic policy priority and economic policy making).

What determines how much and from whom the state should tax? In other words, what creates national and regional variations in the size of tax revenue? More specifically, why do European states have relatively higher tax revenues than Asian or North American states? For these questions, this study contends that different tax structures reflect different balances between equality and efficiency in terms of the state's policy priority. And more importantly, the different balances between equality and efficiency are determined by the state-society relations.

There is a fundamental dilemma concerning taxation: while the state wants to raise more taxes, the society (citizens) wants to pay less tax (Steinmo 1998; Campbell 1993; Downs 1960). From this fundamental dilemma we may simply expect that if the power balance between the state and the society is skewed toward the state, then the state can raise tax. However, the reality is more complex, because all tax should be legitimized in a democratic political system. That is, in a democratic political system, if the costs of taxation go beyond the benefits provided by the state or if the tax burden exceeds the society's ability and incentive to produce taxable incomes for being able to pay tax, then taxation will not be legitimated. This means that the size of taxation is optimized a level determined by the society's ability and incentive to pay. Therefore, the state's main concern in taxation will be making its decision of how to tax efficiently, without generating economic disincentives.

In a related issue, Barro (1990) claims that there is a positive relationship between low tax rates, low government spending, and high economic growth. In a more recent study testing Barro's hypothesis, Scully also argue that "the fiscal state contributes to economic growth as it expands from relatively small level and retards economic growth as it expand beyond some optimal or growth-maximizing level" (2003:300). The underlying theoretical rationale of both is based on a simple economic theory that higher taxes have negative effects on economic actors' incentives in terms of labor supply, saving and investment. As a result, they have negative effects on economic growth. Of course, this is only one side of an ongoing controversy, with other economists

disclaiming this negative relationship between high tax and low economic growth. For instance, an eminent economist of tax policy, Slemrod argues that “ the evidence is mixed. Barro finds that there is such a relationship, and others uncover one, but many studies find that there is no such relationship. So the evidence is not at all clear” (2003:7). Despite this controversy, it is a popular idea that cutting tax will induce high economic growth. Furthermore, the idea has played a powerful ideational role in tax policy in most Western societies since Regan implemented by dramatic tax cut in 1981 (Steinmo 2003; Tanzi 1987).

This raises an interesting question: if there is a negative relationship between the level of tax and economic growth, why do some economies have relatively higher taxes? One possible answer is that the optimal level of taxation, based on the logic of economic efficiency, may be disturbed by the frictions in politics. According to Downs (1960), what determines the actual level of taxation in a society is the interaction between politicians’ rationality of maximization of political support (votes) and the degree of voter information concerning how the government uses the collected taxes. He argues that when voters are in the state of “preponderant ignorance”, in which “citizens are ignorant of both the items in the budget and their benefits and costs”, the size of the government budget is likely to be larger than the correct size (1960:556).

The deep belief from which Downs drew this kind of reasoning is that there is an equilibrium expressed, by the term ‘the correct budget’ between supply and demand of public goods produced by the state. His insight is that in a world of imperfect information politicians’ desire to maximize political support distorts the equilibrium of the correct budget. Consequently, in a democracy, the government’s budget is always too small or too large. This represents the fundamental idea of the balanced budget suggested by the neo-classic economists and public choice theorists. In this perspective, the relationship between the state and society or between politicians and citizens is considered as the relationship between the producer and consumers of public goods. As Downs

assumes, however, the market of public goods does not work like the market of private goods because there are higher transaction costs and information costs than in economic markets.

But the real problem is that Downs' argument misleads us as to the nature of public goods produced by the state. Phelps (1985:335-336) defines the nature of public goods as follows:

Whatever the amount produced, it is never necessary in order to avoid shortage and inefficiency of consumption that consumers be induced to consume the good in a smaller quantity or less often by means of a price charged for the quantity used. The reason: With a collective good there cannot be any problem of shortage, "excess demand," and failure of the market to clear, even at a zero price charged, since *everyone* is technologically able to consume the *whole* amount produced *simultaneously*. The classical rationale for charging consumers a price does not apply to collective goods.

His point is insightful for understanding that a society is tolerate of too small or too large government budget not because it is rationally ignorant but because it knows well that there are a certain kind of good that can never be produced by the logic of the private market. In this sense, taxation is a price of having a state, even if sometimes it is expensive.

On the other hand, taxation is also related to the issue of equality and redistribution. Taxation is an important mean for the state to institutionalize its public power of the provision of social welfare and public economy. In fact, as Steinmo notes, modern tax systems were "a partial solution to the growing problem of inequality in modern society" under the pressure of redistribution in income and wealth from the middle and working classes (2003). However, an interesting point is that the use of tax as a mean of redistribution policy began before the middle and working classes had achieved their political rights (Steinmo 2003). This point is closely related to the fact that in modern history of tax policy, it was geopolitical conflict that allowed a state to extend its redistribution policy through

progressive taxation as societies are more tolerant of high tax during war (Campbell 1993). Therefore, after the World War I and II, the fiscal capacity of the state increased significantly in most Western societies.

All tax has a redistributinal effect and therefore all tax generates conflicts among different social interests (Alt 1983). The most crucial question, then is how to distribute the tax cost among different social interests. It is the power relations among different social interests that determine the distribution of tax costs in democratic political systems. This fact suggests an important point that more powerful social interests in terms of the access to political authority can influence strongly on a political authority's decision-making regarding tax structures. In addition, the more social interests involved in this decision-making, the more complex the resulting tax structure. When multiple political actors compete for political authority over taxation, taxation tends to be the object of political compromise among competing interests. As a result, the tax structure will be more complicated by "small adjustment and narrow reform" reflecting the multitude of political actors (Alt 1983: 183).

From this argument, we find a clue for explain the peculiarity of European states - relatively larger tax revenue and lower direct taxation than other regional states. In the following section, we discuss two arguments: 1) when the state extends its public power, the size of overall tax revenue tends to increase. In this regard, the size of tax revenue is a good indicator of the size of the state and public economy; 2) on the other hand, the size of direct taxation depends on power balances, political compromise, and the multitude of political actors among different social interests, particularly, between business and organized labor.

Politics of Taxation: The State's Public Power, Social Concertaion, and Taxation

Steinmo argues that the size of tax revenue determines the size of the welfare state, rather the reverse (1993). More importantly, the size of tax revenue is determined by the degree of

fragmentation of political authority over the decision of national tax systems. The fragmentation of political authority may generate a situation in which the main concern of political actors is to reduce their own constituents' tax burden rather than to realize an efficient and fair national tax system by the institutionalization of political compromise among different social interests, such as business and the organized labor. This point is insightful for understanding why the American tax system differs from the Swedish tax system. Unlike a common expectation that the Swedish tax system is more progressive, as Steinmo mentions, the American tax system is one of the most progressive tax systems. Why? The reason is simple. The American progressive tax system is the outcome of the politics of special interest groups, while the Swedish tax system is the outcome of the politics of class compromise.

The fragmented political authority via checks and balances in America strengthens special interest groups, while centralized political authority via political compromise among disciplined political parties strengthens the state. From this reasoning, we can reconsider the meaning of a progressive tax system. It does not automatically mean that it is more equitable. When we distinguish vertical equity from horizontal equity, we see that the American system is much closer to a horizontal equity system. This feature reinforced the complexity of the American tax system as it was designed to allow various tax exemptions, deductions, and special rates in order to satisfy various special interest groups. The final result was the complex tax system and small tax revenue. Many American fiscal economists have criticized their complex tax system for being inefficient, arguing that the destructive effect of tax policy should be minimized as much as possible by tax cuts as discussed in the previous section. However, it is the very nature of the American political system itself rather than policy makers' mistakes that resulted in the complex tax system.

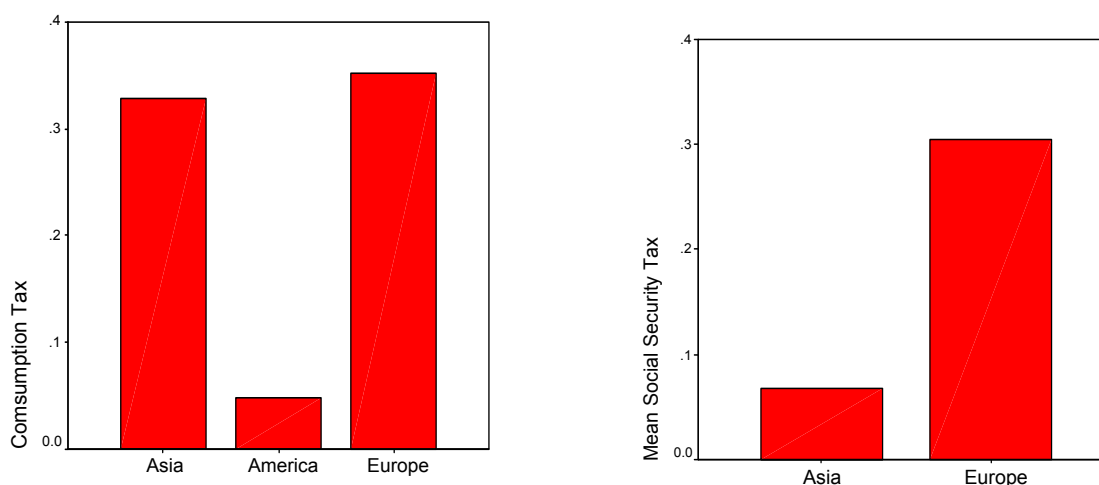
Although it has distinctive national features, an analysis of the Swedish tax system provides general guidelines for understanding the nature of tax systems in European welfare states. The most distinctive aspect of European tax systems is characterized by as higher social security and

consumption taxes but lower income taxes. That is, most European welfare states have employed extensive indirect taxation. As Atkinson (1977) mentions, the basic choice of tax policy is the choice between direct and indirect taxes. Some studies argue that the most important reason for politicians to prefer indirect taxes is because they are 'hidden taxes' which increase overall tax revenue without confronting policy makers with any political repercussions (Peters 1991). In a similar vein, some economists hold the view that although indirect taxation contributes to an increase in total tax revenue, it does not have much redistribution effect. More recent studies of direct or indirect taxes for redistribution tend to see direct taxation as a more effective instrument for both total tax revenue and redistribution.

Why did European welfare states employ higher indirect taxes if they do not have as much redistribution effects? To solve this puzzle, we need to consider the coexistence of social security taxes and consumption taxes in European tax systems. This represents the product of social concertation based on the political compromise between business and organized labor. Traditionally, the political left and the organized labor have not supported consumption taxation because they believe that it is naturally regressive (Steinmo 1993). Instead, they tend to prefer direct income taxation. In contrast, business groups prefer 'invisible taxes', such as consumption taxes. Again, what determines the introduction of consumption taxes is the degree of the fragmentation of political authority over tax policy, in other words, the state's ability to institutionalize political compromise between competing social interests. In European tax systems, the coexistence of social security taxes and consumption taxes was a kind of political exchange between business and organized labor, mediated by the centralized state authority. That is, it was the product of class politics. The same approach is not applicable to the American tax system since the nature of American politics is characterized by individualistic egalitarianism.

At this point, we turn to the nature of Asian tax systems. It is clear that Asian tax systems are more similar to the American tax system as they have lower tax revenue and higher direct taxation.

Figure 4-4 Consumption and Social Security Taxes in Asia, America and Europe (1973-2000)



Source: IMF, Government Finance Statistics, various years. Washington D.C.: international Monetary Fund
 Note: Asian countries included: Indonesia, South Korea, Japan, Malaysia, Philippine, Singapore, and Thailand.

However, similar tax structures do not necessary imply that political authority is fragmented in Asian states. In fact, in Asian states, the political authority over tax policy is controlled by the state. Unlike European states, however, Asian states do not need to institutionalize political compromise between competing social interests nor do they need to complicate their tax system in order to satisfy special interest groups. This point is supported by the fact that unlike the American tax system, most Asian states have higher consumption tax unlike the American tax system as seen in Figure 4-4. Considering why the United States does not have a national consumption tax, this fact indirectly implies that Asian tax systems are based on centralized political authority not to have numerous veto points in decision making of tax policy like European welfare states. However, the most important motivation of Asian states to employ consumption taxation lies in the need to increase total tax revenue, rather than the need for class compromise. Given the tendency for indirect taxation to be more regressive, higher consumption taxes suggests that in general, the Asian tax systems with their neutrality of redistribution are more skewed toward the policy priority of efficiency. This point is

also captured by the evidence that, in comparison to European tax systems, Asian tax systems do not extensively use employers' social security contribution for the purpose of income redistribution.

In sum, the Asian tax system is an interesting hybrid between the European and American tax systems. Like American system it is based on direct taxation and low tax revenue. At the same time, however, it has high consumption tax like European system. This hybrid feature of the Asian tax system reflects the nature of Asian political systems, in which there is no interest group politics and no need of political compromise between business and organized labor under a centralized political authority. More importantly, this characteristic of the Asian political system has allowed the state to aggressively seek economic efficiency and growth.

EXPLAINING THE STATE'S CHOICE OF REGIONALISM

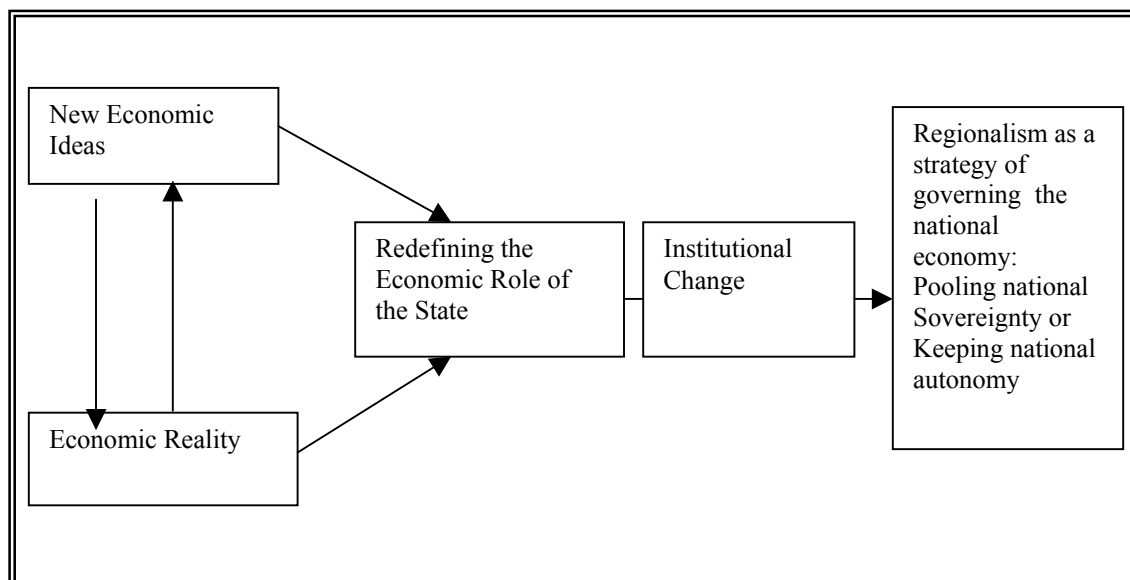
Causal Mechanism of the State's Choice of Regionalism

Up to this point, I have discussed how to conceptualize the state's economic role and how to develop empirical measures able to capture regional and national variations in terms of the state's economic role. As mentioned earlier, the main concern of the present research is to explain the regional variations in the institutionalization of regional cooperation in Europe and Asia. Put otherwise, why did European states develop deeper regionalism requiring them to delegate their national authority to a supranational institution? In contrast, why did Asian states show reluctance to deepen their regional cooperation despite increased economic interdependence? In answering these questions, this study claims 'Bring the State Back in Again', believing that we can explain states' actions only when we understand the nature of the state. Therefore, most of this study has focused on the analysis of the state per se. Now, we turn to the issue of how to use the conceptualization and empirical measures of the state's economic role for a comparative study of regionalism.

Economic Idea and the State's Economic Role: When Does the State Redefine Its Economic Role?

Figure 5-1 presents the causal mechanism of state's choice of regionalism proposed by this study. The main idea of this causal mechanism is that the larger the deviation between a new economic idea and the economic reality of a society, the stronger the motivation for redefinition of the state's economic role. Consequently, the more radical and broader the institutional change the state pursues in governing national economy. The effect of economic ideas in shaping the state's economic policy is fundamental. The state interprets economic reality, evaluates its performance and determines its economic policy priority and the pattern of policy making by relying on the existing dominant economic ideas. In a sense, economic ideas play an important role as "cognitive paradigms

Figure 5-1 A Causal Mechanism of the State's Choice of Regionalism



and world view” in the state’s economic policy making (Campbell 2002). But the role of economic ideas is functional, rather than economic ideas per se are meaningful for the state’s economic role.

The main function is to solve puzzles or anomalies with which the state is confronted governing its national economy. Therefore, the political power of economic ideas depends on their effectiveness in solving contemporary economic problems. Also, this implies that, whenever the existing economic ideas are considered as dysfunctional, the state and economic policy makers will search for a new set of economic ideas. Hall (1983:10) made an insightful observation regarding the rise of a new set of economic ideas:

The persuasiveness of a new set of economic ideas is always relational, that is to say, it depends not simply on the ideas themselves but on the way in which they fit with the other existing ideas, including the pertinent array of existing

economic theories, recognized puzzles and observations of the contemporary economic world.

As Hall exactly points out, the persuasiveness of a new set of economic ideas is not determined by its theoretical superiority alone. Rather, it depends on how much it is deviant from the orthodox economic ideas. The state and economic policy makers are in search for a new economic idea and tend to want to 'a new thing' which allows them to interpret and evaluate their economic reality from a different angle. In addition, for politicians and political parties who want to defeat the incumbent governing parties, it is necessary to provide new economic ideas and new economic policy prescriptions in elections. The more divergent from the old economic ideas of the incumbent parties, the more powerful and attractive the challengers' ideas will be to voters and economic policy makers. The electoral success of conservative parties and political leader such as Margaret Thatcher in 1979 and Ronald Reagan in 1980 are good examples for this point. Both provided new economic policies based on neoliberal economic ideas.

However, the most important condition influencing the persuasiveness of new economic ideas is economic reality itself. Economic reality includes both national economic performance and the institutional settings constructed by old economic ideas. In particular, national economic performance such as economic growth, is considered as an objective measure to judge the utility of old economic ideas. That is, the old institutional settings concerning policy priority and policy making pattern will not entirely be illegitimated by a new set of economic ideas as long as a state is in the state of high economic growth. Of course, it is possible that the influence of the new economic ideas will result in a partial modification of the old institutional settings. However, such partial modification results in policy change rather than a broad institutional change.

In contrast, if a state has experienced a persistent decline in national economic performance, the persuasiveness of the new economic ideas may be enhanced. Moreover, if there is a large gap

between the ideal that new economic ideas promise and the current economic reality, then the new economic ideas can be regarded as a powerful instrument for economic transformation and reform. Dissatisfaction with economic reality tends to justify a new set of economic ideas. As a result, the new economic ideas will gain their political power by playing key roles in the formation of new economic policy. Furthermore, a large gap between new economic ideas and economic reality can motivate the state to redefine its economic role by changing its economic policy priority and the pattern of economic policy making in the name of economic reform and economic transformation. We also expect that the larger the gap between new economic ideas and existing economic reality, the more radical will be the change the state pursues.

But it is not an easy task to establish a new economic role for the state. Economic reality is constructed by the old economic ideas and imposes institutional constraints on the state's capacity for implementing economic transformation. In other words, economic reality institutionalized under the old economic policy priority and the old pattern of economic policy making provided a solution for the collective action problem in the past. But it becomes a problem, requiring another collective action solution in the present. Therefore, the success of economic transformation depends on the state's capacity to deal with those institutional constraints effectively. More importantly, if it is under higher institutional constraint, states tend to adopt more radical institutional innovation for economic transformation

To change the old policy priority and policy making pattern always requires a process of justification because both correspond to social and cultural factors rather than simply to ideological factors (Hall 1989). Moreover, if the state has to interact with the society in the negotiated agreement mode, as European states do, then the costs of justification will be higher than in the hierarchical direction mode or majority voting mode. At this point, we need again remember that the state is a corporate actor as well as a collective actor. This implies that the state will seek a strategy which reduces the costs of justification in order to effectively implement its policy change.

One possible strategy for this is to insulate the state authority for economic policy making from the influence of the society. But how is this possible?

The Logic of Regionalism: When does the State delegate its authority to a regional institution?

It is well known that the idea of delegating monetary policy to a more conservative central bank is very influential in the analysis of macroeconomic policy. Delegation can be seen as a way of insulating monetary policy-making authority from the society. An economist Dixit (1998:65) defines the concept of delegation as follows:

An action that removes one's future freedom of action is to give the power to take that action to someone else who does not suffer from the same temptation of opportunism, because this delegate has either different preferences or a simple mandate to act in a particular way.

His definition implies that the need to delegate the power of action to a third party comes from the temptation of opportunism. If so, why should we avoid the temptation of opportunism? Williamson claims that opportunism increases transaction costs and decreases the possibility of cooperation among actors by "misleading, distorting, disguise, obfuscate or otherwise confuse" actors' collective interest, defining opportunism as "self-interest seeking with guile"(1985:47).

According to Williamson's logic, actors need to establish safeguards such as contracts and credible commitments. To delegate the power of action to a third party is therefore a way of establishing credible commitments and keeping opportunism in check. The underlying assumption of the logic of delegation is that individual rationality does not generate social rationality. In other words, individuals do not contribute voluntarily to the production of collective goods. Consequently, an institution, able to enforce collective action to individuals must be established. This is a kind of hierarchical solution of collective action that assumes the existence of institutions

created to manage society, and the recognition of some collectivity that has sufficient power to coerce contributions for the collective good (Lichbach 1996).

What is an implication of this logic of delegation for understanding the logic of regionalism? Imagine a simple game of regionalism in which two states (or two groups of states) are involved, and each of them choosing between two options, namely, regional cooperation (cooperate) and national autonomy (defection). Two assumptions are given: 1) regional cooperation is a collective good for both states; 2) states' regional cooperation depends on their ability to solve domestic collective action problems in terms of the relations between the state and society. If we set actors and choices in a game, the next thing is to determine the payoff structure in the game. Figure 5-2 presents the payoff structure of an Assurance game. In this situation, both states' preferred outcome is mutual regional cooperation. As long as the other state cooperates, there will be no gain from rejecting regional cooperation. This game situation is different from the Prisoners' Dilemma (PD) situation that is usually assumed as a typical situation of international cooperation. The PD game is characterized by situation in which an equilibrium outcome is suboptimal because, for both states, the dominant strategy is 'defect', that is, preserving national autonomy regardless of the other state's choice. Therefore, both states cannot move from the suboptimal equilibrium, giving up their national autonomy as the dominant strategy.

A critical difference between the PD situation and the Assurance situation is that there exists a Pareto-superior equilibrium in Assurance, even though preserving national autonomy is still an equilibrium point. In other words, the choice of defection is no longer a dominant strategy. Consequently, there exists a greater possibility that the choice of regional cooperation can be a focal point. Before accepting this conclusion, however, we still have to explain how states can move away from mutual defection toward an agreement of mutual cooperation and what influences the states'

Figure 5-2 Regional Economic Cooperation as an Assurance Situation

Cooperation: State B State A	Regional Cooperation		National Autonomy	
Regional Cooperation	4	4*	1	3
National Autonomy	3	1	2	2*

ability to achieve mutual cooperation. States' ability to mutual cooperation depend on "the ability of states to act as a unitary actor" (Martin 1993:107). If both states can solve their domestic collective action problem, they can act as unitary actors. This, in turn, means that states can have considerable freedom of action, decisiveness, and a stronger commitment to making mutual agreement of regional cooperation. However, the ability of states to act as a unitary actor is determined by the interaction mode between the state and society.

The majoritarian voting interaction mode and hierarchical direction interaction mode between the state and society are more likely to allow the state to act as a unitary actor than is the negotiated agreement interaction mode. This means that, in these situations, it is not so difficult for states to move away from mutual defection if they are willing to pursue regional cooperation. That is, regional cooperation depends on states' decisiveness and commitment to making a mutual agreement on regional cooperation. At the same time, under majoritarian voting or hierarchical direction interaction mode, states do not feel the necessity of creating a highly institutionalized regional institution in order to achieve a mutual agreement of regional cooperation. In both these models, the uncertainty about states preferences will not be greater than under the negotiated voting mode in which states' preferences depends on their societies' preferences. Thus, as long as state know the other state's preference, they will converge on the choice of mutual cooperation, which all of them prefer, without developing a centralized mechanism.

In contrast, when both states have the negotiated agreement interaction mode, freedom of state action will be more constrained. Therefore, under this mode, it is more difficult for the state to act as a unitary actor and achieve mutual agreement on regional cooperation, even if they are willing to

achieve regional cooperation. In this situation, one possible solution is to create a centralized mechanism for establishing credible commitments and to delegate authority to the centralized mechanism (Martin 1993; Stein 1982). By doing this, the state can insulate itself from the society and finally move away from the suboptimal equilibrium of defection.

As a more specific example of this situation, we can consider the successful fiscal stabilization of the Italian government in 1998. For the Italian government, it was crucial to join the European Monetary Union because it considered the EMU as the foundation stone of macroeconomic policy. Many doubted the possibility of the Italian government's success in achieving the Maastricht deficit target. The problem of excessive government expenditure was closely related to Keynesian approach of big government and government intervention in the Italian economy that has been established in Italy after the "Hot Autumn of 1969" (MaCarthy 1997; Sbragia 2000). That is, in Italy, the expansion of welfare expenditure had become an important way of solidifying polarized Italian civil society, but at the cost of fiscal indiscipline.

This implies that fiscal stabilization could not be achieved without the formation of political consensus in Italian society. However, it is difficult to achieve political consensus in a highly polarized society such as Italy's society. In this situation, the strategy chosen by the Italian state was to delegate the policy authority of fiscal stabilization to a small group of technocrats and mobilize the Italian nationalism, directly relating the future of Italy to the achievement of the Maastricht criteria for entering the European Monetary Union (EMU). The case of Italy demonstrates that how the state effectively use its commitment to a centralized mechanism at the supranational level to solve collective action problem at the national level.

In sum, two points are important. First, the success of regionalism does not simply depend on the inter-state relations. Rather, it is determined by intra-state relations, namely, the interaction mode between the state and the society. Second, when the state cannot act as a unitary actor, the

success of regional cooperation depends on the achievement of a centralized and hierarchical mechanism to coerce the state away from its societal constraints.

The Inside-Out Perspective of Regionalism: Regionalism as a Strategy of Governing National Economy

This study suggests that regionalism is a strategy the state can adopt to transform the national economy. However, different states choose different types of regionalism because they are confronted with different degrees of institutional constraints in implementing economic transformation. This argument represents an analytical departure from previous studies of regionalism based on the *outside-in* framework. The outside-in framework defines the concept of regionalism as a strategy for international cooperation in terms of security and international trade and prioritizes external factors such as the end of the Cold War and globalization. For instance, Rosecrance argues that “an end to the bipolar cleavage” resulted in “a restoration of regional sovereignty” and “several regional powers dominating their geographical areas” (1991: 373-375). Lake and Morgan (1997) also analyze the rise of regionalism in terms of ‘a balance of power system’ in the post Cold War world, where nobody wants to take the full responsibility for international crisis and conflicts.

Unlike these views which see regionalism as a strategy of coordination of the post Cold War security problem, many studies conducted by economists relate regionalism to globalization and neoliberal world economic order. They analyze regionalism in terms of international trade. That is, they define regionalism as the development of preferential trade arrangements. In this field, one of the important debates is whether regionalism is conducive to the development of multilateral trade system such as the GATT and the WTO. Bhagwati (1991) claims that major regional arrangements are “stumbling blocks” which undermine the development of a multilateral system because they are based on preferential arrangements. Another influential view is that regionalism (regionalization of

trade) and multilateralism (globalization of trade) can be harmonized with one another in terms of international trade even though there is an optimal level of regionalization of trade (Frankel 1998; Frankel et al.1998b). However, this kind of ambivalent effect of preferential trade systems is not a new observation. Viner (1950) already argued that preferential trade arrangements can have lead to both trade creation and trade diversion.

These studies commonly assume that multilateralism, in other words, globalization, is good because it enhances economic efficiency. This tendency is also represented in a political science by those who specialize the politics of international trade. Milner's (1997) work defines regionalism as a strategy of regional trade liberalization sought by political leaders in response to the demands of the economics of scale from firms. She writes, "the more important scale economies are to firms, the greater the increase in firm profits from regionalism and hence, *ceteris paribus*, the more motivation for leaders to choose regionalism" (1997:90). In fact, the statement that we should be interested in the effect of regionalism to increase firm profits is strongly normative.

This kind of normative statement is an important feature of the outside-in approach to regionalism. Regardless of their specific concern - either security or international trade - all of the above mentioned studies assume that regionalism is the state's reaction to the stimuli of international political and economic order and that its response should be effective. Since they believe that "reason is universal" (Amin and Polan 2001:563), they do not consider that different states can interpret the stimuli of international political and economic order differently and hence react differently. The problem is that if we hold to their assumption and belief, we can never explain why Asian states do not proceed toward deeper regionalism as European states did, and, we have to conclude that they are irrational.

In contrast, the inside-out perspective suggested by this study assumes that regionalism is the state's strategy or institutional instrument, for implementing neoliberal economic transformation in national economy rather than regionalism itself being the primary goal of the state. Of course, this

approach recognizes the importance of the changing nature of the world economic order in shaping state action and choice of regionalism. However, this study stresses that the state does not respond automatically to external changes. Rather, since it is an institutional actor, it tends to preserve its old policy priorities and policy making pattern as much as possible. Without being convinced that the old one no longer works, the state will not accept a new policy priority and policy making pattern. Therefore, there is always the state's effort to partially reform or modify the old one before giving it up entirely. For instance, it was only after the failure of Mitterrand's socialist experiment in the neo-Keynesian approach that France moved finally toward a neoliberal austerity policy and support of the European Single Market. In 1981, the socialist Francois Mitterrand was elected as the president and the Gaullist Jacques Chirac as minister of finance. They launched an experiment of redistribution and nationalization on the purpose of the extension of public economy. They believed that this policy would stimulate economic growth by increasing domestic demand. Politically, they were in a favorable situation because they had the support of a Socialist majority in the National Assembly.

However, economically, their experiment was initiated at a time of rapidly growing unemployment and high interest rates worldwide. That is, the general macroeconomic climate was not favorable to such an expansionary fiscal policy (Hansen 2001). Hence, their policy's positive effect on domestic demand was offset by its negative effect on domestic production and private investment mainly caused from the increased interest rates. The Mitterrand government was caught in a situation in which the state should issue a government bond for financing such a redistribution and nationalization experiment. But, it increased interest rates and discouraged investment. This domestic situation was worsened by the negative effect of the USA's high interest rate policy (Schirm 2002). Finally, The Mitterrand government gave up its historical experiment after the Balance of Payment deteriorated rapidly from -0.7% of GDP in 1981 to -2.2% in 1982 and finally turned to the neoliberal economic policy. Furthermore, under the leadership of Jacques Delors

France became the most active member state to support the creation of the European Single Market to represent the neoliberal turn in European economies.

The Rise of Neoliberal World Economic Order: Different Responses in Europe and Asia

Since the mid-1970s a new set of economic ideas has dominated all discourse - neoliberalism. As Hall mentions, if the persuasiveness of neoliberalism depends on its ability to recognize and solve puzzles that the old economic ideas could not deal with, our concern should focus on the question: What were the puzzles? The rise of neoliberalism as a new set of economic ideas cannot be explained without considering the instability of the world economy since the 1971 demise of the Bretton Woods system of pegged exchange rates, the Oil crisis of 1973, and the world wide recession of the early 1980s.

The breakdown of the Bretton-Woods system is explained by both demand-side factor such as “the increase in global demand and inflation associated with U.S pursuit of the Vietnam War” and supply-side factor such as “the growing dispersion of negative supply shocks” mostly caused by the end of the postwar growth boom and the rise of labor militancy in some European states (Bayoumi and Eichengreen 1994:825). The point is that the growing negative supply shocks reduce the state’s capacity to deal with demand management policies and, as a consequence, the correlation between supply and demand shocks tends to be larger. This situation finally forces the shift from fixed exchange rates to floating exchange rates.

The reason for this is that under fixed rates, monetary policy is constrained by the need for exchange rate stabilization through flattening the aggregate demand curve, whereas under floating rates, monetary policy can increase price volatility regardless the aggregate demand curve. Therefore, the shift from fixed rates to floating rates means that the existing institutional constraint on monetary expansion is actually removed. Consequently, it becomes inevitable that states will search for a new method of monetary control to replace the old system. The breakdown of Bretton Woods

system can be understood in this context. In addition, the OPEC oil price rise reinforced the general trend of inflation and worldwide high interest rates because it created a situation where many states compete to borrow the abundant Petrocurrency funds (Whitely 1989). This situation enhanced the monetarists' position of deflationary policy.

As a result, the neoliberal discourse of market-oriented reform and in particular, the monetarist approach of emphasizing the regulation of money supply to accommodate the real economic growth rate has been the dominant economic model in the most influential international organizations such as the International Monetary Fund and the World Bank (Gilpin 2001; Verdun 1999; Bourdieu 2001). The common theme of neoliberalism is “de-politicization of market” and “the application of market solutions for public problem” (Strang and Bradburn 2001:129; Chang 2002:550). Neoliberalism is an ideational impetus, which challenges the economic role of the state per se. Neoliberalist economists criticize European welfare states' excessive public power. Under the famous thesis of ‘Eurosclerosis’, they believe that it results in their chronic economic diseases such as higher inflation, persistent unemployment, and lower economic growth. At the same time, neoliberal economists have expressed their dissatisfaction with Asian developmental states' intervention in market governance because they believe that ‘markets develop naturally’ (Stiglize 1992:75).

The Neoliberal Turn of European Regionalism

It was in the very situation of declining economic growth accompanied by high inflation and high unemployment since the mid 1960s that the neoliberal economic ideas obtained their persuasiveness among economic policy makers in most European states. The persistent coincidence of inflation and unemployment was seen as an anomaly that existing Keynesian economic ideas could not explain. This situation is described very well in the following statement made by a political leader of the British Labor Party, James Callaghan:

We used to think that you could spend your way out of a recession and increase employment by cutting taxes and boosting government spending. I tell you in all candour that that option no longer exists and that insofar as it ever did exist, it only worked by injecting a bigger dose of inflation into the economy, followed by a higher level of unemployment, at the next step (quoted in Armstrong et al., 1984:427).

With the decline of Keynesian economic ideas, three variants of neoliberal economic ideas - monetarism, fiscal conservatism, and supply-side economics - appeared attractive alternative ideas for the management of national economy following the stagflation in the 1970s. European states have tried to reverse the economic decline, triggered mainly by the end of the Bretton Woods System and the OPEC oil crisis, through developing a mutual self-binding institution to diffuse their authority into two different levels, that is, national and regional, and to achieve functional separation between public power and market governance at two levels (Milward 1992 ; Hoffman 1995; Streek 1997; Hooghe and Marks 2001). The idea of diffusing national authority to different levels of governance seems a very radical departure from the conventional idea of national sovereignty.

So, why did European states decide to diffuse their political authority over governing their national economies? The necessity of such radical institutional change arose from the fact that there was a substantial deviation between the economic policy prescriptions dictated by neoliberal economic ideas and economic reality, historically constructed by the Keynesian welfare nation state since 1945. The larger the deviation between economic ideas and economic reality, the more radical the institutional change with regard to the state's adaptive capacity will be.

The most important factor influencing the state's adaptive capacity is the relation between the state and organized interests in a society. The relationship between the state and organized interests in turn influences national patterns of economic policy-making. But it is also possible that the state's

purposive reform of old patterns of economic policy making can change present relations between state-organized interests for enhancing the state's adaptive capacity. At this point, we need to remember the mixed nature of the state, which is both a corporate actor able to make strategic choices 'decoupled' from the private interests and a collective actor, dependent on the preferences of social interests.

In his work of the European Community, Streeck (1996:300) wrote:

The civilization of modern capitalism under national economic governance was accomplished by mobilizing of public power, i.e. of a specific capacity of the modern state to create and enforce status rights and obligation for participants in economic transactions, in particular rights and obligations of citizenship.

From this Polanyian perspective of the state and the market, Streeck interprets the history of European integration as the history of conflicts between two alternative political-economic projects: the 'common market-making' project and a 'supranational welfare state-building' project (Streeck 1996:301). However, the final winner was the former neoliberal project since the Single European Act (SEA) of 1986 declared the establishment of an internal market before the end of 1992. In this regard, many claim that European regionalism after 1986 should be defined as the age of new regionalism, different from the old regionalism prior to the neoliberal turn of world economic order (Shrim 2002; Spindler 2002). In the same vein, Stubbs (2000:232) points out, "the wide variety of regional organizations formed from the mid-1980s belong to what has been termed the 'new regionalism'." The rise of new regionalism in Europe is explained by remembering the very fact that Margaret Thatcher regarded the SEA as the victory of the successful British model of Europe (Shrim 2002). The same point is also expressed by Streeck that "the battle on the political economy of

European Union is over, that Thatcher won and Delors lost, and that this is very likely irreversible”(1996:302).

The neoliberal turn of European integration enforced European states to change their old policy priority and policy making patterns because they weakens social interests’ influence over realizing the insulation of the market from political regulation. This means a change in the interaction mode between the state and society. The European negotiated agreement interaction mode between the state and society has operationlaized through coalition government based on parliamentary party system in the field of distribution and corporatist system of social concertation, as discussed in the previous chapter. However, as the nature of European integration shifted from the vision of regulated capitalism and a Social Europe to the vision of a self-regulating market and a Competitive Europe, the tension between national political systems and European governance also increased. The ongoing debate over a perceived democratic deficit of the European Union represents this increasing tension.

There has been a significant change in terms of the nature of European democracy. While some define it as the transformation from negotiation democracy to majoritarian democracy, others conceptualize it as a convergence toward the model of American democracy based on pluralism and presidentialism (Armingeon 2002; Coultrap 1999; Hix 1998). Whatever the definition of the change in the nature of European democracy, the common point is that there is a growing tendency toward a loss of parliamentary control over government decision-making as well as the lack of social interests representation at the supranational level. Against this kind of argument of democratic deficit in the European Union, one possible counterpoint can be expected as follows:

In its origins, the EU was an international organization and therefore not subject to constitutional principles that apply to its constituent polities. If member states are democratic and the EU is the creature of the member

states, why, it was asked, should the EU replicate direct democratic channels that already exist in individual countries? (Marks 1997:32).

Although the author's real intention in asking this question is shown by his emphasis of "the institutional genesis of the EU as an offspring of national institutions that claim exclusive sovereignty in their respective territories," his question reflects the emergence of a new type of democracy in Europe. Borrowing O'Donnell's terminology, we may name it a delegative democracy. According to O'Donnell's (1994) definition, delegative democracy is more majoritarian, but less liberal democracy. It is also strongly individualistic since under delegative democracy, voters' group identities and affiliations do not matter when choosing individual politicians who are supposed to take care of national interests. In this sense, delegative democracy is more favorable to presidentialism. This description of delegative democracy provides some insight into the European phenomena of growing state executive power, contrasted to the weakening national legislative power and interest group representation in the decision making process. Accordingly, these phenomena enhance the plebiscitarian principle of representation and undermine the European democratic tradition of group-based representation based on principles of distributional justice and democratic legitimization (Klaussen and Tilly 1997).

In Search for a Asian Model of Development

The persuasiveness of neoliberal economic ideas is confronted with a serious challenge in Asia. Most Asian states have experienced rapid and persistent economic growth referred to as 'the Asian miracle', for last three decades despite Asian state's aggressive intervention of market. When the World Bank downplayed the Japanese model of economic development and the necessary role of the state in Asian economies in publishing *World Development Report 1991*, Japanese's government strongly argued that the World Bank should understand the distinctive nature of Asian economic

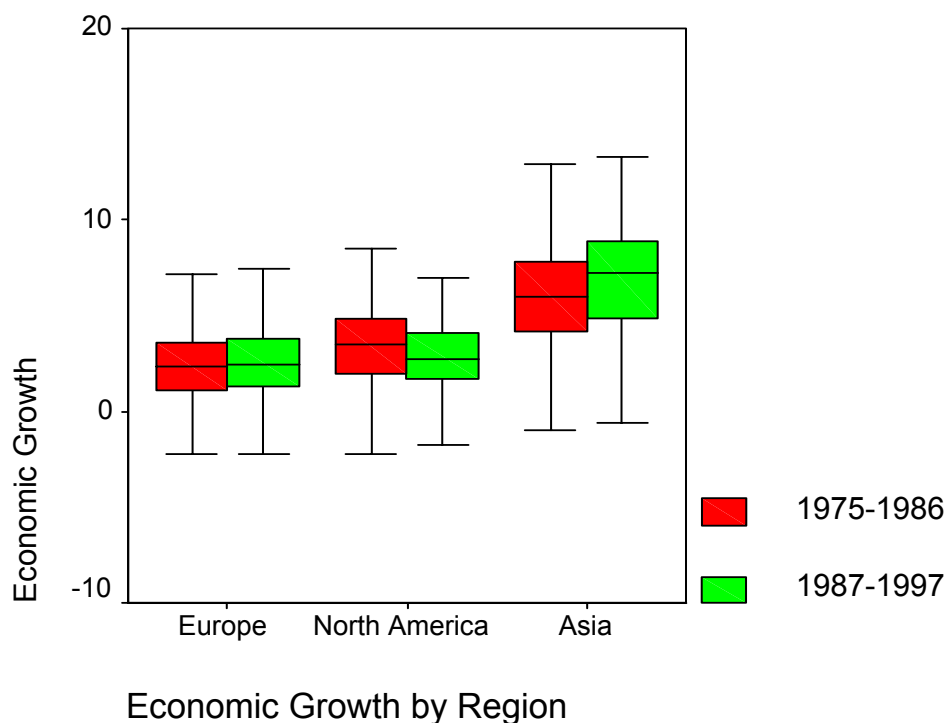
development if it wished to provide useful policy advice for developing economies. For this end, Japan proposed *the East Asian Miracle Project* to examine whether either the neoclassic economic growth model to emphasize the importance of factor accumulation such as the capital stock and the rate of saving or the endogenous model to value the state intervention for technology development and productivity growth through various policy instruments is better in explaining the Asian economic development (Gilpin 2001).

The World Bank accepted Japanese government's proposal and released an official report, *the East Asian Miracle*, was published in 1993. The main conclusion of the report confirmed the superiority of the neoclassic economic growth model. It claimed that the persistent economic growth in Asia can be explained by their states' market-conforming economic policies such as low inflation, low budget deficit, efforts to minimize price distortion and to maximize domestic savings, and capital accumulation. Yet, in this report, the World Bank still argued that Asian states' intervention was ineffective at best (World Bank 1993).

As figure 5-3 shows, Asian states' economic growth performance is outstanding compared to European and North American states. While both Europe and North America have decreasing or stable but at a lower level of economic growth, Asian states show sustainable economic growth. Even after the Asian financial crisis, the general trend of persistent economic growth did not disappear. Table 5-1 provides an empirical evidence for this point. Most Asian states experienced an abrupt decrease in economic growth in 1998, but they recovered very rapidly from the shock of financial crisis of 1997. As a result, many states returned to their normal levels of economic growth by 1999.

During the late 1980s and early 1990s, the economic success of Asian states, particularly, the Four Asian Tigers' (Taiwan, Hong Kong, South Korea, and Singapore) made neoliberal economists reconsider their primary assumption of 'spontaneous' development of markets, arguing that “

Figure 5-3 Economic Growth by Region (1975-1997)



Source: IMF, *International Financial Statistic Yearbook*, Washington D.C: International Monetary Fund (1998)

economic development is dependent on a society's getting its political as well as its economic fundamentals right" (World Bank 1997; Gilpin 2001:331). Unlike European states, Asian states did not have a strong public power based on well-defined social rights. In a sense, the balance between public power and market governability was substantially weighted toward the latter. An important point here is that this feature of Asian states may be more conducive to their adjustment to a neoliberal world economic order than European states. European states are heavily constrained by domestic resistance to the change of opportunity structure whenever they try to implement market-

Table 5-1 Growth Rate of GDP in Asian Countries after 1997 (% per year)

	1997	1998	1999	2000	2001	2002
<u>East Asia*</u>	7.1	2.9	7.3	8.1	4.4	6.5
China	8.8	7.8	7.1	8.0	7.3	8.0
Hong Kong	5.1	-5.0	3.4	10.2	0.6	2.3
Korea	5.0	-6.7	10.9	9.3	3.1	6.3
Taiwan	6.7	4.6	5.4	5.9	-2.2	3.5
<u>Southeast Asia**</u>	4.4	-6.6	4.1	6.2	1.7	4.1
Indonesia	4.7	-13.1	0.8	4.8	3.3	3.7
Malaysia	7.3	-7.4	6.1	8.3	0.4	4.2
Philippine	5.2	-0.6	3.4	4.4	3.2	4.6
Singapore	8.5	-0.1	6.4	9.4	-2.4	2.2
Thailand	-1.4	-10.5	4.4	6.1	5.8	6.4

Source: Asian Development Bank, Asian Development Outlook 2003, Manila: Asian Development Bank. p. 281

Note: *: East Asia includes China, Hong Kong, South Korea, Mongolia, and Taiwan.

** : Southeast Asia includes Cambodia, Indonesia, Lao People's Dem Rep, Malaysia, Philippines, Singapore, Thailand, Viet Nam.

oriented reform and a monetarist approach to economic recovery.

This point explains the reason why Asian states want to preserve national sovereignty by developing a market-oriented regional economic cooperation rather than relying on a more centralized and legalized regional institution as 'the third party enforcement'. However, we should note that Asian state's strategy of economic adjustment and economic liberalization is not based on purely neoliberal principles but, on the Asian way of state intervention. This is the very reason why Asian states are once again playing a crucial role in implementing neoliberal market-oriented reform and economic liberalization. It might be an irony that neoliberal market depoliticization is achieved by state intervention. However, it also supports many economic sociologists' argument that "state action *always* plays a major role in constituting economies, so that it is not useful to posit states as lying outside of economic activity" (Block 1994:696).

Explaining National Variations of Regionalization: Still the Century of Nation-State?

Many assert that national distinctiveness in the structures of production and in the relationship between the state and the market is fading with the globalization and regionalization of the world economy. Ohmae (1991:x-xi) writes:

It [the interlinked economy] is becoming so powerful that it has swallowed most consumers and corporations, made traditional national borders disappear, and pushed bureaucrats, politicians, and the military toward the status of declining industries. The emergence of the ILE has created much confusion, particularly for those used to dealing with economic policies based on conventional macro-economic statistics that compare on nation against another. Their theories don't work anymore.

It is true that there is a general tendency for national political economies to converge toward a dominant model of market governance, the neoliberal model. But it is also true that unlike the globalists' expectation, the world economy has not been globalized rather it has regionalized. By the same logic, we can consider that, unlike the regionalists' expectation, the world economy may not be so much regionalized but rather still nationalized. The diversity of national capitalisms is explained by the fact that "the distinctive institutional architecture and cultural configuration of the state (both locally and nationally) serves to channel, filter and mediate common challenges in highly specific ways, often reinforcing the distinctiveness of national capitalism"(Hay2000: 512).

With this consideration, this section directly deals with the issues to what extent national economies are regionalized. The main question is: why are some states more regionalized while others are less so? To answer this question, we first need to distinguish the concept of regionalization from that of regionalism. Put concisely, regionalization refers the actual process of the economic convergence of national economies in a given region. Regionalism, on the other hand,

is a strategy or a political project in order to achieve a regional order of economic coordination among states in a given (Hveem 2000; Spindler 2002). This conceptual distinction makes us examine the extent to which regionalism, as a state' strategic and political project, can generate its intentional outcomes, that is, the regionalization of national economies. The central claim is that the degree of regionalization is determined by domestic political institutional arrangements rather than a particular type and level of regionalism.

Measuring Regional Capital Market Integration: Convergence and Divergence of National Interest Rates

Regionalization of national economies has many aspects, such as intra-regional trade and intra-regional foreign direct investment. Most studies of regionalization or globalization have focused on these aspects. This study also examined these aspects in Chapter 3. In this section, however, we turn to a new aspect of regionalization, that is, regional capital market integration. Capital market integration refers the formation of integrated international markets for goods and financial assets beyond national barriers and controls following to the growing capital mobility and the deregulation and liberalization of financial markets since the 1970s.

There is a huge literature discussing capital market integration in the globalized world economy from various perspectives and policy prescriptions. One important arguments in this field is that real interest rates tend to be equalized across different national economies as a result of capital market integration (Frankel 1979; Mishkin 1984; Nelson 1985; Wu and Chen 1998; Goodwin 2002). Oatley writes that “the interest parity condition states that in a world of tightly integrated financial markets, a condition economists call “perfect capital mobility”, the risk-adjusted domestic interest rates must equal the world interest rate”(1999:1006). Of course, this argument remains controversial in terms of empirical evidence.

The argument of a relationship between interest rate parity and capital market integration suggests that we may get useful information regarding the degree to which national economies are integrated at the regional level from examining interest rate disparity across different economies in a given region. Put concisely, we can indirectly measure the degree of capital market integration by examining the comovement of national interests in a given region. The underlying idea is that, as national economies become more integrated at the regional level, their interest rates are more likely to converge and hence there are relatively smaller differences among national interest rates. In fact, the creation of the European Monetary Union was initiated by this idea. That is, European states no longer fix their own interest rates, policy on inflation or exchange rates. Instead, since the creation of European Monetary Union in 1998 a single interest rate has been collectively set by the European Central Bank in Frankfurt. Motivated by this European experience and the argument of interest rate parity and market integration, this study suggests the following simple indicator to measure the degree of regional capital market integration:

$$CMI_{ij} = \frac{abs[r_{ij} - Rr_{j\text{mean}}]}{Stv(Rr_j)}$$

Where

CMI_{ij} = the degree of regionalization in capital market integration in each year

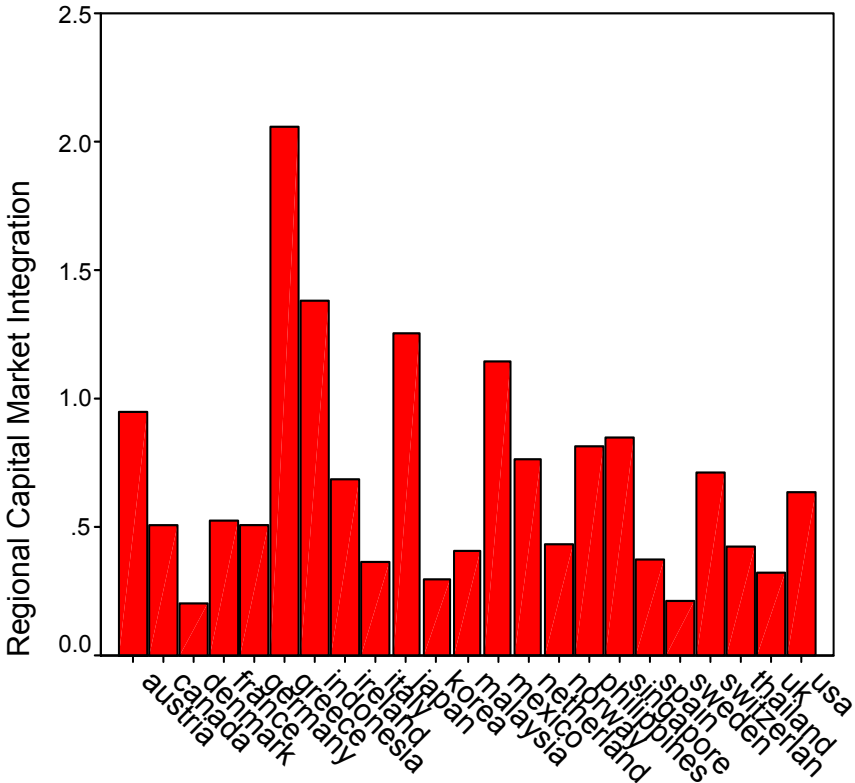
r_{ij} = national interest rates in each year

$Rr_{j\text{mean}}$ = regional mean score of national interest rates in each year

$Stv(Rr_j)$ = the standard deviation score of national interest rates in each year

Figure 5-4 presents national variations in regional capital market integration measured by the above formula. Higher scores indicate lower degrees of regionalization, as the larger the deviations of national interest rates from a regional mean interest rate in a year, the less regionally integrated the

Figure 5- 4 National Variations of Regional Capital Market Integration (1981-1997)



national capital markets. This figure suggests some interesting points. First of all, European states have higher levels of regional capital market integration than Asian and North American states. Second, while Greece, Indonesia, Japan and Mexico show lower levels of regionalization, Denmark, Italy, Norway, Spain, Sweden, and UK in Europe, and South Korea and Malaysia in Asia show higher levels of regionalization. In particular, Japan's lower level of regionalization seems puzzling when we consider its leading position in Asian regionalism. On the other hand, it is also puzzling that some European states such as Norway and Sweden, who do not have a EU membership or have long hesitated to join the EU, have higher levels of regionalization. These facts imply that

Table 5-2 Interest Rate, Exchange Rate, and Monetary Autonomy by Economic Interest Groups

		<i>Interest rate</i>	<i>Exchange rate</i>	<i>Monetary Autonomy vs. Exchange rate flexibility</i>
<i>Domestic Market</i>	Tradable (import-competing)	Low	Depreciation	High (Support for a floating Exchange rate system)
	Nontradable		Appreciation	
<i>International Market</i>	Tradable (export-oriented)	High	Depreciation	Low (Support for a fixed Exchange rate system)
	Nontradable		Appreciation	

national variations in regionalization cannot be explained without understanding the distinctiveness of national economies and domestic motivations.

The Distributional Effects of Capital Market Integration

The use of interest rate as a monetary policy instrument has a significant distributional effect. Table 5-2 summarizes different economic interests' preferences over monetary policy and exchange rate policy. First, we distinguish economic interest groups according to their market orientation in economic activities, that is, domestic market or international market. However, economic groups with the same market orientation, can be reclassified into two groups -economic actors who produce tradable goods and those who produce non-tradable good. According to this interest group classification, we next examine their preferences concerning interest rate, exchange rate, and monetary autonomy. Given the assumption of 'the Impossibility of Trinity' in a world of free capital mobility, the preference of monetary autonomy will determine the preference of exchange rate flexibility.

Frieden (1991) points out that lower interest rates and monetary expansion benefit domestic capital to produce non-tradable goods and services such as the residential construction industry, real

estate, health care, leisure industry and education. In contrast, higher interest rates and monetary stringency are good for international capital or export –oriented manufacturers and agriculture. However, growing capital mobility makes this type of distributional effect ambiguous. In a world of fully mobile capital, states cannot manage their macroeconomic policy by interest rate change, because while higher interest rates will cause capital inflow and currency appreciation, lower interest rates will result in capital outflow and currency depreciation. That is, macroeconomic management no longer operates simply via monetary policy and interest rates but via exchange rate policy. More importantly, this changed situation also generates a more complicated logic of distributional effect of macroeconomic management. For domestic capital, lower interest rates and monetary expansion are good for them, but, at the same time, currency depreciation generated by lower interest rates is bad for them. As a result, distribution effects will cancel each other out. The same logic is applied to the international capital. Higher interest rates and monetary stringency are good for them, however currency appreciation is bad for them.

National currency depreciation and appreciation have been the most traditional means of economic adjustment, as it can keep up a high level of investment and income at the cost of inflation (Anderson 1987). States devalue their currency when they want to encourage exports and discourage imports and reduce the current account deficit. Sometimes, devaluation is an alternative way to increase domestic aggregate demand in order to fight unemployment in a situation where expansionary fiscal policy is unpopular. However, devaluation may aggravate inflation. Devaluation increases the price of imported goods and as a result, workers may demand wage rises as compensation. In turn prices increase and output decreases. At the same time, devaluation increases real exchange rates and domestic goods lose competitiveness. This may also dampen investors' confidence in the economy and destroy the credibility of a domestic currency, causing a reduction of saving rate, increased interest rates, and increased inflationary expectation. Considering this kind of vicious cycle, devaluation is regarded as a signal of economic instability. However, revaluation also

has the same problem. If a state has a strong commitment to low inflation and increases interest rates fight inflation, it causes real appreciation that puts pressure on import-competing industries and consequently slows economic growth (Eichengreen and Frieden 2001). In this regard, both devaluation and revaluation increase economic uncertainty and market transaction costs.

The most important effect of capital market integration is that it is no longer possible for states to change the price of their currencies by devaluation or revaluation as a national instrument to deal with asymmetric disturbances (De Grauwe 2000). This is the cost of capital market integration. At the same time, however, capital market integration benefits states by reducing economic uncertainty and transaction costs of cross-border economic activities. If so, who supports capital market integration? Obviously, they are internationally oriented economic interest groups, such as international banks and multinational corporations. In contrast, domestically oriented economic interest groups, such as import-competing industries in steel and transportation sector, organized labor in declining manufacturing sectors, and their political parties will not support it (Eichengreen and Frieden 2001).

This fact can explain why opposition to a fixed exchange rate and the EMS came from left parties and the organized labor in France and Italy in the early 1980s despite they support the EU (Frieden 2001). Therefore, if states have strong commitment to price stability, the reduction of economic uncertainty and transaction costs, and to world competitiveness and credibility, then they should effectively deal with the distributional conflicts among economic interest groups in order to pursue capital market integration. However, a state's ability to solve distributional conflicts will be significantly influenced by the nature of the political institutions in its society.

Political Uncertainty and Economic Uncertainty: Political Institutions and Capital Market Integration

Different interest rates indicate differences in national economic policy across national economies. This implies that more similar interest rates across national economies indicate more similar economic policy across national economies. More significantly, the possibility of successful economic coordination among different regional economies is likely to be higher when states have similar economic policy priorities. Based on this logic, the degree of deviation from a regional mean interest rate indirectly reflects the expected costs of economic coordination among national economies in a given region. That is, the higher the divergence of national interest rates in a given region, the higher the cost of economic coordination among national economies at the regional level.

At the same time, divergence in national interest rates reflects states' preference for national autonomy in governing their economies. This means that there is a trade-off between national monetary autonomy and exchange rate stability. For this point, Wyplosz (1997:3) argues:

[a] country that wants to conduct an independent monetary policy, raising or lowering interest rates for the purpose of its domestic economy, must allow its exchange rate to fluctuate in the market. Conversely, a country confronted with full capital mobility that want to fix its exchange rate must set its interest rate to be exactly equal to the rate in the country to which it pegs its currency; since monetary policy is determined abroad, the country has effectively lost monetary policy independence.

The need to preserve national monetary autonomy comes from the fact that states want to achieve macroeconomic stability by separating their economy from external disturbances, such as asymmetric influences from other economies. However, at the same time, states want to response

effectively and independently to internal disturbances, mostly caused by domestic political uncertainty and distributional conflicts. In democratic political systems, political uncertainty is caused by the very nature of politics. Moe (1990) points out that political power and public authority is a kind of property right, but unlike markets, in politics property rights are not well defined and are very uncertain. In a similar vein, Riker also argues that “disequilibrium is the characteristic feature of politics” (Riker 1980:443).

Riker defines disequilibrium as the absence of a decisive winner under the majority rule. If we define the concept of equilibrium as an outcome of a game that is stable in the sense that no single player wants to deviate from the equilibrium, then any equilibrium in political games cannot achieve such kind of stable outcomes. In a sense, Olson (1986) shares Riker’s view of politics as a state of disequilibrium in that he sees politics in general and the advanced democracy in particular, as a source of economic inefficiency since the political competition of organized interests in democratic political systems can generate ‘institutional sclerosis’ which has significant negative effects on the achievement of economic efficiency.

From this view, political institutions matter when determining economic efficiency and performance. Turning to the next question, which type of political institutions is more conducive to reduce political uncertainty and, therefore to achieve economic efficiency? Many studies emphasize the superiority of parliamentary-PR constitutional arrangements (consensus democracy) to presidential-plurality constitutional arrangements (majoritarian democracy). For instance, Lijphart (1999) disclaims a conventional wisdom that single party majority governments with plurality electoral systems are more decisive, more effective policy makers, and, therefore, better at macroeconomic management and performance. Providing a cross-national statistical analysis of the effect of consensus democracy on seven macroeconomic variables (economic growth, GDP deflator, inflation, unemployment, strike activities, budget deficit, and economic freedom), he concludes that “ the evidence with regard to economic growth and economic freedom is mixed,

with regard to all of the other indicators of economic performance, the consensus democracies have a slightly better record and a significantly better record as far as inflation is concerned” (1999:270).

His theoretical rationale for this is that more effective macroeconomic management depends on political stability, predictability, and the formation of broad political support rather than decisiveness and flexibility. In this respect, consensus democracy, characterized by parliamentary-PR electoral system and coalition government, can provide ‘steady’ and ‘centrist’ policy making, and a ‘broad consensus’ of government policy. In other words, consensus democracy creates “ more stable, steady, continuous, and more predictable forms of government than majoritarian systems with alternating governmental responsibilities” (Crepaz 1996a:8).

In the same vein, but relying on a different theoretical reasoning, Perry and Robertson, in their analysis of the effect of political uncertainty on capital market performance, argue that “constitutional design or specifically, electoral laws, are proximate influences on transaction costs within the political market” (1998:134). According to their logic of the transaction costs of politics, electoral uncertainty is the main source of transaction costs in politics. The higher electoral uncertainty is, the higher transaction costs in political market will be, and consequently, the higher capital market risks. More specifically, for the private investors in capital markets, in particular government bond markets, capital market risks depends on the degree of capital market integration measured by interest rate changes. If international capital markets are integrated, then the interest rates of national economies will converge because they experience similar adjustments within an integrated trade zone. This makes the private investor reduce their transaction costs, mostly caused by information costs, because in an integrated capital market the interest rates of one country become more predictable.

An important point to note is that the degree of capital market integration is influenced significantly by the degree of electoral uncertainty since “elections generate a degree of probability and contingency for all policies” (Perry and Robertson 1998:140). Based on this understanding of

the interaction between political markets and capital markets, Perry and Robertson conclude that proportional representation and partisan diversity may be more conducive to the reduction of the market uncertainty. Freeman, Hays and Stixs (2000:455) also contend the same point that “the impact of opinion polls, electoral uncertainties, threat of government dissolution, and other political events on the probabilities of switches in exchange rate regime will be greater in countries plurality rather than PR electoral system.”

In contrast, some political economists discredit the effectiveness of consensus democracy in reducing political uncertainty. Rather, they argue that consensus democracy is frequently related to government inability and incredibility in implementing desirable policy changes and therefore, it increases political uncertainty. For instance, it is a pervasive argument that proportional representative electoral systems and larger coalition governments are associated with the delay of fiscal adjustment and with higher public debt than majoritarian electoral systems and a single-party government (Grilli, Masciandaro and Tabeillini 1991; Alesina and Drazen 1991). In this perspective, political institutions affect the behavior of governments with different ideological or policy preferences, directly influencing government stability and ideological polarization (Persson and Svensson 1989). Thus, unstable and polarized governments behave more myopically and, as a result, tend to discount the future more. Unstable and polarized governments can be found more frequently in PR electoral systems than in majoritarian and plurality systems.

Alesina and Drazen provide a theoretical model to explain coalition governments' inability to adopt a sharp policy change for fiscal stabilization. They introduce ‘the war of attrition model’ to explain why governments fail to implement a new policies for fiscal stabilization. Their central point is that fiscal stabilization requires a clear agreement regarding who among different political actors and interest groups will pay for the cost of stabilization since fiscal stabilization always has a distributional implication in the form of the tax burden. Thus, if there is no consensus or compromise on the allocation of the burden of policy change for fiscal stabilization among different

interests, then the introduction of fiscal stabilization will be delayed. As a result, it becomes a kind of war of attrition.

The same logic can be applied to capital market integration. As we discussed, capital market integration has distributional effects on different economic interests. If states cannot achieve consensus or compromise over the allocation of the burden of policy change for capital market integration, then capital market integration will be delayed. An important question is which type of institutional arrangements is more effective for achieving the political consolidation required for radical policy change. Many political economists assert that a single-party majority government and plurality electoral system are better perform this goal. In a similar vein, Tsebelis (1995) argues that under the distinction between policy stability and policy change, political systems with a small number of veto players and smaller ideological distances between different political actors have a higher possibility of policy change.

Why can we assume that majoritarian democracy is more constructive for achieving political consolidation of a new policy with significant distributional effects? Olson's theory of encompassing distributional coalitions provides the most systemic answer to this question. That is, majoritarian democracy is more effective in producing encompassing distributional coalitions and, as a result, for achieving political consolidation of a new policy as a public good when there is the resistance from private interests. For Olson, the formation of encompassing distributional coalitions is the same as the creation of majority voters. Therefore, Olson emphasizes the strength of majoritarian democracy as "a model of an exceptionally simple and prototypical democracy with a thoroughgoing 'winner take all' character" (Olson 1986:167). His emphasis of the strength of majoritarian democracy is also confirmed by his point concerning the superiority of two party systems in which "the incumbent party seeking reelection has an incentive to bring about conditions that will make a majority of the voters want more of the same"(1986:169).

Reconsidering A Dichotomy between Consensus Democracy and Majoritarian Democracy

When we consider the distributional effects of capital market integration, the degree of regionalization will be determined by the extent to which national political institutions effectively deal with distributional conflicts among different economic interest groups. However, as we discussed, there is no agreement of which type of institutional arrangements is more effective in reducing distributional conflicts and political uncertainty. Some argue that consensus democracy is more conducive to solving distributional conflicts since it is more likely to create a broad consensus and stable policy coalitions among different interests than majoritarian democracy. Others claim that majoritarian democracy is more effective in implementing policy changes since it tends to have fewer veto players and ideological polarization. However, this study suggests that the nature of political institutions should not be understood as a dichotomous choice between consensus democracy and majoritarian democracy. In this study, two models of democracy are operationalized by the executives-party dimension originally developed by Lijphart (1999) and are measured on a continuum.

Lijphart distinguishes two types of democracy by ten variables according to two dimensions, the executive-parties dimension and the federal-unitary dimension. However, in this study, the focus will lie on the first dimension to specify “the arrangement of executive power, the party and electoral systems, and interest groups” (Lijphart 1999:3). Concerning the aspect of interest group politics, Lijphart refers to a distinction between pluralist interest group system and corporatist interest group systems. But, in this study, the aspect of interest group representation will be analyzed in terms of Olson’s theory of a positive relationship between majoritarian democracy and encompassing democracy rather than the conventional distinction between pluralist and corporatist interest group systems. More importantly, it will be operationalized in terms of the executive’s capability to produce encompassing distributional coalitions. Table 5-3 presents five aspects of the executive-parties dimension and the operational indicators for each aspect.

Table 5-3 The Executive-Parties Dimension in Consensus vs. Majoritarian Democracy

<i>Executives-Parties Dimension</i>	<i>Indicators</i>
<i>Concentration of Executive Power</i>	The Checks and Balance of the Executive Power Government Polarization Government Fractionalization
<i>Executive-Legislative Relations (executive dominance)</i>	The Total Number of Seats held by all government parties
<i>Executive Capability in creating encompassing distributional coalitions</i>	Government Special Interests: the largest government party represents any special interests The Degree of Institutionalized Democracy
<i>Electoral System</i>	Plurality vs. PR electoral system
<i>Constitutional Design</i>	Presidential System vs. Parliamentary System

On the basis of five aspects of the executive-parties dimension, many studies have defined a democratic system as a majoritarian democracy when it has a higher concentration of executive power, executive dominance in the executive-legislative relations, two party system, presidential system, plurality electoral system and encompassing distributional coalitions (Lijphart 1999). The reverse conditions are used to define consensus democracy. However, we cannot be certain that executive power is always more concentrated and stronger in majoritarian democracy than consensus democracy. Although consensus democracy is frequently characterized by parliamentary, multi-party, and PR electoral systems, we cannot say that all parliamentary governments with multi-party coalitions and PR electoral laws have weak executive powers.

If we observe that coalition governments under a parliamentary system and PR electoral system enjoy strong executive power, then how can we distinguish them between majoritarian democracy and consensus democracy? The Federal Republic of Germany is a good example of this point as it is a hybrid between majoritarian democracy and consensus democracy (Shmidt 2002). Therefore, this study suggest a more pragmatic approach to analyze the performance of national political institutions in terms of the management of distributional conflicts and the reduction of political uncertainty. This is to focus on specific institutional aspects, rather than the dichotomous choice between majoritarian democracy and consensus democracy.

The first aspect of the executive- parties dimension is the concentration of executive power. Lijphart (1999:114) measure the concentration of executive power in terms of the breadth of representation and the numbers of parties in the governing coalition. His measures tend to focus on various formal institutional factors. However, this study is more concerned with government behavior patterns and more substantive and informal factors such as ideology to directly influence public policy making. So, three measures will be suggested for the aspect of centralization of executive power: the degree of checks and balances of executive power, government fractionalization, and ideological polarization within the government.

For the second aspect, the dominance of executive, this study measures it in terms of government strength. Government strength depends on the governing parties' strength in parliamentary voting. Governing parties' strength in parliamentary voting can be measured by the total number of seats held by all government parties, as many studies of European coalition governments point out (Muller and Strom 2000). This measure is more straightforward than Lijphart's indicator, cabinet durability. Cabinet durability has mostly been considered as an indicator for cabinet stability rather than the dominance of executive. Of course, Lijphart (1999) himself mentions this fact, but he does not provide any systemic explanation of why we should think the dominance of executive in terms of cabinet stability, except that there is a positive association between cabinet duration and effective government policy making. But Sartori criticizes Lijphart's point about the association between cabinet durability and effective governance of the executive, arguing that "the problem is not longevity, how long governments last, but whether governments are given the capacity to govern. Stable government may be a facilitating condition, but is certainly not a sufficient condition for effective government" (1997:113).

As Lijphart points out, the dominance of the executive can be conceptualized as executive strength relative to that of the legislature. It refers to the executive's bargaining power to achieve its desirable policy in relation to the legislature. The total number of seats held by all government

parties is a direct measure of the executive's bargaining power. In coalition governments, a cabinet's bargaining power may be determined some other factors, such as cabinet discipline and ideological distances among the cabinet composition parties. However, as Muller and Strom (2000) argue, governing parties tend to have a kind of mutual binding agreement about the rules of the game within a government coalition prior to the formation of a coalition government. This coalition agreement can discipline party behaviors within a coalition government.

The third aspect needs more explanation. Despite Olson's argument regarding the positive relationship between majoritarian system and encompassing distributional coalition, some studies consider consensus democracy as a proxy measure of encompassing organizations (Lijphart and Crepaz 1991; Crepaz 1996a and 1996b). It is worth noting, in particular, Crepaz' argument that, while Olson's theory of encompassing distributional coalitions is a powerful explanation of government behavior and performance, his empirical operationalization - strong two-party systems with plurality electoral rules - does not fit with reality (Crepaz 1996b). Actually, he empirically tests Olson's theory by developing a proxy measure of encompassing distributioanl coalitions, namely, "popular cabinet support" as "the sum of popular votes for parties that make up a coalition government with the goal to produce unified public policy" (Crepaz 1996a: 10). Crepaz's underlying assumption is that consensus democracy to have PR electoral systems and large coalition governments tends to represent higher numbers of voters than majoritarian democracy to have plurality electoral systems and single party governments.

Both Olson's majoritarian interpretation and Lijphart and Crepaz's consensus interpretation of encompassing distributional coalitions can contribute to our understanding of the relationship between the private interest and the public interest in democratic political systems. However, Lijphart and Crepaz's conceptualization of popular cabinet support as a proxy for encompassing distributional coalitions does not appropriately capture Olson's original conceptualization. Olson relates the concept more often to government's capability to deal with special interest groups and

macro-political conditions, such as political stability, foreign invasions, and the degree of institutionalized democratic political systems (Olson 1982). Therefore, in this study, the concept of encompassing distributional coalitions will be operationalized in terms of the government capability to create encompassing distributional coalitions. Two alternatives, government special interests and the degree of institutionalized democracy will measure it. I will discuss specific data sources and measurements for these indicators in the next section.

Finally, for party system, electoral system and constitutional arrangement (presidentialism vs. parliamentary), the conventional distinctions plurality versus proportional representation and presidential government versus parliamentary government will be used. Both electoral systems and government type can influence the nature of the party system in a political system. As Lijphart (1994) point out, the disproportionality of electoral systems serves as the link between the electoral system and the party system, as disproportionality reduces the number of parties and increases the possibility of the creation of a majority. However, disproportionality decreases political representation. The distinction between plurality and proportional representation can be understood by the notion of disproportionality. In plurality systems, legislators are elected using a winner-take-all and first past the post rule, while in proportional representation systems they are elected on the basis of the percent of votes received by their party. A conventional idea is that plurality electoral systems tend to generate two-party systems and single-majority party government, while proportional representation electoral systems tend to multi-party systems and coalition governments.

However, Sartori discounts this conventional idea on the basis that the effect of electoral systems on the number of parties and the type of government depends on the nature of political cleavages historically constructed in a society. This factor influences the degree of party fragmentation, polarization and party discipline. In this regard, the nature of party system is not simply the object of constitutional engineering, according to Sartori (1997), the key to the stable and

effective governance is the existence of structured party system. In the absence of a structured party system with strong and disciplined parties, the constitutional choice between presidential government and parliamentary government does not effect stable and efficient governance.

In short, this section discusses the effects of domestic political institutions on the regionalization of national economies. Comparing two competing ideal types of democratic governance, this study suggested a pragmatic approach of government performance and political institutions. Its purpose is to find more specific institutional conditions that influence political uncertainty and the management of distributional conflicts, modifying Lijphart's operationalization of the executive-parties dimension. This pragmatic approach does not imply that the distinction between majoritarian democracy and consensus democracy is not important. Rather, the point is that some conventional generalizations based on the dichotomy between two types of democracy do not work when explaining the real relationship between government performance and political institutions.

Main Propositions

Proposition 1: Regionalism is a strategy pursued by states that wants to adapt successfully to the neoliberal world economic order. However, if a state shows better economic performance in terms of economic growth, then it is less likely to prefer deeper regional economic cooperation because it believes that deeper regional economic cooperation may constrain its national policy autonomy and therefore disturb its present economic stability and competitiveness.

Proposition 2: Different states have different preferences over the degree of regional economic cooperation. It is the state-society relation that influences states' preference of the degree over regional economic cooperation. If a state has state-society relations based on negotiated agreements, then the state will be more favorable toward deeper regional economic cooperation. In contrast, if a

state has state-society relations based on majoritarian voting, then it will be less favorable toward deeper regional economic cooperation.

Proposition 2-1: Path dependent effects of domestic constraint from higher public power and social concertation induce states to pursue deeper regional economic cooperation. In such cases regionalism is considered as a part of self-binding strategy to increase their commitment and credibility of neoliberal economic reform.

Proposition 3: While the concept of regionalism is defined as a strategy pursued by the state, the concept of regionalization refers the actual outcome of national convergence in terms of macroeconomic performance. Based on this conceptual distinction, the degree of regionalization in national economies may not directly vary with a particular type of regionalism since the actual process of regionalization will be influenced by the distinctiveness of national economies and the nature of domestic political institutions.

Proposition 3-1: The degree of regionalization can be measured by the degree of capital market integration in a given region. The degree of regional capital market integration depends on nation-specific ways of dealing with the distributional effects of capital market integration. However in general, consensus democracy (majoritarian democracy), characterized by parliamentary-PR electoral systems (presidential-plurality electoral system), would be more conducive to capital market integration because of its capability of reducing political uncertainty and creating stable coalitions among different interests.

A CROSS-NATIONAL QUANTITATIVE ANALYSIS OF THE CHOICE OF REGIONALISM AND REGIONALIZATION

This section presents a quantitative analysis of the central questions proposed in this study. The main goal of the section is to test the theoretical propositions empirically by undertaking cross-national statistical analysis. It is not an easy task to express abstract theoretical ideas and complex realities through cross-national statistical analysis. However, an important strength of cross-national statistical analysis is its ability to develop more general concepts and its concern of increasing comparability. Cross-national statistical analysis is based on the idea of “statistical regularity” that assumes the logic of if-then propositions (Mckeown 1999). In the logic of if-then propositions, all concepts are assumed to be general and all observations are covered by these general concepts. When a research pursues statistical regularities, the major concern is to test a particular if-then proposition with enough cases to generalize it rather than to explore how the particular proposition is explained in some specific conditions. Therefore, inevitably, statistical regularities are achieved at the expense of complex realities. Considering this nature of cross-national statistical analysis, the purpose of this study in doing cross-national statistical analysis will be limited to testing the main hypothesis of states’ choices of regionalism and regionalization.

This section consists of three parts. The first part provides a descriptive analysis of the relationship between regional variations in economic growth and the degree of regional economic cooperation, employing analysis of variance and tabular analysis. This part provides an analysis of proposition 1. The second part focuses on a quantitative analysis of the state’ economic role and the choice of regionalism, based on proposition 2 and 2-1. The main purpose of this part is to assess the degree to which the distinctive nature of the state’s economic role in governing national economy suffices to precisely explain and predict a state’s choice of the level of regional economic cooperation. Two methods will be used for testing the main hypotheses: discriminant analysis and

an ordered probit model. In the third part, I will test proposition 3 and 3-1 concerning the effect of domestic political institutions as well as the effect of regional institutions per se on the degree of regionalization. For this, I will conduct a pooled time-series /cross-sectional panel analysis consisting of 28 countries over the time period from 1981 to 1997 (N=28, T=17) with the panel corrected standard error procedure.

The Level of Regional Economic Cooperation and Economic Growth in Asia and Europe

Hypotheses

Proposition 1: If a state shows a better economic performance in terms of economic growth, then it is less likely to prefer deeper regional economic cooperation because it believes that deeper regional economic cooperation may constrain its national policy autonomy and therefore disturb its present economic stability and competitiveness.

Hypothesis 1: The level of regional economic cooperation is negatively associated with the economic growth of states within that region

Regionalism is a strategic choice pursued by states that want to increase their macroeconomic stability and competitiveness under the neoliberal world economy. In a given region, therefore, the level of regional economic cooperation among states depends on their economic performances and capacity to adapt to the neoliberal world economic order. The underlying idea behind hypothesis 1 is that the most important motivation to develop regional economic cooperation comes from states' concern regarding national economic performance. In other words, it is assumed that there is no strong motivation to seek regional economic cooperation if a state's national economic performance is good.

Although most studies of international cooperation tend to disregard the cost of cooperation itself, it is clear that collective action among states creates collective action costs in terms of national

policy autonomy. It is a kind of transaction costs generated by developing mutual dependence. Therefore, unless states can be sure that regional economic cooperation will improve their economic performance, they will hesitate to develop deeper regional economic cooperation. This section explores this principle hypothesis, namely, that economic growth is negatively associated with the level of regional economic cooperation, by employing tabular analysis and analysis of variance.

Measuring the Level of Regional Economic Cooperation

To test hypothesis 1, we first need to measure the level of regional economic cooperation in terms of the degree of national economic policy autonomy. The underlying idea is that there is a reverse relationship between the level of regional economic cooperation and the degree of national economic policy autonomy. That is, we assume that the higher level of regional economic cooperation, the less a state's national economic policy autonomy. Unfortunately, there is no available data set which directly measure the level of regional economic cooperation in this manner.

As an alternative, this study proposes a coding scheme for the level of regionalism based on ordinal scale measurement. In this coding scheme, the values indicating different levels of regional economic cooperation are assigned by a rank-ordering logic based on five categories. We can select the category that best describe the degree of national economic policy autonomy under a particular regional arrangement. The five categories are classified according to different types of regional economic cooperation: (0) no regional economic cooperation; (1) Economic Forum; (2) Free Trade Agreement; (3) Custom Union; (4) Common Market; (5) Economic Union.

It is generally assumed that economic forum represents the lowest level of regional economic cooperation, while economic union is the highest level of regional economic cooperation. A good example of an economic forum is APEC. APEC represents a new type of regional economic cooperation in that it is not a formal trade agreement but a community formed to pursue free trade and free investment across different regions. APEC is based on voluntary cooperation rather than a

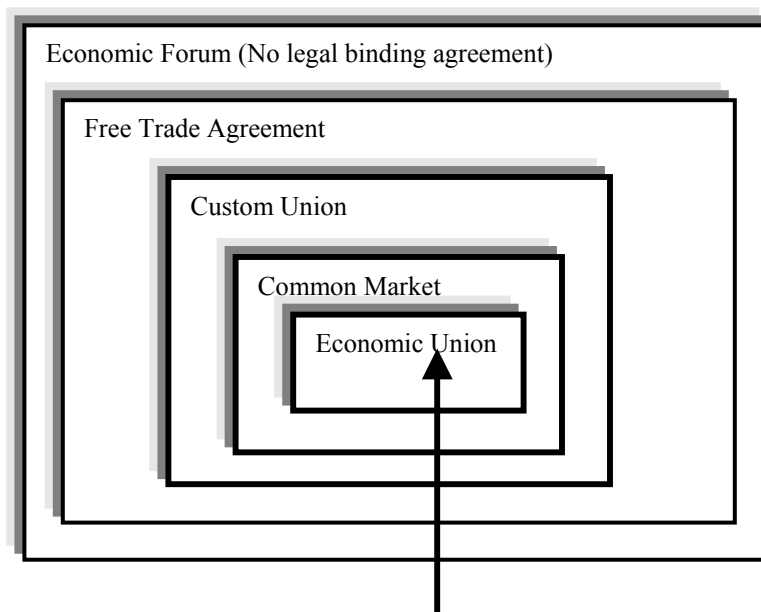
legal binding agreement. This implies that it will be more difficult for member states to reach an agreement as well as to effectively implement it without consensus. Conversely, each member states will enjoy greater national economic policy autonomy.

On the other hand, free trade agreements, such as North America Free Trade Agreement (NAFTA), can be distinguished from economic forum by the existence of legal binding agreement among member states. A Free trade agreement is a regional arrangement under which member states eliminate internal barriers such as tariffs and border restrictions, for free trade, but retain their own external tariffs against non-member states.

When we define deeper regionalism as “the liberalization of trade in service, the harmonization regulatory regimes, co-ordinations of macroeconomic policies” (OECD 1996:126), the next level of regional economic cooperation - custom unions - can be considered as a kind of cut-point dividing between deeper economic integration and conventional liberalization of trade. A custom union is a regional arrangement under which member states have a common external tariff, implying that members have common external trade policies. With a common external tariff, no member state in a custom union is in a position to gain a competitive advantage by reducing the external tariffs. The European Economic Community (EEC) of 1957 and the *Mercado Comum do Sul* (MERCOSUL), which comprises Brazil, Argentina, Paraguay and Uruguay, are both custom unions.

On the other hand, a common market is a regional arrangement designed to extend the scope of economic coordination beyond eliminating trade barriers among member states into free movement of labor and capital. The size of internal market within a regional bloc is extended by this removal of internal trading barriers. The Single European Act of the 1986 was this type of case. Finally, economic union occurs when member states agree to coordination beyond common trade policies and free movement of labor and capital and synchronize fiscal and monetary policies concerning

Figure 6-1 The Level of Regional Economic Cooperation and National Policy Autonomy



The deeper the regional economic cooperation, the less national economic policy autonomy

interest rates, inflation, and exchange rates. Consequently, each member state in an economic union should expect a significant loss of its national macroeconomic policy autonomy. The European Union represents this level of regional economic cooperation. Figure 6-1 presents the relationship between the level of regional economic cooperation and national economic policy autonomy.

Based on these different levels of regional economic cooperation, we can construct a rank ordering to indicate states' degree of national economic policy autonomy. Economic forum indicates the highest level of national economic policy autonomy, while economic union is associated with the lowest level of national economic policy autonomy. It is simple to assign a value for each Asian state as the widest and most persistent regional economic cooperation among Asian states began with the creation of APEC in 1989. Of course, Southeast Asian states have a longer history of economic cooperation developed through ASEAN since 1967. However, ASEAN has never obtained broad support from other Asian states, particularly, the Northeast Asian states, Japan, South Korea, and Taiwan. So, we will not consider ASEAN as a broad regional arrangement influencing most Asian

states. Thus, for Asian states (Indonesia, Korea, Japan, Malaysia, Philippine, Singapore, and Thailand), a value of (0) will assigned for the period from 1975 to 1989 and a value of (1) for the period from 1990 to 1997.

For European states we need to be more careful in assigning the values because the process of European integration is more complicated than that of Asian regionalism. First, European integration evolved from custom union through common market to economic union. According to the chronological history of the European Union, the European Economic Community (EEC) Treaty in 1957 laid down the following four objectives:

1. The removal of all tariffs and barriers of internal trade for making the Community a free trade area.
2. The creation of a Common External Tariff (CET) and Common Commercial Policy (CCP)
3. The prevention of competition among member states
4. The free movement of good, services, labor, and capital

Considering those four tasks, the main task of the EEC Treaty may be considered as the creation of a European common market, not just the realization of a custom union. However, it was the Single European Market project (SEM) at the Milan meeting of the European Council in 1985 that EC member states directly declared the realization of an internal common market by 1992. The SEM project represents a critical junction of the history of European integration. Armstrong and Bulmer (1998:2) interpret the significance of the SEM as follows:

A minimalist interpretation of the SEM is that it was a programme of legislation developed with a view to achieving one of the original goals of the 1957 Treaty of Rome: the creation of a common market. A maximalist interpretation, however, is that the programme provided a platform for a major revival of European integration itself.

Following this interpretation of the SEM, we define the level of European regional economic cooperation during the period from 1986 to 1992 as being at the level of common market and at the level of economic union after this period.

Second, all of the present EU member states did not join at the same time. Therefore, we need to examine when and, at which level, each European state participated in the process of European integration. For instance, Italy, Germany, France, and Benelux states including Belgium, Luxembourg, and Netherlands have participated since the European Coal and Steel Community (ECSC) began European integration in 1951. In contrast, Austria, Sweden and Finland did not join the EU, at the level of economic union until 1995. Third, some non-EU states have long economically cooperated through the European Community Free Trade Agreement (ECFTA) even if they have not joined the European Union. Switzerland, Norway and Iceland fall into this category. On the basis of these three considerations, Table 6-1 indicates when and at what level, each European state began participation in the process of European integration. With these three considerations, we can assign each European state in any year, to one of the five categories of regional economic cooperation. For instance, Germany is assigned to a “3”, to specify custom union from 1975 to 1985, a “4”, to refer common market, from 1986 to 1992, and a “5” economic union, from 1993 to 1997.

A Descriptive Analysis of the Relationship between Economic Growth and the Level of Regional Economic Cooperation

As the first step for testing Hypothesis 1, we need to sort out the relationship between economic growth and the level of regional economic cooperation. The contingency table is useful

Table 6-1 EU Membership and the Evolution of European Integration

Austria	1995 (economic union); before then, Join the European Community Free Trade Agreement with the EC (EU) in January 1973.
Belgium	1951 (custom union)
Denmark	1973 (custom union)
Finland	1995 (economic union); before then, Join the European Community Free Trade Agreement with the EC (EU) in January 1974.
France	1951 (custom union)
Germany	1951 (custom union)
Greece	1981 (custom union)
Iceland	Non-EU, Join the European Community Free Trade Agreement with the EC (EU) in April 1973.
Ireland	1973 (custom union)
Italy	1951 (custom union)
Luxembourg	1951 (custom union)
Netherlands	1951 (custom union)
Norway	Non-EU, but Join the European Community Free Trade Agreement with the EC (EU) in July 1973.
Portugal	1986 (Common market); before then, Join the European Community Free Trade Agreement with the EC (EU) in January 1973.
Spain	1986 (common market)
Sweden	1995 (economic union); before then, Join the European Community Free Trade Agreement with the EC (EU) in January 1973.
Switzerland	Non-EU, but Join the European Community Free Trade Agreement with the EC (EU) in January 1973.
UK	1973 (custom union)

Source: Wim F.V.Vanthoor. 2002. *A Chronological history of the European Union 1946-2001*. Cheltenham: Edward Elgar; the EU, the history of the European Union (1973-2003).
http://europa.eu.int/abc/history/1973_en.htm

for this purpose. Table 6-2 represents the contingency table for cross tabulation analysis of the level of regional economic cooperation by economic growth. For this cross table elaboration method, the sample observations of economic growth for each country in each year are classified into one of three categories, high, moderate, low economic growth on the basis of the mean value of economic growth in each year. “Low” economic growth is assigned to the observations to be lower than the mean value of each year and are coded as (1). “Moderate” economic growth is equal to or slightly greater than the mean value and are coded as (2). “High” economic growth is significantly larger than the mean value and are coded as (3). Countries included in this analysis include 18 European

Table 6-2 The Level of Regional Economic Cooperation by Economic Growth (1975-1997)

Growth	No cooperation	Economic Forum	Free Trade Agreement	Custom Union	Common Market	Economic Union	total
Low	12.8%	2.5%	0%	24%	14.8%	16.4%	100%
Moderate	27.6%	4.5%	31.3%	18.7%	13.4%	4.5%	100%
High	55.6%	27.2%	7.9%	2.6%	2.0%	4.6%	100%
total	96%	34.2%	39.2%	45.3%	30.2	25.5%	

and 7 Asian countries. To produce a more general discussion of the relationship between level of regional economic cooperation and economic growth, three North American states (USA, Canada, and Mexico) are included in the sample. The data of economic growth rate used are collected from the IMF *International Financial Statistics Yearbook*.

As we can see from Table 6-2, the actual relationship between the level of regional economic cooperation and economic growth is in line with the hypothesis. Deeper regional economic cooperation (custom union, common market, and economic union) is more frequently pursued in condition of low economic growth. No cooperation and economic forum are more common in conditions of high economic growth. Finally, free trade agreement tends to appear more frequently with moderate economic growth. More specifically, 82.8% of the total cases of high economic growth were engaged in lower levels of regional economic cooperation (No cooperation or economic forum). 55.2 % of the total cases of low economic growth were involved in a custom union, common market, or economic union, all representing deeper regional economic cooperation. Therefore, we can confirm hypothesis 1 by the data in Table 6-2.

For the next step in the analysis, this simple contingency table is elaborated by the use of a control variable for region. The logic behind employing this cross table elaboration method is that the relationship between economic growth and the level of regional economic cooperation should be split for each region. The reason for this is that it is possible that the relationship between economic growth and the level of regional economic cooperation is distinctive in each region. The

dependence of the level of regional economic cooperation on economic growth is depicted in a partial table for each region.

Table 6-3 presents the elaborated tabular analysis of the level of regional economic cooperation by economic growth and region. In each cell, we can find two pieces of information: the country identification of actual cases and the percentage of the column total. First, for European states, we see that there is a clear tendency that relatively larger numbers of European states (3.4% --> 11.7% --> 47.9%) appear in the cells to represent a deeper regional economic cooperation (custom union, common market and economic union) as economic growth declines.

This implies that when most European states are in a situation of high economic growth, they are less likely to participate in deeper regional economic integration, such as a custom union, common market, or economic union. According to Table 6-3, only Six European states (Denmark, Luxembourg, Germany, Ireland, Finland, and Portugal) were engaged in deeper regional economic cooperation even in the condition of high economic growth. In contrast, most European states were participating in deeper regional economic cooperation, when they showed moderate or low economic growth. For instance, the case of Greece provides a good example for this point. When Greece was experiencing low or moderate economic growth since 1979, it was a member states of the EEC, EC, and EU. However, it was not engaged in any regional economic cooperation when it was experiencing high economic growth.

Second, for Asian states, it is important to note that most Asian states were experiencing high economic growth between 1975 and 1997, in fact, 70.8% of the total cases for Asian states are coded as high economic growth. This is in clear contrast to European states which show only 6.5% high economic growth. According to theory, therefore, Asian states do not have their strong motivation toward deepening regional economic cooperation beyond the creation of a free trade zone. Someone may ask: if most Asian states have enjoyed high economic growth, why did they not stay at the status quo of no regional economic cooperation? Why did they decide the creation of a

Table 6-3 The Level of Regional Economic Cooperation by Economic Growth Elaborated for Region (1975-1997)

Economic Growth	Level of Regional Economic Cooperation					
	No Cooperation	Economic Forum	Free Trade Agreement	Custom Union	Common Market	Economic Union
Europe Low (71.7%)	Greece (0.5%)		Austria Norway Finland Portugal Spain Sweden Switzerland Iceland (23.4%)	Belgium Denmark France Germany Greece Ireland Italy Luxembourg Netherlands UK (20.8%)	Belgium Denmark France Germany Greece Ireland Italy Luxembourg Netherlands Portugal Spain UK (12..8%)	Belgium Denmark Finland France Germany Greece Italy Luxembourg Netherlands Portugal Spain Sweden UK (14.3%)
Moderate (21.7%)	Greece (0.2%)		Austria Finland Iceland Norway Portugal Spain Sweden (9.7%)	Belgium Denmark France Greece Ireland Italy Luxembourg UK (6.0%)	Germany Greece Ireland Netherlands Portugal Spain UK (4.3%)	Finland Ireland Sweden UK (1.4%)
High (6.5%)	Greece (0.5%)		Finland Iceland Norway Switzerland (2.7%)	Denmark Ireland Luxembourg (1.0%)	Germany Ireland (0.7%)	Finland Ireland Luxembourg Portugal (1.7%)
Asia Low (13.7%)	Korea Malaysia Philippine Singapore (8.1%)	Japan Philippine Thailand (5.6%)				
Moderate (15.5%)	Indonesia Japan Philippine Thailand (11.8%)	Indonesia Korea Japan Philippine (3.7%)				
High (70.8%)	Indonesia Korea Japan Malaysia Philippine Singapore Thailand (45.3%)	Indonesia Korea Japan Malaysia Philippine Singapore Thailand (25.5%)				
North America Low (58.0%)	US Canada Mexico (44.9%)		US Canada Mexico (13.0%)			
Moderate (27.5%)	US Canada Mexico (24.6%)		US Mexico (2.9%)			
High (14.5%)	US Canada Mexico (13.0%)		Mexico (1.4%)			

free trade zone such as APEC, even if APEC represents the lowest level of regional economic cooperation? For this question, we need to consider the fact that, for Asian states, the primary motive behind regional economic cooperation was defensive. That is, it was a response to the unilateral action of the United States and the European Community in restricting access to their domestic markets and a means of enhancing competition in third-country markets (Ravenhill 2001).

In the mid 1980's, the US, in particular, became more aggressive in protecting its domestic markets from North Asian economies, while using US trade law such as section 301 of the Trade Act and the 'super 301' amendment, to enforce them to open their domestic markets after 1985. In this situation of US unilateralism, Asian states agreed to reinforce multilateral trade liberalization by creating APEC, as it became essential for their sustainable economic growth when considered their export-oriented economies. But they rejected the US's proposal of legalization of regional cooperation in the first Pacific Economic Cooperation Committee (PECC) Trade Policy Meeting in San Francisco in March 1986. As Ravenhill points out, Asian states' rejection was not about the US's proposal of making a resolution of multilateral trade liberalization per se, but the US's move away from a consensus approach in PECC toward a legalistic approach to regionalism.

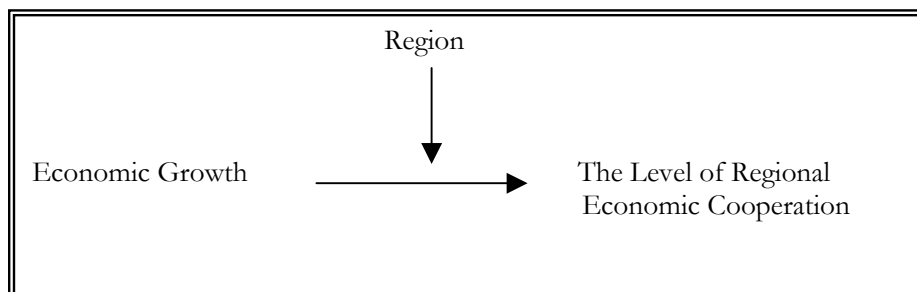
For Asian states, the US's legalistic approach to regionalism was interpreted as a US strategy "to deploy unilateralism enforcement measures in order to force to opening of Asian markets and change "protectionist" Asian policies" (Kahler 2000:568). Therefore, they want to develop their own way of regionalism. In this respect, as Drysdale and Elerk (1996) argue, Asian rejection of legalism can be understood as a new approach to regionalism, that is, voluntarism. Under regional cooperation based on the norm of voluntarism, "all participants have positive interests in abiding by their undertakings, there is no need to waste time on lengthy processes of drafting legalistic texts, making them formally binding by requiring the formal ratification of international treaties by legislatures of each participant and setting up enforcement mechanism" (Drysdale and Elerk 1996:125).

Third, the relationship between economic growth and the level of regional economic cooperation is also confirmed by a more generalized comparison of North American states. In North America, the creation of a free trade agreement to legally bind member states were achieved in a situation where most member states were low economic growth. As we see from Table 6-3 of the three member states of NAFTA, only Mexico consistently engaged in a free trade agreement regardless of its economic condition. In contrast, it was only in the situation of low economic growth that the US and Canada decided to form a regional arrangement for creating a free trade area with Mexico. That is, it was difficult to develop a regional arrangement in the North America region when US and Canada enjoyed moderate or high economic growth rates. This point is also supported by the pervasive argument that “NAFTA was initiated by the leaders in an interdependent economy facing poor economic conditions” (Milner 1998:29).

In conclusion, the above contingency table shows that “region” is an interacting variable. That is, the precise effect of economic growth on the level of regional economic cooperation depends on the region. The reverse is also true in that the precise effect of region on the level of regional economic cooperation depends on the degree of economic growth. Figure 6-2 presents the nature of the relationship among three variables. The negative relationship between economic growth and the level of regional economic cooperation is very clear for the cases of Europe, but relatively weak for the cases of Asia and North America. The effect of region on the level of regional economic cooperation is demonstrated by the fact that each region shows a distinctive pattern of regional economic cooperation.

While the dominant patterns of regionalism in Europe are custom union, common market, and economic union, in Asia and North America they are economic forum and free trade agreement. More importantly, the distinctive pattern of regional economic cooperation in a given region is directly related to the degree of economic growth in that region. If the mean growth rate in a region

Figure 6-2 Region as an Interacting Variable



is relatively low, then the region shows deeper regional cooperation, such as the case of Europe. In contrast, if the mean growth rate in a region is relatively high, then the region shows no cooperation or economic forum. When the mean growth rate in Europe was relatively high, the region showed no cooperation. In contrast, when the mean growth rate in Europe was relatively low, the region developed deeper regional economic cooperation. On the other hand, Asia consistently shows relatively high economic growth rate, consequently, the region has developed a lower level of regional economic cooperation. It is quite common for the relative strength of the hypothesized relationship between two variables to be more pronounced in one category of the control variable than in another. More importantly, the presence of such a difference between subcategories reflects the complexity of social reality. For this study, this general statement can be understood in terms of understanding of the concept of region as a distinctive social situation influencing the relationship between economic growth and the level of regional economic cooperation in a given region.

On the basis of all these descriptions of the relationship between economic growth and the level of regional economic cooperation, we can directly test hypothesis 1 by employing one-way analysis of variance. According to hypothesis 1, we believe that the means of economic growth are not equal across different levels of regional economic cooperation. Table 6-4 provides a summary of these means and the result of one-way ANOVA test. As can be seen, there exists a clear division line

Table 6-4 The Means of Economic Growth by the Level of Regional Economic Cooperation and the Result of One-way ANOVA Test

	MEAN	N	STANDARD DEVIATION		
NO COOPERATION	5.06	167	3.65		
ECONOMIC FORUM	6.45	56	3.04		
FREE TRADE AGREEMENT	2.31	160	2.75		
CUSTOM UNION	2.15	115	2.14		
COMMON MARKET	3.05	74	2.23		
ECONOMIC UNION	2.76	72	2.23		
TOTAL	3.49	644	3.19		
	SUM OF SQUARES	DF	MEAN SQUARE	F	SIG
ANOVA					
Between Groups	1387.615	5	277.523	34.35	.00
Within Groups	5154.618	638	8.079		
Total	6542.232	643			

Levene Statistic=9.029

$\pi = .000$

separating economic forum from the other levels of regional economic cooperation. For those states with a level of regional cooperation higher than economic forum, the mean for economic growth declines sharply from 6.5 % to 2.3 %.

On the other hand, in a one-way ANOVA test, our concern is to test whether means from different groups (different levels of regional economic cooperation) differ from each other by examining the ratio of variance *between* groups compared to the variance *within* groups. The statistical significance of means for economic growth across different levels of regional economic cooperation is also confirmed by the F statistic which reflects the difference between the between-group variance and the within-group variance in the model. The F statistics in Table 6-4 is 34.35. This confirms hypothesis 1: The level of regional economic cooperation is negatively associated with economic growth.

Explaining a State's Choice of Regionalism: The Economic Role of the State and the Level of Regional Economic Cooperation:

Hypotheses

Proposition 2: Different states have different preferences for the degree of regional economic cooperation. It is the state-society relation that influences states' preferences for the degree of regional economic cooperation. If a state has a state-society relationship based on negotiated agreements, then the state will be more favorable toward deeper regional economic cooperation. In contrast, if a state has a state-society relationship based on majoritarian voting, then it will be less favorable of deeper regional economic cooperation.

This proposition can be restated in terms of the economic role of the state, captured according two dimensions: economic policy priority and the pattern of policy making.

Proposition 2-1: Path dependent effects of the domestic constrain created by higher public power and social concertation in the negotiated interaction mode will induce states to pursue deeper regional economic cooperation. This is because they tend to consider regionalism as a strategy that will contribute to increasing their commitment to and credibility of neoliberal economic reform by self-binding and insulation from their societies.

In order to test proposition 2-1, it will be "unpacked" into the following testable hypotheses.

Hypothesis 2-1: If a state has higher public power, measured by total tax revenue, then the state is more likely to pursue deeper regional economic cooperation. In other words, the level of regional economic cooperation varies directly with total tax revenue.

Hypothesis 2-2: If a state has higher social concertation, measured by direct taxation, then the state is more likely to pursue a deeper regional economic cooperation. In other words, the level of regional economic cooperation varies inversely with direct taxation.

Methodological Considerations: Comparing Discriminant analysis and the Ordered Probit Model

A general specification of the empirical model used in this analysis as follows:

$$\begin{aligned} & \textit{Level of Regional Economic Cooperation}_{i,t} \\ & = f(\textit{Tax Revenue}_{i,t}, \textit{Direct Taxation}_{i,t}, \textit{Economic Growth}_{i,t}, u_{i,t}) \end{aligned}$$

where $u_{i,t}$ is normally distributed error term. The subscript i refers to one of the N cross-sectional units, and the subscripts t refers to one of the T time points. This model will be tested by the data for 28 countries (7 Asian countries, 18 European countries and 3 North American countries) from 1975 to 1997. The data are collected from IMF, *Government Financial Statistics* and *International Financial Statistics Yearbook*.

For testing hypothesis 2 and 2-1, this study employs two methods: discriminant analysis and a random panel ordered probit model. The reason both methods are used is more theoretical than methodological. The dependent variable, level of regional economic corporation, can be conceptualized as an ordinal variable if we assume theoretically as I discussed in last part that the higher the level of regional economic cooperation, the less national autonomy in macroeconomic policy making. When an ordinal variable is assumed, an ordered probit model is appropriate. However, the problem is that it is not theoretically certain that different levels of regional economic cooperation should be conceptualized as ordinal outcomes. We can also consider them as different types of regional economic cooperation rather than different degrees of regionalism, in other words, as a nominal variable rather than as an ordinal variable. This implies that there is no reason to expect any evolutionary process of regionalism from low to high levels. In this case, the use of discriminant analysis is more proper. Long (1997:115) argues that:

It is important to note that simply because the values of a variable can be ordered does not imply that the variable should be analyzed as ordinal. A

variable might be ordered when considered for one purpose, but be underordered or ordered differently when used for another purpose

Considering Long's point, the use of discriminant analysis can be justified if our purpose is to test whether, without considering the dependent variable as an ordinal variable, the model can correctly classify observations into different categories of the dependent variable. The dependent variable - level of regional economic cooperation - is trichotomous, with categories of 0 (no cooperation), 1 (low level of regionalism), and 2 (high level of regionalism). If we assume that the variable is nominal, then the estimating technique should yield equivalent results regardless of the particular ordering, for example, whether the categories are ordered 0,1,2 or 1,0,2 (Aldrich and Cnudde 1975). While a discriminant analysis meets this condition, an ordered probit model does not satisfy it.

Therefore, I first assume that the level of regional economic cooperation is a nominal variable and conduct a discriminant analysis. In doing the discriminant analysis, my main concern is to test my theoretical model by examining exactly how it can classify different levels of regional economic cooperation. Furthermore, the discriminant analysis allows us to identify which cases are misclassified by the model. Next, I will turn to analyze the same dependent variable as an ordinal variable by employing an ordered probit model. When doing a nonlinear probability model, the main concern is to analyze the marginal effects of independent variables on the probability of a particular outcome of the dependent variable.

What determines States' Choice of Regionalism? : A Discriminant Analysis:

Research Question: The main question addressed here is whether levels of regional economic cooperation are predictable from the distinctive economic role and capacity of a state plays in governing the national economy. Therefore, the independent variables are state's public power vs. market governability, and social concertation vs. encompassing distributional coalitions. These are

measured quantitatively by total tax revenue and direct taxation respectively. The dependent variable is the level of regional economic cooperation. When the dependent variable is categorical, but the independent variable is interval, discriminant analysis can be used to answer the very question that we are interested in this section. The complexity in a state's choice of regionalism cannot be fully understood by a small number of selected variables. Accordingly, the ambition of the discriminant analysis presented here is relatively moderate. It is designed to investigate whether the hypothesized independent variables are meaningful in explaining a state's choice concerning the level of regionalism it becomes involved in.

A Note on Discriminant Analysis: Discriminant analysis is useful for both exploratory and predictive purposes. More specifically, it can be used when a researcher wants to determine whether there are differences among the mean values of the independent variables for two or more groups. In this regard, it is similar to the analysis of variance (Wesolowski 1976). It is also appropriate when the main research interest is to determine which variables account for these differences, as well as understanding how groups are discriminated and classified.

In this study, the main purpose of the discriminant analysis is to assess the degree to which hypothesized variables explain and predict a state's level of regionalism. The main concern is to predict the particular outcome of the dependent variable in which we are interested, rather than predict the probability of its belonging to a particular outcome of the dependent variable. That is, we are interested in answering the question: "how do we predict the category of an observation as a function of its values on dependent variables?" (Aldrich and Cnudde 1975: 587). This distinction is crucial to understanding the main purpose of discriminant analysis, especially, as compared to logistic regression. An important issue concerning the use of discriminant analysis, is its relative advantage, or disadvantage, as compared to logistic regression. Some statisticians claim that, while logistic regression is appropriate regardless of the underlying distribution of the independent

variables, discriminant analysis is appropriate only under conditions of multivariate normal distribution and homogeneity of covariances (Press and Wilson 1978).

Other studies of discriminant analysis disclaim this argument, pointing out the strength of the linear discriminant analysis initially introduced by Fisher. They argue that “without the assumption of normality and equal covariance matrixes, the main justification for its use is that it spreads the two sample means apart as far as possible, scaled in a particular way, using a linear combination of variables” (Panel of Discriminant Analysis 1989:39). That is, linear discriminant analysis maximizes the distance between different groups, and consequently produces a function that has a strong discrimination power among groups. Thus, as many studies contend LDF is quite a robust technique. Also, LDF is appropriate in classifying the observations in samples that consist of multivariate observations of group membership, just like the sample in this study.

In order to conduct discriminant analysis we need first understand the concept of discriminant functions as the linear combinations of standardized independent variables which yield the largest mean differences between groups. If the dependent variable is a dichotomy, there is one discriminant function; if there are k levels of the dependent variable, up to $k-1$ discriminant functions can be extracted. A simple way to interpret discriminant function coefficients is to consider them as similar to the factor loading scores of variables in a factor analysis (Pennings et. al 1999). That is, the larger the discriminant function coefficients are, the greater the contribution of each independent variable to the discrimination between groups.

Results of a Discriminant Analysis: In the previous part we classified the level of regional economic cooperation into 6 categories (no cooperation, economic forum, free trade agreement, custom union, common market, and economic union). However, the main concern of this section is not to explain each sub-category of regional economic cooperation, but to identify and theorize about the structural factors that influence states’ motivation toward deeper regionalism. Therefore, in order to simplify the discriminant analysis, in this section the level of regional economic

Table 6-5 Mean Values of Independent Variables per Level of Regionalism (1975-1997)

Level of Regionalism	Tax Revenue (%)	Direct Tax (%)	Growth (%)
No Regional Arrangement	0.16	0.45	5.06
Low Level	0.24	0.29	3.38
High Level	0.36	0.32	2.57
Total	0.26	0.35	3.49

Source: IMF, Government Finance Statistics, in various years.

cooperation will be reclassified from the six original categories into three categories: 0= no regional economic cooperation; 1 = low level of regionalism (economic forum or free trade agreement); 2 = high level of regionalism (custom union, common market or economic union). As we already mentioned in the previous section, a custom union can be considered as a cut-point to distinguish between deep economic integration and conventional liberalization of trade as the creation of a custom union is an essential step for moving toward a common market and economic union. We can infer this point from the experiences of the EEC in Europe and MERCOSUR in Latin America.

The first step in doing a discriminant analysis is to examine whether the mean values of two independent variables (total tax revenue and direct taxation) across two groups of low and high regionalism are roughly in line with the hypotheses. Table 6-5 summarizes the means of two variables for each group. We see that while there is a roughly a negative relationship between direct taxation and the level of regionalism, there is a positive relationship between total tax revenue and the level of regionalism. This is consistent with the hypotheses. Economic growth is included in the model for discriminant analysis on the basis of the discussion in the previous section and the cooperation.

Next, we proceed to the interpretation of the canonical discriminant functions in the light of my theory. Table 6-6 presents the results of the discriminant analysis used to predict the level of regional economic cooperation. The number of discriminant functions is 2. Remember, as we mentioned, the maximum number of functions is equal to the number of groups of the dependent

Table 6-6 Discriminant Functions at Group Means and Coefficients based on Rotation of Structure Matrix.

Discriminant Functions across groups:		
Group	Function	
	1	2
No cooperation	-1.795	.314
Low level	-.218	-.490
High level	1.328	.205
Discriminant Function Coefficients:		
	Function	
	1	2
Total tax revenue	.990	.033
Direct Taxation	-.197	.964
Economic Growth	-.256	.186

variable minus one. Also, remember that the discriminant function coefficients can be interpreted in the same manner as factor loading scores. The canonical discriminant function tells us that the respective factions separate between groups by looking at the means for the functions across them. When we examine the first canonical discriminant function across groups, we see that it discriminates between the high level of regional economic cooperation (average position 1.328 with respect to first discrimination) from the other groups, in particular, from no cooperation (position -1.795 with respect to the first discriminant function). We can also examine discriminant coefficients based on the factor structure matrix. By examining the factor structure we can determine which independent variables defines a particular discriminant function. The discriminant function coefficients are in fact the correlation between the variables in the model and the discriminant functions. So, we can consider these coefficients as factor loading scores of the variables on each discriminant function.

A positive position relative to the first discriminant function is associated with total tax revenue (+.99). On the other hand, negative positions relative to the first discriminant function are associated with direct taxation (-.197) and economic growth (-.256). These results are consistent with

the hypothesized relationships. That is, the high level of regional economic cooperation is associated with high total tax revenue, low direct taxation, and low economic growth. Considering that the discriminant function coefficient for total tax revenue is larger than other coefficients for direct tax and economic growth, we can say that the size of total tax revenue is more important than other variables in discriminating between different levels of regional economic cooperation.

The second discriminant function is less easily interpreted on the basis of the theory. It separates the low level of regional economic cooperation from the two other groups. The second function captures that low level of regional economic cooperation (average position -.490) is associated with high direct taxation (.964) and high economic growth (.186). Unlike the theoretical expectation, however, it also relates it to high total tax revenue (.033). This implies that the higher-order discriminant functions are random from the point of view of the substantial theory and, therefore the number of discriminant functions should be reduced a priori, even if they are statistically significant.

Explaining Misclassified Cases: At this point, we turn to the issue of evaluating the predictive power of independent variables in classifying levels of regional economic cooperation. The main concern here is to examine how well we can predict to which group a particular case belong. For this purpose, we need to examine the classification statistics. Table 6-7 presents the classification results. First of all, the classification function should not be confused with the discriminant function. This classification function is useful for deciding which group each case most likely to belong, by proving classification scores for each group. The classification function coefficients can be interpreted as the weight scores for each independent variable, in the computation of the classification score for each group.

Table 6-7 Classification Results

Classification Function Coefficients:

No cooperation = $-33.44 -29.69$ (tax revenue) -8.38 (direct tax) $+ .33$ (Economic growth)
 Low level = $-26.47 -24.55$ (tax revenue) -10.28 (direct tax) $+ .21$ (economic growth)
 High level = $-16.18 -18.15$ (tax revenue) $- 8.68$ (direct tax) $+ .17$ (economic growth)

Classification Results	Predicted Group Membership		
	No cooperation	Low level	High level
Actual Group			
No cooperation	91.6%	8.4%	0%
Low level	31%	37%	31.9%
High level	.4%	17.6%	82%

69.4% of actual grouped cases are classified correctly.

While the coefficients for the tax revenue are larger than other variables in all three groups, those of economic growth are relatively smaller. This implies that the size of tax revenue is more likely to influence the classification of different levels of regional economic cooperation than are other variables. In the light of theoretical argument presented in this study, this result also suggests that the public power of the state, measured by the size of tax revenue, is most likely to influence a state's choice concerning the level of regional economic cooperation. On the other hand, direct taxation shows the second larger coefficients in all of three groups. The difference between direct taxation and economic growth in terms of the weight of the classification score, however, is relatively large. That is, along with tax revenue, direct taxation also contributes significantly to the classification of each case.

Once we compute the classification scores for each case according to the above classification functions, we can proceed to decide which group each case belongs to. Moreover, we can determine how well the present classification function performs in predicting or classifying actual cases' group membership. In Table 6-7, the classification result tells us that overall the level of regional economic

cooperation was predicted in 69.4% of the 644 cases. More specifically, no cooperation and high level of regional economic cooperation are predicted with great accuracy by the model in that the model predicted 91.6% of no cooperation cases and 82% of high level of cases were predicted for the respective group.

However, the model shows poor performance in predicting cases of low level regional economic cooperation. This suggests that a state's choice of economic forum or free trade agreement may be an alternative strategy to both avoid the cost of losing national autonomy caused by deeper regional integration while gain more benefits from the trade liberalization generated by the creation of a free trade zone than from the choice of no cooperation. Asian states, in particular ASEAN states, have long shown reservation and no enthusiasm about regional economic cooperation. Some European states, such as Norway and Sweden, have also long been reluctant to join in deeper regionalism. However, all of them also understood that trade liberalization would be inevitable for their economy. Consequently, they preferred low levels of regional economic cooperation, such as an economic forum or free trade agreement, or delayed their participation in the process of deeper regionalism.

We can identify each misclassified case by the casewise prediction procedure, which compares the actual group membership and the predicted group membership. From this identification process, two findings should be noted. First, for Asian states, most of the misclassified cases are the cases to cover the period from 1990 to 1997. Second, for European states, most of the misclassified cases come from Austria, Finland, Germany, Norway and Sweden. The first finding is not surprising when we consider that Asian states agreed to the creation of APEC despite reservation. The most important driving force in creating APEC was essentially external, that is, the challenge of the closed regionalism in Europe and North America. As Pomfret (1998:54) wrote:

For East Asian policy makers the key issue in international commercial diplomacy during the late 1980s and early 1990s was how to react to the spectre

of regional trading blocs in Europe and in the Americas. Regionalism has not been a major feature of Asian economic relations during the second half of the twentieth century; even the more formalized regional trading arrangements such as the Association of Southeast Asian Nations (ASEAN) or those between Australia and New Zealand had little impact on trade flows. The EC92 program and the Canada-US Free Trade Agreement and the initiation of negotiations to expand the latter to include Mexico stimulated a re-evaluations of this situation.

Therefore, if there had been no such this external challenge, we can predict that Asian states might not have created APEC. In this regard, the misclassified cases from 1990 to 1997 reflect the dilemma between Asian states' hesitation of engaging in deep regionalism and their need to extend their trade market through multilateralism in order to create sustainable economic growth.

The second finding raises puzzling and more complicated questions. The predicted group membership for Austria and Finland, Sweden and Norway from 1975 to 1993 was group 2 (high level of regional economic cooperation), but their actual group membership was group 1 (low level of regional economic cooperation). The model did not correctly predict the cases for Austria from 1975 to 1993 even if it predicted correctly the cases after 1994, when Austria started to prepare for the process of application for EU membership. In other words, according to the model specified on the basis of theory, Austria should have joined the EU much earlier. The same situation also applies to Finland, Sweden and Norway. As is well known, all of four states have been reluctant to the EU. Austria, Finland, and Sweden are the latest member states to have joined the EU, while Norway is still a non-EU state. How can we explain their reluctance to the EU and these states' national preferences for European regionalism?

Very interestingly, Germany is the opposite example. The model predicted Germany as group 1, but the actual membership of Germany was consistently group 2. This implies that Germany differs

from other European states its distinctive balance between public power and market governability, between social concertation and encompassing distributional coalitions, and national economic performance measured by tax revenue, direct taxation and economic growth respectively. In other words, despite the distinctiveness of national political economy, Germany has played an important role with France as the engine of European integration. Germany may be an exceptional case, not explainable by the theoretical model of states' choice of regionalism developed in this study. If so, how can we explain the leadership of Germany in accelerating the process of deeper regionalism in Europe? What was Germany's motivation for European integration?

In order to solve these puzzles, we first need to examine four states more closely. Table 6-8 provides the data of average tax revenue, direct taxation and economic growth as important indicators to reflect main features of the national political economy in 18 European states from 1975 to 1997. Remember that tax revenue, direct taxation and economic growth are used as indicators to measure public power, class compromise and social concertation, and economic performance in this study. We see that Austria, Finland and Norway are not significantly different from other European states when compared to the EU regional average. Sweden and Germany are more interesting because both states have relatively low direct taxation, implying that social concertation, based on class compromise between business and labor, is more institutionalized than other European states.

However, while Sweden show very low economic growth performance, Germany has higher economic growth than the EU regional mean. This fact is also puzzling because this study argues that there is a negative association between economic growth and the level of regional economic cooperation. Accordingly, we expect that, while Sweden may have a strong motivation forward deeper regionalism, Germany will not. But the reverse was real. The following analysis deals directly with these puzzles, providing more focused explanations based on national contexts, in particular, historical factors and political impediments.

Table 6-8 Tax Revenue, Direct Taxation and Economic Growth in Europe (1975-1997)

	Tax Revenue	Direct Tax	Economic Growth(%)
Austria	.32	.22	2.31
Belgium	.42	.38	1.84
Denmark	.33	.43	2.14
Finland	.27	.33	2.15
France	.37	.19	2.10
Germany	.27	.19	2.61
Greece	.26	.23	2.43
Iceland	.24	.16	3.35
Ireland	.33	.38	4.77
Italy	.34	.35	2.20
Luxembourg	.43	.39	2.70
Netherlands	.44	.31	2.25
Norway	.33	.23	3.47
Portugal	.29	.23	3.22
Spain	.37	.26	2.26
Sweden	.33	.19	1.51
Switzerland	.19	.16	1.33
UK	.32	.43	2.07
EU total	.33	.28	2.50
Asia	.16	.45	6.30
North America	.16	.50	2.9

Austria, Finland, Norway, and Sweden: Table 6-9 presents the results of the 1994 referenda on EU membership in Austria, Finland, Norway and Sweden. As we see, three states - Austria, Finland, and Sweden - finally obtained the necessary majority required to ratify EU membership in the national referendums of 1994. Norway repeated, however, the outcome of the first referendum in 1992, rejecting the EU membership. All of the four states have an important common factor influencing the formation of their national preferences regarding European integration. This factor is the issue of neutrality. Since World War II, Austria, Finland, and Sweden have been neutral, maintaining their special relationship with the Soviet Union. Although Norway was one of the founding states of the North Atlantic Treaty Organization (NATO), its security policy has traditionally been in line with the balance of other Nordic states. The issue of neutrality is especially important to Austria and Finland. In both states, it has influenced national identities, as their history can be understood as the

Table 6-9 The 1994 EU Referendums in Austria, Finland, Norway and Sweden

Results	% Yes	%No
Austria 12 June	66.6	33.4
Finland 16 October	56.9	41.1
Norway 27 November	47.5	52.5
Sweden 13 November	52.3	46.8

Source: John Fitzmaurice.1995 “The 1994 Referenda on EU Membership in Austria and Scandinavia: A Comparative Analysis” *Electoral Studies*. *Electoral Studies* 14: 226-232.

history of the struggle to defend their national territorial boundary from Germany and Russia respectively (Gstohl 2002).

In this regard, the idea of national sovereignty has been crucial in the formation of public opinion regarding EU membership in both states. Some studies argued that “without the neutrality obligation and the Germany clause in the State Treaty, Austria would probably have become a full member of the EEC a long time ago” (Gstohl 2002:17). Finland’s neutrality principle has been strengthened by the fact that the Finnish economy has special ties with the Soviet Union through a bilateral foreign trade (Anderson 1987). As a result, Finland was politically constrained in terms of its EU policy by its special relationship with the Soviet Union until the Collapse of the Soviet Union and the end of the Cold War. Even after the collapse of the Soviet Union, Finnish national feelings regarding the potential threat from Russia remained strong (Fitzmaurice 1995).

On the other hand, for Sweden the issue of neutrality is far less significant in determining its EU policy. Swedish foreign policy under Social Democratic governments has always emphasized a balance between East and West. The most important explanation of Sweden’s reluctant EU policy can be found in its economic and political uniqueness. Swedish economy is based on the combination of welfare state and economic efficiency. Swedish politics is based on a combination of democratic and effective policy making. Since the late 1940’s the Swedish economy has been characterized by “the Rehn-Meidner programme”, designed to pursue both full employment and low inflation through a solidaristic wage policy, active labor market policy, and restrictive fiscal and

momentary policy (Weiss 1998). According to Swedish commentators, the 1974 Instrument of Government that first codified parliamentary government in the Swedish constitutional history, facilitated an effective democracy in which “the parliamentary majority arrived at by democratic elections would not be hindered from conducting forceful policies of reform which involved government intervention in a variety of social field”(Algotsson 2001:53).

The Social Democrats pursued a political ideal of institutionalizing “a government supported by a majority in the democratically elected parliament” (Algotsson 2001:53). This political ideal constructed a Swedish political system based on the principles of majoritarian democracy and effective government policy making. Ziller (2001) also argues that the Swedish model of government is distinctive from the standard European mode. While the standard European model of government can be characterized by an “integration of political and administrative authority” based on the idea of “a unified executive branch of government”, the Swedish model of government can be described as “independence of political and administrative authorities” influenced by the idea of institutional separation between policy-making and policy implementation. An important point is that the unique nature of the Swedish economic and political systems has constructed the Swedish national identity the political dominance of the Social Democratic Party. As Heclø and Madsen (1987:27) argue, “Social Democrats have captured the idea of the nation ---- they have successfully interpreted the national identity as one of an ever-reforming welfare state, a national social community always striving to make itself more of a community.” All of these factors forged Swedish Exceptionalism and, as long as this national identity remained influential, EU membership could not obtain the necessary majority in the Swedish politics.

If so, how did Austria, Finland and Sweden succeed in creating the necessary majority for the EU membership in the 1994 EU referendums? The shift of public opinion toward a pro-EU position in Austria and Finland can mainly be explained by a common expectation that even though the principle of neutrality remained of important concern, EU membership would give them

economic advantage, through integrated into a larger market. For Austria, in particular, EU membership was necessary because since 1981, Austria had already had bilateral monetary union with Germany. This made it easier for Austria to participate in EMU as well as the EU. For Finland, the 1989 economic recession was decisive in enhancing pro-EU groups, such as business, view that EC membership was essential to attracting foreign direct investment to the country as well as achieving currency stability.

The effect of economic crisis, shifting public opinion toward pro-EU position can also be applied to the case of Sweden. As we see from table 6-8, Sweden has been troubled by the reduced economic growth performance since the heyday of the Rehn-Meidner programme in the early 1960s, leading into disfavor the Swedish Exceptionalism. But it was not until 1990 that public opinion rapidly changed toward a pro-EU position. In 1990, the Swedish economy was confronted by a massive capital flight, severe deflation and unemployment rose from 2% to 7-8% in a short time. As a result, in 1992, the Riksbank gave up its fixed exchange rate, letting the krona float (Henrekson et al. 1996). This economic crisis forced organized labor, such as the Swedish Confederation of Trade Union and the Swedish Confederation of Salaried Employees, to move toward a pro-EU position, even if the public sector union still opposed EU membership for Sweden (Gstohl 2002).

On 25 November 1992, the Norwegian government applied for EU membership after a long history of reluctance regarding European integration. Norway felt the same strong pressure that Sweden Finland, Austria already had. However, the Norwegian public rejected EU membership in date. The Labor Party and the Conservative Party supported the EU membership, whereas the Centre Party and the Christian Democratic Party opposed it. The main cleavage between the two groups lay on the conflict between modernisers and traditionalists (Fitzmanurice 1995). Even among traditionalists such as fisheries business and labor, however, there existed a serious disagreement regarding what are the economic gains from EU membership. While the fish-processing and fish-farming industries had a pro-EU position because they expected the extension of their export

market, the fishermen's organization strongly rejected EU membership because they feared that joining the EU would deteriorate the Norwegian model of full employment and active and direct state intervention (Gstohl 2002). The success of the Norwegian model has been largely influenced by its large oil revenue. This enables Norway to enjoy much more freedom to pursue policies such as full employment and a balanced budget than other small open economies. This economic strength also explains why the Norwegian model can still be effective despite the neoliberal turn of most European economies. The Norwegian rejection of EU membership should be understood in this context.

Germany: Unlike most European states, Germany has a relatively lower tax revenue and low direct taxation, as we see in Table 6-8. This implies that unlike other European states with higher public power and social concertation, Germany has harmonized market governability with social concertation based on class compromise. The German state's market governability was an institutional product of "the ordo-liberal architects of West Germany's post war economic constitutions" based on the idea that a strong, but anti-interventionist state would prevent the rent seeking of private interest groups and therefore enable "market-conforming" macroeconomic policies (Carlin 1996:483). Consequently, as Weiss (1998) points out we can describe the main feature of German political economy as "growth with equity".

This distinctiveness of the German political economy suggests that unlike other EU states which consider EU membership as the leverage of improving their national economic strengths, Germany would not have a strong economic motivation toward European integration. This consideration is reflected exactly by the fact that according to theory, the model predicted that Germany would not belong to the category indicating deeper regionalism. So, how can we explain the leadership of Germany in European integration? Katzenstein (1997) views Germany's real concern in European integration as the internationalization or Europeanization of German state identity and institutions. For other European states it is also "the institutionalized taming of Germany's power in Europe".

Many have argued the importance of German unification as a turning point in German European policy, even if some stress more continuity than change in German European policy and foreign policy, after the German unification, pointing out Germany's persistent reservation of the use of military force and the multilateral foreign policy framework based on the bilateral relations with France and the US (Hyde-Price and Jeffery 2001; Anderson 1997; Webber 2001b; Meier 2002).

According to Anderson (1997:82), Germany's exaggerated multilateralism such as acting like the smaller member state than France or Britain during the period of reunification, has significantly changed into "a more visible, assertive power projection" in the EU since unification. From this view, the Maastricht Treaty and European Monetary Union is a kind of exchange between other European states' anxiety regarding internal market and Germany's hegemonic position, especially in European monetary politics. In addition, as Garrett (2001b:123) notes, for Germany, socializing the costs of integrating East Germany, the old eastern bloc into Europe among other European states by enhancing deeper regionalism was very attractive. However, the German government under Helmut Kohl's political leadership had to confront a strong opposition from The Bundesbank insisting that European monetary integration would jeopardize German price stability. And the Bundesbank's opposition was very persuasive among German public, who have a strong pride their national currency and concern a possibility that a weak common currency would increase inflation, eroding pensions and investments (Calleo 2001).

The conflict between German political authority and German monetary authority reflected different perspectives of what was German national interest. The 1992 collapse of the European Exchange Rate Mechanism (ERM) caused by German fiscal expansion following unification and anti-inflationary monetary policy, forced the Bundesbank to increase the money supply by decreasing interest rates in order to slow down rapid capital inflow. But the German monetary authority rejected other ERM countries' request for domestic monetary stability. On the other hand, German political authority understood that Germany's hegemony in European monetary policy

could be reinforced by creating a single European currency dominated by Germany. More importantly, this could reduce the effect of the US dollar and the Japanese yen on the German macroeconomy (Garrett 2001a). An important point to remember is that the German political authority's commitment to a single European currency was shared by most European political leaders including Mitterand and Chirac in France and d' Alema and Prodi in Italy. Why did they have such a strong commitment to European monetary integration despite having to confront strong domestic political resistances? Calleo (2001:195) argues this question as follows:

Support for a common European currency has been building for long time. It was a project whose practical and symbolic consequences seemed on a scale worthy of the great challenges of the time. But the determination of Europe's leaders reflected more than dutiful devotion to continuous European integration. Leaders and elites shared a growing sense that European economies were entering a structural crisis in their relations with the global economy. EMU would, they thought, make their economies much stronger. Their reasoning reflected a potent if anomalous mixture of liberal, mercantilist, and protectionist perspectives

In this regard, we can explain Germany's choice of European integration in the more political perspective of European states' active role in constructing the future of Europe.

Predicting a State's Choice of Regionalism: Ordered Probit Model

Research Question: We now turn to another research question: what is the probability of each choice (no cooperation, low and high level of regional economic cooperation) when three independent variables (tax revenue, direct taxation and economic growth) change from their minimum value to their maximum value? More specifically, when states increase their tax revenue or

change their tax structure by shifting from direct taxation to indirect taxation and when states' economic growth rates decrease or increase, do these changes influence their choice of regional economic cooperation? If so, what is the probability of each outcome as a state's economic role and economic performance change?

A Note of Ordered Probit Model: When considering the ordinary nature of the dependent variable, many argue, "ordinary variables require special statistical methods or should be replaced with truly continuous variables in causal models" (Winship and Mare 1984:512). Measuring the level of regional economic cooperation as a continuous variable would be the best, because it makes it possible to use a linear regression model (LRM) that can provide simple and direct interpretation. Unfortunately, we do not have a comprehensive measure for different levels of regionalism. Therefore, we assume that the level of regional economic cooperation is a latent variable, that is, an unobserved variable. What we can observe is its ordered categories. In this situation, the use of the ordered probit model is most appropriate.

Another important aspect of model specification is consideration of the data structure to be used in testing the model. The data used are based on cross-sectional and time-series ($N=28$, $T=23$), and the use of ordinary ordered probit model may ignore the possibility of cross-sectional or temporal dependence of the data (Beck, Katz and Tucker 1998). When Beck, Katz and Tucker (1995) argue why ordinary logit or probit is inappropriate for binary time-series-cross-sectional data, however, their focus is the problem of temporal dependence in event history data, such as international conflict data. For instance, the probability of dyadic conflict in a given year may be dependent on the conflict history between two countries. When this temporal dependence is not properly specified in the model, an ordinary logit or probit analysis can result in biased inference. A simple solution is to add temporal dummy variables to an ordinary logit model, as Beck, Katz and Tucker recommend.

However, in my analysis, this temporal dependence is not a serious problem. There is no theoretical reason to expect that the yearly observations of the choice of level of regional economic cooperation will be dependent. More importantly, Beck, Katz and Tucker's argument is based on a binary choice model designed to specify the success or failure of an event such as war. In contrast, my analysis focuses on the probability of three outcomes that cannot be specified in the manner of event history data. In my analysis, the cross-sectional dependence problem may be more serious than any potential temporal dependence problem, as we suspect that country-specific effects influence a state's choice of level of regional economic cooperation. In this regard, we may consider fixed effects analysis as a control for individual differences (country specific effects) that are not captured by the independent variables.

However, many studies argue that fixed effects probit models have a problem with inconsistent coefficients (β). The standard panel data model when the dependent variable is discrete is:

$$y_{it}^* = \beta' x_{it} + \alpha_{it} + \mu_{it}$$

Where β is a vector of parameters to be estimated, x is a vector of independent variables, α is an individual specific effect, μ is a disturbance term, and y^* is a latent dependent variable. The subscript i refers to one of the N cross-sectional units, and the subscript t refers to one of the T time points. According to Hsiao (1986:156), unlike linear-regression, the Maximum-likelihood estimators (MLEs) for α_i and β are correlated with each other in discrete-choice models. As a result, when T is fixed, the inconsistency of α is transformed into the MLE for β . This problem cannot be solved even in the condition where N tends toward infinity. In particular, where the number of time periods ($T=23$) is small, compared to N , like the data used in this study - the MLE with fixed effects model may generate inconsistent estimates (β). More importantly, Green points out that "the probit model does

Table 6-10 Alternative Ordered Probit Regression Analyses of the State's Choice of Levels of Regional Economic Cooperation: Index Function for Probability

	ORDERED PROBIT	RANDOM EFFECTS
Tax revenue	9.573 (.522)**	11.821(.538)**
Direct taxation	-2.608 (.273)**	-1.213 (.333)**
Growth	-.809 (.149)**	-.236 (.186)
Log likelihood ratio	-452.198	-303.442
Sample size	644	644

*p <0.1;**p <.05

not lend itself well to the fixed effects treatment”, because “with large numbers of cross-sectional units, estimation of α_i s is intractable” (2000:837).

More substantially, Beck and Katz (2001:489) also criticize the use of fixed effects in time-series cross-sectional models with discrete dependent variable. The use of fixed effects can underestimate the explanatory power of the substantive independent variables, other than the fixed effect. More specifically, if I include fixed effects in this model, it means that the probability of choosing a particular outcome among the three levels of regional economic cooperation will be explained by some unmodeled idiosyncratic country-specific feature, rather than the substantive independent variables (size of tax revenue, direct taxation, and economic growth), which capture the distinctive nature of a national political economy. Thus, the best solution to the problem of unmodeled heterogeneity is to include any substantive explanatory variables. If a particular explanatory variable to replace the fixed effects is not known, then the use of a random effects model is more appropriate. Based on this discussion, I consider the use of panel ordered probit model with random effects most appropriate to the theory and data.

Results: First, for the purposes of comparison, I estimate both the ordered probit and the panel ordered probit with random effects models. Table 6-10 presents the results of these two models. In both models two theoretical variables, tax revenue and direct taxation, are statistically significant with the expected signs. Economic growth loses significance in the random effects model. Second, I

Table 6-11 Comparing the Model Prediction to the Actual Data

Ordered probit predicted actual	no	low	high	marginal
No	107	58	2	167
Low	42	92	82	216
High	0	60	201	261
marginal	149	210	285	644 (62%)

Likelihood ratio statistics =579.605

Random effects predicted actual	no	low	high	marginal
no	0	164	3	167
low	0	143	73	216
high	0	33	228	261
marginal	0	340	304	644 (57.6%)

Likelihood ratio statistics =39.894

also compare the model predictions to the actual data in order to assess the measure of fit for the two models as shown by Table 6-11. An interesting point to note here is that the ordered probit model performs better in predicting the actual cases of no cooperation and high level cooperation, whereas the panel ordered probit with random effects shows higher success in predicting the actual cases of low level and high level regional economic cooperation.

However, overall, the ordered probit model has a higher percentage of successful predictions than the panel ordered probit model. I also examine the likelihood ratio test statistics for both models. As we see, the ordered probit model returns much higher likelihood statistics than the panel ordered probit with random effects. These results suggest that the consideration of panel data structure is not crucial to my analysis. However, these results cannot justify abandoning random effects modeling, as I have no theoretical rationale justifying the use of ordinary probit analysis in the panel data structure. According to Beck, Katz and Tucker (1998:1273), a possible situation where we can confidently use ordinary logit or probit analysis is the optimistic situation where the

Table 6-12 Marginal Effects of Variables in the Panel Ordered Probit with Random Effects

	NO COOPERATION	LOW LEVEL	HIGH LEVEL
Tax revenue	-.840	-1.884	2.724
Direct taxation	.086	.193	-.279
Economic growth	.001	.003	-.005

* Marginal effects are estimated at the mean values of three variables.

systemic level variables “vary by time but not across units”. Only in the situation where the systemic level variables can theoretically explain the dependent variable and are statistically significant, we can use confidently ordinary logit or probit models. However, I have no such systemic variable capable of justifying the use of ordinary probit analysis. Therefore, I will be more cautious and choose the random effects model.

Table 6-12 presents the marginal effects of three variables in the random effects model. The marginal effects refer to the effects of a change in the independent variables on the probability that a state will choose one of the three regional economic cooperation outcomes. The marginal effects of tax revenue increase roughly as the level of regional economic cooperation increases. In contrast, the marginal effect of direct taxation and economic growth decreases as the level of regionalism increases. While the marginal effect of tax revenue is substantial at all three levels, economic growth has negligible a marginal effect for all three levels of regional economic cooperation. The negligible marginal effect of economic growth seems questionable when we consider that, as I analyzed in the previous section, there is a meaningful association between economic growth and the level of regional economic cooperation. However, we know that the existence of a meaningful association between two variables does not imply any direct causal relationship. If the total effect of a variable consists of direct and indirect effect, we may assume that economic growth has an indirect effect on a state’s choice of regionalism. Therefore, we cannot simply conclude that economic growth has no causal effect on the level of regional economic cooperation.

Figure 6-2 Effect of Tax Revenue on the Predicted Probability of Levels of Regional Economic Cooperation (1975-1997)

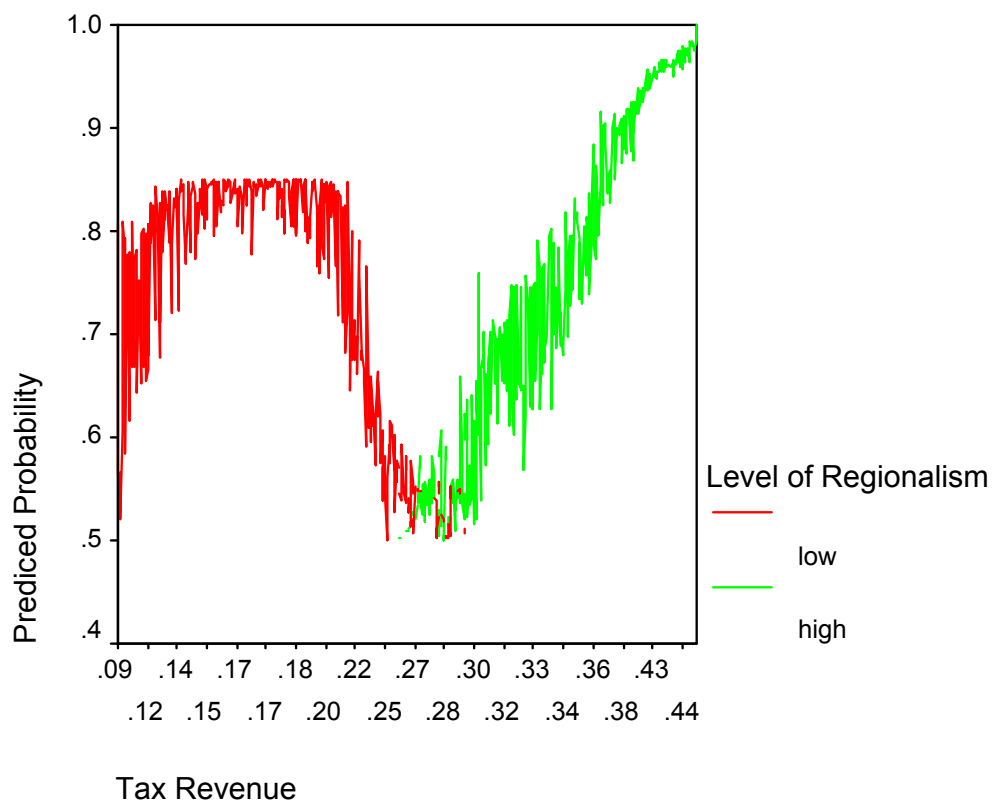


Figure 6-2 shows the predicted probability of a particular level of regionalism as the size of tax revenue increases. As we see, the predicted probability of a high level of regionalism significantly increases as the size of tax revenue increases. More specifically, when the size of tax revenue exceeds the mean value (.26), the probability of high level regional economic cooperation rapidly increases. As discussed in Chapter 4, the size of tax revenue is a proxy measure of a state's economic policy priority between equality and efficiency, and between public power and market governability. Therefore, this result suggests that states that are more concerned with equality and public power

are more likely to choose deeper regionalism in the neoliberal world economic order, shifting their economic policy priority from equality to efficiency.

National Variations in Regionalization: The Effect of National Political Institutions on Regionalization

Hypotheses and Variables

Proposition 3: While the concept of regionalism is defined as a strategy pursued by the state, the concept of regionalization refers to the actual outcome of national convergence of macroeconomic performance. Based on this conceptual distinction, the degree of regionalization in national economies may not directly vary with the particular type and level of regionalism. The actual process of regionalization may be influenced by the distinctiveness of national economies and the nature of domestic political institutions, rather than by the particular type and level of regionalism itself.

Proposition 3-1: The degree of regionalization can be measured by the degree of capital market integration in a given region. And the degree of regional capital market integration depends on nation-specific ways of dealing with the distributional effects of capital market integration. However, in general consensus democracy (majoritarian democracy) characterized by parliamentary-PR electoral systems (presidential-plurality electoral system), is more conducive to capital market integration because of its ability to reduce political uncertainty and creating stable coalitions among different interests.

Hypothesis 3-1: Regionalization is more likely to be higher after APEC (1989), the EU (1992) and NAFTA (1994).

Hypothesis 3-2: Regionalization in terms of regional capital market integration, is more likely to be higher in states that have developed deeper regionalism (custom union, common market, economic union) than states that have developed a low level of regionalism (economic forum or free trade agreement).

Hypothesis 3-3: Regionalization in terms of regional capital market integration is more likely to be higher in states that have majoritarian democratic institutions.

Hypothesis 3-4: Regionalization in terms of regional capital market integration is more likely to be higher in states that have consensus democratic institutions.

Model Specification and Variable Descriptions

The main hypotheses will be tested by the following general model specification:

$$\begin{aligned}
 & \textit{Regionalization}_{i,t} \\
 & = f(\textit{Government fractioanlization}_{i,t}, \textit{Checks and balances}_{i,t}, \\
 & \textit{Ideological polarization}_{i,t}, \textit{Government strength}_{i,t}, \textit{Government} \\
 & \textit{special interest}_{i,t}, \textit{Electoral system}_{i,t}, \textit{Presidentialism}_{i,t}, \textit{Polity}_{i,t}, \textit{APEC}, \textit{EU and NAFTA effect}_{i,t}, \\
 & \textit{Level of regional economic cooperation}_{i,t}, \textit{Control variables}_{i,t}, u_{i,t})
 \end{aligned}$$

where $u_{i,t}$ is normally distributed error term. The subscript i refers to one of the N cross-sectional units, and the subscripts t refers to one of the T time points. This model will be tested by the data for 28 countries (7 Asian countries, 18 European countries and 3 North American countries) from 1981 to 1997.

Dependent Variable: The dependent variable is the degree of regionalization. As discussed in the previous chapter, the variable will be measured by the degree of deviation of national interest rates from the regional mean interest rate for each year. Actually, this indicator measures the degree of co-movements of interest rates across different national economies under the consideration that in more regionally integrated economies, the variances in interest rates across national economies will be smaller. In understanding the nature of regionalization, the most important point to remember is that it propels neoliberal economic reforms within national economies. Neoliberal reforms also impose a serious dilemma for the state. At this point, it is proper to quote Rodrik's argument that

Table 6-13 Variables, Indicators and Hypotheses

VARIABLES AND HYPOTHESES	INDICATORS
<p><u>Dependent Variable:</u> Regionalization: the degree of capital market integration in a given region.</p> <p><u>Independent Variables:</u> 1) The Effect of Regional Institutions The Effect of Regionalism : Regionalization is more likely to increase after the creation of APEC, the EU and NAFTA.</p> <p>Level of Regional Economic Cooperation : Regionalization is more likely to increase as the level of regional economic cooperation becomes higher.</p> <p>2) The effect of Domestic Political Institutions Concentration of the executive power : The smaller (larger) ideological polarization, the higher regionalization. : The smaller (larger) government fractionalization, the higher regionalization : The higher (lower) check and balance of executive power, the higher regionalization.</p> <p>The Dominance of Executive : The more (smaller) seats of the governing parties, the higher regionalization.</p> <p>The Capacity of Executive to create encompassing distributional coalitions : Regionalization is less likely to be higher when the governing parties represent special interests..</p> <p>Polity : Regionalization is more likely to be higher in a more institutionalized democracy</p> <p>Electoral Sstem : Regionalization is more likely to be higher in plurality electoral systems. : Regionalization is more likely to be higher in proportional representation electoral systems.</p> <p>Presidential vs. Parliamentary System : Regionalization is more likely to be higher in parliamentary systems than presidential systems. : Regionalization is more likely to be higher in presidential systems than parliamentary systems</p> <p>3) Control variables Public Investment Economic Openness National Income level The Level of Capital Market Development Credit Market Regulation Labor Market Flexibility Inflation</p>	<p>National Convergence of Interest Rates</p> <p>Dummy variable to indicate before and after APEC (1989), the EU (1992), NAFTA (1994)</p> <p>Dummy variable to indicate no cooperation, low level and high level of regional economic cooperation</p> <p>Ideological Polarization in Government =Maximum difference of orientation among governing parties(0-2) Government Fractionalization =chance that two random draws will produce deputies from different governing parties The Check and Balance of Executive Power =the number of veto players</p> <p>Government Strength = the total seats of the governing parties</p> <p>Government Special interest =Is 1st government party represent special interest?</p> <p>Polity Score =the degree of the institutionalization of democratic political systems</p> <p>Dummy Variable to indicate plurality system or PR system</p> <p>Dummy variable to indicate presidential system or parliamentary system</p> <p>Government Capital Formation as % of GDP Export as % of GDP Dummy variable to indicate high, middle, and low level of national income Dummy variable to indicate four levels of capital market development 10 points score to measure the degree of credit market regulation 10 points score to measure the degree of labor market flexibility Consumer Price Index</p>

Note: For data source, see Appendix.

“international economic integration thus poses a serious dilemma: Globalization increases the demand for social insurance while simultaneously constraining the ability of governments to respond effectively to that demand. Consequently, as globalization deepens, the social consensus required to keep domestic markets open to international trade erodes” (1997: 465). Regional or domestic political institutions directly influence a state’s ability to manage this kind of dilemma and consequently, the degree of regionalization of national economies.

Independent Variables: The independent variables in this model are regional institutions, domestic political institutions and some control variables for economic preconditions that influence capital market integration. Table 6-13 summarizes the variables, their indicators, and more specific hypotheses for each variable.

The Effects of Regional Institutions: First, the effect of regional institutions on the degree of regionalization will be analyzed in terms of both the effect of regionalism and the effect of different levels of regionalism. The effect of regionalism refers to the comparison of levels of regionalization before and after APEC (1991), the EU (1992), NAFTA (1994), which are the most comprehensive regional organizations in the history of regional economic cooperation in each region. We expect that after the creation of APEC, the EU and NAFTA, the degree of regionalization in the relevant region would be increased significantly. The effect of different levels of regionalism on regionalization examining whether different types of regionalism effects the degree of regionalization. For instance, APEC and NAFTA as a free trade zone represent low levels of regional economic cooperation, while the EU as an economic union represents the highest level of regional economic cooperation. This difference is hypothesized to influence the degree of regionalization in each region since it is generally assumed that higher economic coordination across

member states in a given region creates higher convergence of national economies and, therefore, higher regionalization of national economies. In this study, I will directly test this idea.

The Concentration of Executive Power and Government Strength: Second, to examine the effect of domestic political institutions, the dichotomy of consensus democracy and majoritarian democracy will be disaggregated into five aspects as already mentioned in the previous chapter. It is possible that one aspect of the executive-parties dimension may support a positive effect on majoritarian democracy on achieving macroeconomic policy, in contrast, another aspect may confirm a positive effect of consensus democracy on macroeconomic performance. In addition, there is no consensus concerning how each aspect is related to majoritarian or consensus democracy. For instance, some argue that majoritarian democracy tends to increase the capability of the executive to produce encompassing distributional coalitions (Olson 1986). However, others claim that through the mechanism of social concertation, consensus democracy is more successful in creating encompassing distributional coalitions (Crepaz 1996a). Therefore, this study will focus on identifying the specific aspects of democratic systems that influence the degree of regionalization in terms of capital market integration.

As argued in the previous section, capital market integration generates a distributional conflict between internationally oriented economic interests and domestically oriented economic interests. In order to achieve an economic policy, the government needs both decisiveness and consensus in economic policy making. The best way would be to harmonize these two virtues. But, it is very difficult if not impossible. The concentration of executive power is more favorable for increasing government's decisiveness in implementing unpopular economic policy because it can prevent the fragmentation of government policy making authority by many veto players. Therefore, we can expect that when executive power is more concentrated, regionalization, in terms of capital market integration will be higher. More specifically, we expect that lesser ideological polarization,

fractionalization, and checks and balances of the executive power will create higher decisiveness in the executive power, and, therefore higher regionalization in terms of capital market integration.

However, at the same time, the concentration of executive power can increase policy rigidity and consequently reduce the possibility of policy change. Capital market integration assumes capital market liberalization and also requires for the state to implement neoliberal economic reform through deregulation and depoliticization of economic actions. A possible logic for this is that the formal fragmentation or dispersion of government policy making authority may induce neoliberal economic reform in the form of deregulation and depoliticization of economic actions.

For instance, checks and balances on the executive power increases predictability and decrease government regulation of firms and individuals' economic activities (Beck et al.2002). In other words, as becomes more politicized political authority, so does economic policy. As many economists argue, these effects are closely related to capital market liberalization. Decisiveness in government policy making can also be enhanced when government parties can generate broad political support for their economic policy in the legislature. But, the same logic of policy rigidity and government regulation can be applied to the relationship between government strength and regionalization. In this regard, the concentration of executive power and dominance of executive seems have conflicting effects on regionalization.

Government Special Interest: On the other hand, a government's capacity to produce encompassing distributional coalitions is related to the formation of political consensus in government policy making. There is always a conflict of public interest and private interest in democratic political systems. The success of an unpopular policy with strong distributional implications depends on the government's ability to create political consensus among conflicting interests. This type of government ability will be increased when government parties do not represent any particular special interest. As Rodrik (1997) points out, the globalized economic order attenuates the asymmetry

between winners and losers. In a sense, a state's ability to govern its national economy in the globalized economic order depends on its "structural mobilization of bias" ability, to borrow Scharttschneider's phrase. That is, the state should portray itself as the protector of public interests beyond winners and losers. The state will fail in the structural mobilization of neoliberal social order when it is projected as the protector of the winner. From this point, we can hypothesize that regionalization is less likely to be higher when governing parties represent special interests.

Electoral Systems: It is an established argument that PR electoral systems and multi-party systems are more inclusive in terms of political representation than plurality electoral system and two-party system. According to Crepaz and Birchfield (2000:207), consensus democracy, based on inclusive political representation, is more likely to increase a state's responsibility and legitimacy concerning the implementation of neoliberal policy change. This is "the more inclusive, consensual, and encompassing political institutions are, the more they thwart sector specific pressures towards globalization, whereas exclusive, majoritarian political systems tend to come under strong influence from the winners of globalization to liberalize or from the losers of globalization to prevent neoliberal convergence." Swank (2002:45) interprets Crepaz and Birchfield's argument in terms of the possibility of more deliberative policy making. He argues that "PR and multiparty systems are more likely to afford workers and other economic interests harmed or threatened by globalization relatively potent institutional mechanisms to resist adverse policy changes and to pursue compensation."

However, their conclusions regarding the consequence of more deliberative policy making differs significantly. Crepaz and Birchfield consider that consensus democracy is more successful in implementing neoliberal policy because deliberative policy making can provide "the procedural guarantor of legitimacy of government facing the challenges of globalization" (2000:212). In contrast, Swank concludes that the deliberative mechanism in consensus democracy will slow down

“relatively rapid and substantial rollbacks in social welfare provision and neoliberal welfare state restructuring” (2002:46). Therefore, we can expect that electoral systems may have multidirectional effects on regionalization.

Presidentialism and Parliamentarism: Presidentialism can be characterized by the separation of executive and legislative authorities. Since Lintz’s (1994) criticism of presidential systems, many have argued that, in presidential systems, governments are more unstable and incapable of managing the relationship between the executive and legislature. This is because it is more difficult to achieve a majority government supported by a majority of legislative parties in presidential systems. But, some studies of European coalition government based on parliamentary systems argue that “minority government should be seen as a normal outcome of the process of democratic party competition in Europe rather than as some sort of obstacle to it” (Strom 1990; Gallagher, Laver and Mair 1995:306). Thus, we cannot simply assume that parliamentary systems are more conducive to the formation of a majority government. The existence of a majority government is crucial for both the decisiveness and consensus formation in government policy making. We will directly test these two competing arguments by analyzing the effect of different constitutional designs on regional capital market integration.

Polity: This variable refers to the degree of the institutionalization of the democratic political system. Our concern is with the relationship between institutionalized democracy and economic liberalization. It is a conventional idea that more institutionalized democracies have more developed property rights and economic freedom. And well-developed property rights and economic freedom are necessary conditions of economic liberalization. However, at the same time, economic liberalization is constrained in democracy because it is not possible, without extensive state intervention and regulation, to prevent monopolies, protect property rights and economic freedom,

and reduce any harm caused by a self-regulating market. For this point, Dahl (1998: 173) argues that “democracy and market-capitalism are locked in a persistent conflict in which each other modifies and limits the others.” From this discussion, we expect that the effect of polity on regional capital market integration may be multidirectional.

Control Variables: The control variables used in this model are selected according to three criteria. First, a control for the effect of the level of national economic development, the level of national income and the level of capital market development will be included. Second, we should also consider that the distinctiveness of national economic institutions directly influences interest rate changes and capital market integration, such as exchange rate regimes, government regulation in credit, capital and labor markets and government investment. Finally, for external constraint on national economies and internal disturbance, we need to include the degree of economic openness and inflation.

Results and Discussion

In conducting pooled time-series-cross-section data analysis, most studies employ Beck and Katz's (1995) panel corrected standard errors procedure to provide estimates of the error correcting both for autocorrelation and heteroskedasticity on the basis of Ordinary Least Squares (OLS) regression. Given that data structure is one in which the number of time points is less than twice that of the number of units ($T=17$, $N=28$), this study follows their method. However, two methodological issues should be addressed before proceeding to the interpretation of statistical results.

The first issue is to consider country-specific effects on the dependent variable. Actually, it is a popular practice to include country-specific dummy variables in studies of comparative political economy. For instance, Garret et.al (2001) in their study of capital account liberalization in 140

Table 6-14 Regression Results: Domestic Political Institutions, Regional Institutions, and Regional Capital Market Integration in 28 Countries (1981-1997)

	MODEL 1	MODEL 2	MODEL3
Lagged Dependent Variable			.5414** (.0631)
Checks and Balances	.0091 (.0111)	.0429** (.0101)	.0252** (.0074)
Government Fractionalization	-.4069** (.0881)	-.2183** (.0715)	-.1413** (.0662)
Ideological Polarization	.0962** (.0260)	.0230 (.0162)	.0092 (.0170)
Government Strength	.9223** (.0260)	.1659 (.1528)	.1542 (.1273)
Executive Special Interest	.1189** (.0437)	.0685 (.0586)	.0255 (.0381)
Electoral System	.0555** (.0266)	-.1822** (.0558)	-.1090** (.0496)
Presidentialism vs. Parliamentary	.0675** (.0285)	.2543** (.0499)	.0530 (.0535)
Polity	.0065 (.0075)	-.0130 (.0088)	-.0138 (.0078)
APEC, EU, and NAFTA Effects	-.0774** (.0301)	-.1215** (.0291)	-.0610** (.0259)
Level of Regionalism	.0492 (.0358)	.0926** (.0333)	.0298 (.0324)
Public Investment	-.0028 (.0023)	-.0049 (.0029)	.0014 (.0028)
Economic Openness	-.1311 (.1079)	.8619** (.1717)	.5177** (.1778)
National Income	.0044 (.0542)	1.3046** (.3564)	-.1767 (.1631)
Credit Market Regulation	-.0290** (.0121)	.0149 (.0156)	.0094 (.0137)
Capital Market Development	.1834 ** (.0243)	-.9646** (.1785)	.1776 (.1754)
Labor Market Flexibility	.0461** (.0138)	.0360 (.0303)	.0387 (.0288)
Exchange Rate System	-.0853** (.0280)	-.0174 (.0251)	-.0264 (.0221)
Inflation	.0029** (.0011)	.0040** (.0014)	.0015 (.0010)
Constant	-.2259 (.2123)	1.0368 (.4962)	-.0169 (.5164)
R-squared	.3174	.5898	.7167

*p < 0.1; **p < .05

countries for the period from 1979 to 1998 suggest a fixed effect model to allow the intercepts for each country to vary. Swank (2002) also used country dummies in order to adjust for country specific effects and thus to prevent biased estimation in his cross-national data analysis of globalization, democratic institutions and the welfare state. Theoretically, this technique seems to be

desirable. From a perspective of comparative politics, every country has its distinctiveness not to be generalized in terms of history, culture, national identity, and institutions. However, this method has an important weakness as it may cause serious loss of efficiency in estimates of independent variables if country specific dummies are highly collinear with the independent variables or uninterpretable (Stimson 1985). Therefore, if there is no strong evidence that differences between units generates parametric shifts in the regression, then the fixed effects model may not be reasonable. Considering the advantages and disadvantages of the use of country specific dummies, this study compares two models: Model1 (without country dummies) and Model 2 (with country dummies) rather than simply following the popular use of country specific dummy variables. Table 6-14 presents the results of both models.

The most important difference between the two models is that some variables that are statistically significant in Model 1 lose their significance in Model 2. However, the R-squared score is greatly improved in Model 2. The loss of statistical significance of some variable can be understood as the result of a loss in efficiency of the estimates of some independent variables, caused by including country specific dummies. An important point to is that as Stimson points out, when we have uninterpretable country specific dummies, the loss of efficiency in the estimates is the very high price of using country specific dummies. In addition, as the number of independent variables increases, the R-squared increases automatically. More importantly, an increased R-square does not necessarily imply that the specification of Model 2 is better than Model 1 because the strength of the relationship between a set of independent variables and a dependent variable is measured by the coefficients rather than the R-square score.

The second issue to consider is whether the lagged dependent variable should be considered in the analysis of panel data. An important rationale for the inclusion of the lagged dependent is that it can reduce problems with autocorrelation in pooled time-series. Related to this point, Beck and Katz (1995:946 and 1996) note that “in the presence of lagged dependent variables, OLS is

consistent if the errors are temporally interdependent.” Based on this rationale, Swank for example, adds a lagged dependent variable as “an alternative to a first-order autoregressive parameter to the full fixed effects model” in his model of the effect of globalization on social welfare efforts (Swank 2002:85).

In this study, Model 3 follows Swank’s fixed effects model and includes a lagged dependent variable. Compared to Model 2, Model 3 shows an R-square that is dramatically improved to .72. Most standard errors are also smaller. Therefore, in a statistical sense, the fit is much better, however, five variables lost their statistical significance. Among them, public investment, national income, and capital market development even have their reverse signs as compared to Model 2. On the other hand, when we compare Model 3 to Model 1, we find that all political institutional variables, except checks and balances, government fractionalization, and electoral system lose their statistical significance even though the R –square improved tremendously. The sign of electoral system is even changed from positive to negative.

From the comparison of the three models, some may conclude that Model 3 is the best fit. However, as Achen (2000) insightfully argues, this conclusion may be sound in terms of statistical practices, but meaningless in terms of theoretical substance if we have no strong theoretical reason of including the lagged dependent variable. More importantly, although a lagged dependent variable can be considered as a proxy to represent the effects of some unmeasured variables, it does not work like a decent and well-behaved proxy. Rather, the lagged dependent variable biases the substantive coefficients toward negligible values and inflates the effect of the lagged dependent variable, especially, when there is high autocorrelation. Therefore, if we have high autocorrelation, the use of the lagged dependent variables would not appropriate (Achen 2000).

Considering the critiques from Stimson and Achen, a better strategy of interpretation is to examine the sensitivity of each variable according to different model specifications, noting which variable remains consistent and significant rather than preferring a particular model. In order to

correctly interpret the regression results, we need to remember that the higher the national divergence in interest rates, the lower regional capital market integration. So, negative coefficients indicate the variables' positive effects on regionalization. Table 6-14 reveals only three variables - government fractionalization, electoral system, and APEC, EU and NAFTA effects - are statistically significant across different models.

Government fractionalization is a robust predictor of the degree of regionalization, suggesting it has a positive effect on regionalization. Government fractionalization refers the probability that any two deputies, drawn at random from among the government parties would belong to different parties. This definition implies that the higher government fractionalization, the lower the cohesion of the government coalition. More importantly, less a cohesive government coalition allows the governing parties to act independently in consideration of any given policy change, such as capital market liberalization. As a result, it can decrease policy rigidity and increase the possibility of the development of a new policy.

In contrast, the other variables that indicate the centralization of executive power, checks and balances and ideological polarization consistently show negative effects on regionalization, even though they are not statistically significant in all models. How can we explain these divergent results among the three variables which all indicate the centralization of executive power? The answer is that the centralization of executive power has a dual effect on a government's ability of policy making. Government fractionalization is more related to the issue of policy rigidity vs. policy change. Checks and balances and ideological polarization, however, are more closely related to the issue of different interest representation and the protection of minorities.

Checks and balances and ideological polarization can be understood in terms of the existence of multiple decision makers. Beck et.al (2002) argue that "countries with multiple decision makers may offer greater protection from arbitrary government action to individuals and minorities. Interests that are unrepresented by government decision makers when there are few key decision makers may

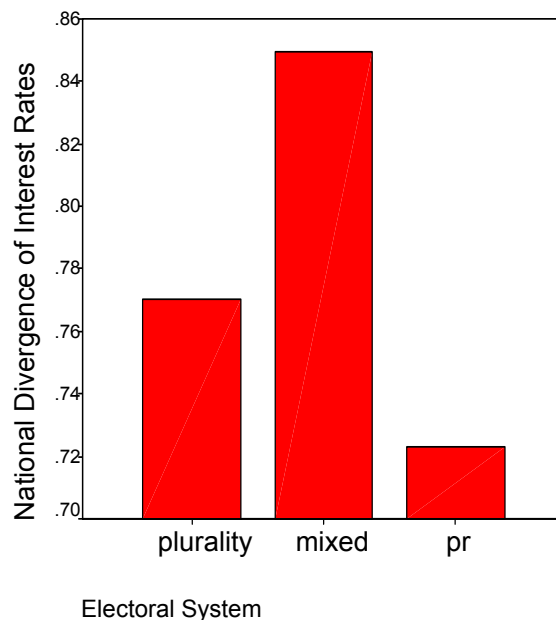
gain representation when the number of decision makers rises” (p.22). The same logic can be applied to ideological polarization when we understand it in terms of different policy orientations. And, as governments are more concerned with different interest representation and the protection of minority, it is more difficult to implement a new policy such as capital market liberalization.

The second robust predictor of regionalization is the effect of regional institutions, such as APEC, EU, and NAFTA. As expected, this variable has a positive effect on regional capital market integration. However, the results of all of three models predict that, as the level of regional economic cooperation increases, the degree of regionalization will decrease. This result conflicts with our expectation that deeper regional economic cooperation will induce higher regionalization than no cooperation, and narrow regional economic cooperation, such as a free trade zone. Rather, it shows that deeper regionalism has a negative effect on the degree of regional capital market integration.

Very interestingly, this finding is consistent with the critics of regionalism that regionalism will jeopardize multilateral and global liberalization by creating preferential treatment for member states against nonmember states (Bergsten 1997). From the perspective of the supporters of global liberalization, Asian regionalism is “open regionalism” defined as “a process of regional cooperation whose outcome is not only the actual reduction of internal (intra-regional) barriers to economic interaction but also the actual reduction of external barriers to economies not part of the regional enterprise; our commitment, above all, to the process of global liberalization” (APEC 1994b).

In contrast, as Lawrence (1996:61) points out, “a Europe that is more deeply integrated could in principle become more or less protectionist and closed to outsiders.” Of course, the question about which type of regionalism - Asian open and market-driven regionalism versus European closed and deeper regionalism - is more favorable to global liberalization is an issue beyond the scope of this study. Yet, this result suggests an important point that the level of regional economic cooperation

Figure 6-3 The Effects of Electoral Systems on Regionalization



itself does not dictate the degree of regionalization. In other words, we have no reason to consider that deeper regionalism is directly related to higher regionalization. Rather, different levels of regionalism reflect different logics of regional economic cooperation mostly constructed by the specific regional context.

Next, although electoral system is statistically significant in all models, the sign is not consistent. As we expected electoral system has multidirectional effects on the degree of regionalization. In Model 2 and Model 3, the sign is negative, but it is positive in Model 1. This implies that the effects of electoral system on regionalization are more sensitive to the existence of country-specific dummies. Figure 6-3 shows the actual data structure of the effect of electoral system on regionalization. While the mixed electoral system is less favorable to regionalization, both plurality and PR system are more favorable to regionalization. As we see from figure 6-3, we cannot consider that, as the proportionality of an electoral system increases, the degree of regionalization also

increases. The three electoral systems can be located on a continuum of proportionality of political representation. Therefore, the figure suggests that the effects of electoral systems on regionalization may be nonlinear, supporting both the logic of majoritarian democracy and that of consensus democracy. That is, electoral system has a negative effect on regionalization when their proportionality is below a certain value, but a positive effect on regionalization when the proportionality is above that value.

Both government strength (the dominance of executive) and government special interest (the government ability to produce encompassing distributional coalitions) have a negative effect on regionalization. Both are related to the issue of political decisiveness and consensus in implementing neoliberal policies such as capital market liberalization. Considering that government strength is measured by the percentage of seats held by government parties, then, the result of a negative effect of government strength on regionalization implies that, when government parties have broader political support, the more difficulty they have in implementing decisively neoliberal policies. This is consistent with Swank's (2002) point that the implementation of neoliberal policy requires political consensus rather than political decisiveness and that in the absence of political consensus and legitimacy, economic liberalization will be slowed. In the same vein, the negative effect of government special interest on regionalization suggests that, when governments represent special interests, they are less likely to be able to implement effectively neoliberal policy. Furthermore, this argument is also confirmed by other result of the effect of presidentialism vs. parliamentarism. In all three models, parliamentary system has a negative effect of regionalization.

Finally, not surprisingly, the effect of institutionalized democracy is multidirectional, supporting Dahl's argument that democracy and capital market system are in a continuous tension between harmony and conflict. Most control variables except exchange rate system and inflation did not have consistent signs. For exchange rate systems, the result in Table 6-14 reveals that the degree of regional capital market integration is more likely to be higher in fixed exchange rate systems. On the

other hand, we find that inflation has a negative effect on regionalization. However, both of these variables are not statistically significant.

Summing up the Cross-National Quantitative Analysis of Regionalism and Regionalization

This section has employed various methods in order to effectively test the main hypotheses developed from my theory. The most important criterion in determining the best method of analyses is its appropriateness in answering the research question. In the first part, a contingency table analysis and one-way ANOVA analysis present us a very clear negative association between economic growth and the level of regional economic cooperation. Next, directly testing the causal mechanism of this study through quantitative analytical tools, such as discriminant analysis and an ordered probit model, the second part suggests that states' choice of regionalism can be explained by their economic policy priority and the pattern of economic policy making, measured by the size of tax revenue and direct taxation respectively. Also, the two different methods, discriminant analysis and the ordered probit model, performed very well for each different research question, both generating the same theoretical conclusion. In the third part, the analysis of panel data by employing three different model specifications demonstrated some important implications of the effect of domestic political institutions. One of the most important implications is that many institutional variables can have a multidirectional effect or nonlinear effect on regional capital market integration, measured by the degree of national divergence of interest rates. However, overall, the results in this section support the logic of consensus democracy, emphasizing the importance of political consensus in implementing neoliberal economic policy such as capital market liberalization. This point is also supported by the fact that government fractionalization has a consistent positive effect on regional capital market integration.

CONCLUSION

This study is inspired by Strange's argument regarding the relationship between market authority and state authority. Her important insight is that non-state authorities are "hierarchical, not democratic" (Strange 1996:196). Therefore, when the market outgrows the state in the globalized world economic order, what is declining is democracy, not the state. In the preceding chapters, I have tried to assess the thesis of the decline of the nation state and offer an alternative argument concerning the economic role of the state in the internationalization of markets. Regional economic cooperation can be understood in this perspective. It is a mean by which states can enhance their market governability rather than an ultimate goal. This instrumental perspective on regionalism underscores this study. Accordingly, some states may be enthusiastic about regionalism, whereas other states may be reluctant to it.

Why are some states enthusiastic about regionalism while others are not? This was the central puzzle that I set out to solve in this study. Basically, this puzzle leads us to consider regionalism from a comparative perspective. Comparing European regionalism to Asian regionalism, I have discussed several issues. European states feel strong insecurity in the globalized world as their national economies is declining in terms of the world competitiveness, whereas Asian economies are strong enough to stand alone, even though many economists criticized Asian crony capitalism after the Asian financial crisis in 1997.

To empirically test this argument, I provide a descriptive data analysis of the association between the level of regionalism and economic growth in the final chapter. I find that there is a negative association between the level of regionalism and economic growth. That is, states are more likely to prefer deeper regionalism when their national economies are confronted with persistent low economic growth. Of course, we cannot confirm a causal effect of economic growth on the choice of regionalism. However, it is clear that national economic performance is an important factor that

influences states' motivation toward regionalism. This finding allows us to understand an important difference between European regionalism and Asian regionalism, confirming Hobsbawm's insight of "Fortress Europe" (1997).

However, when states want to enhance their market governability in situations of poor economic performance, their efforts will be not always successful. States have different capacities for implementing radical economic transformation in their societies, as they have institutionalized different interaction modes of the state-society relations. Essentially, the interaction mode between the state and society is institutionalized historically by a path of national capitalism. Therefore, I have offered a comparative analysis of the European welfare state and the Asian developmental state in terms of the state-society relations.

Furthermore, for a more systemic analysis, I have also developed a general conceptual map of the economic role of the state in modern capitalist economies. In developing this conceptual map, my main idea is that the state always lies in a subtle tension between public power and market governability, and between social concertation and encompassing distributional coalitions. The tension between public power and market governability reflects the trade-off between equality and efficiency in all capitalist political economies. The state needs to regulate the self-regulating market in order to protect its society from the market's instability. However, all states have a different balance between equality and efficiency. On the other hand, the tension between social concertation and encompassing distributional coalitions reflects different patterns of economic policy making. More importantly, two different patterns are based on two different political traditions regarding how the state organizes society. Social concertation is rooted in a corporatist political tradition that emphasizes the political representation of organized social groups and the balance of power among different social interests. Encompassing distributional coalitions, in Olson's term, assume that organized social groups can be predatory for society when they are driven by a rent-seeking motivation. Therefore, a state's economic performance depends on its capacity to avoid the

domination of predatory organized interest groups. For this goal, the state can organize in a plebiscitarian principle of political representation that does not have any presumption of group-based representation. Of course, there is no pure society, in an extreme between equality and efficiency or between social concertation and encompassing distributional coalition. Rather, different societies chose different balances between these two priorities and principles. This is an important underlying idea of my conceptual map of the state's economic role.

The conceptual map is developed to enable a cross-national study of regionalism. Regionalism is a regional phenomenon, however, by choosing each state as the unit of observation, I reduce the level of analysis from the level of region to that of nation-state. This analytical level requires me to develop empirical indicators to measure, directly or indirectly, each state's location on the conceptual map. I present two empirical indicators, the size of tax revenue and direct taxation. Taxation is a crucial policy instrument for managing national political economy. More importantly, it is at the heart of the state authority as well as a reflection of the state-society relationship. While the size of tax revenue indirectly measures the size of public economy, and therefore state's public power, direct taxation measures states' preferences for group-based representation. Using these two empirical indicators, I hypothesize that states that have higher public power and social concertation are more likely to prefer deeper regionalism than states that have lower public power and encompassing distributional coalitions. My hypothesis can be translated into a more empirical expression; the higher a state's tax revenue and lower direct taxation, the higher the possibility of deeper regionalism.

The logical validity of my hypothesis is based on the assumption that states want to implement neoliberal economic transformation in their society in order to survive in the globalized world economic order. In a word, neoliberal economic ideas have their political power and, consequently, states' economic policies have become dominated by neoliberal economic ideas. I assumed that, for European states, neoliberal economic transformation will be a more difficult task than it will be for

Asian states. European states have institutionalized higher public power and strong traditions of social concertation and more difficult tasks require states to implement more radical and compulsory solutions for success. The European solution was to pool states' authority in the third party, the European Union, thus insulating themselves from their societies. In contrast, Asian states were more capable of implementing neoliberal economic transformation, as their societies have long been organized by the developmental state to prefer efficiency and plebiscitarian principle of representation. An important point to remember is that this political environment is more favorable to the neoliberal economic transformation. As a result, Asian states do not have strong motivations toward developing deeper regionalism and they do not want to delegate their authority to a supranational institution.

My theoretical arguments are tested by a quantitative data analysis, using the data to cover 28 countries from 1975 to 1997. Two different methods are used: discriminant analysis and ordered probit model. For more generalized conclusions, I include the data for North American states. To conduct a cross-national data analysis I also develop a measurement of the level of regionalism based on categorical variables. Both these two statistical results confirm my hypothesis. In particular, the explanatory power of public power measured by the size of tax revenue, is impressive. It demonstrates a strong positive relationship between state public power and deeper regionalism. This finding supports my theoretical reasoning that the more difficult the task a state wants to achieve, the more radical and compulsory the solution states needed to achieve the task. Deeper regionalism is an institutional solution for achieving neoliberal economic transformation at the expense of states' public power, moving economic policy priority substantially from equality toward efficiency.

Finally, I examined the actual process of regionalization, distinguishing regionalization from the concept of regionalism. While regionalism refers to a political project pursued by states, regionalization is more influenced by market forces. If a state prefers deeper regionalism, it implies that the state will have higher regionalization. However, regionalization is determined by national

political institutions and other economic conditions. My primacy focus lies on the effects of political institutions on the degree of regionalization.

I consider regionalization as an economic performance. There are two competing approaches to explaining the relationship between political institutions and national economic performance. While some argue that majoritarian democratic institutions are more conducive to effective macroeconomic management, others stress that consensus or negotiated democratic institutions show better economic performance. I related this controversy to the issue of regionalization. In this study, regionalization is defined in terms of regional capital market integration as a neoliberal economic policy. This is also measured by the degree of national convergence of interest rates among states in a given region. I offer an empirical measure for regionalization. For political institutions, I rely on the most recent data set of political institutions published by the World Bank.

In analyzing the effects of political institutions on regionalization, my concern is not to support one of two competing theories. Rather, I assume that most political institutions have multidirectional and non-linear effects on economic performance. Basically, my assumption is closely related to my theoretical idea that there is no pure society between two extremes of consensus and majoritarian democracy. However, it is clear that there is a general tendency toward one of the two models. I want to find a meaningful set of hypotheses, beyond majoritarian and consensus dichotomy, rather than confirm a particular theoretical position. For this purpose, I conduct a panel data analysis of the effects of political institutions on regionalization. Two interesting findings should be mentioned.

First, I find that government fractionalization has a positive effect on regionalization. This finding supports the logic of consensus democracy that the implementation of neoliberal economic policy requires political consensus rather than political decisiveness. Second, interestingly, the level of regionalism itself did not show any statistical significance in any of three model specifications. This finding implies that deeper regionalism does not directly related to higher regionalization. This

finding also supports my main argument that deeper regionalism is a strategy for improving states' market governability rather than being an ultimate goal itself. Different states will choose different strategies for regionalism. However, states' different strategic choices of regionalism do not dictate national economic performance in terms of regional capital market integration. More specifically, we cannot be certain that the legalized and closed European regionalism is better than the market-oriented and open Asian regionalism in terms of neoliberal economic transformation. In this regard, the idea that Asian states should, or will, follow the path of European integration is not valid. European integration is the institutional product of European democracy and national political economy. Therefore, it may not be possible to replicate it in other regions. However, this conclusion do not imply a European exceptionalism that assumes the existence of a European identity, European states' solidarity and cooperative nature, denying any serious effort to put European regionalism into a more general and comparative context.

To conclude, I will succinctly mention an implication of my theoretical argument and empirical analysis for the relationship between regionalism and democracy. In the globalized world economic order and the dominance of neoliberal idea, states *intentionally* diffuse their authority to non-state actors because they are more concerned with the problem of achieving credible commitment rather than democratic accountability (Majone 1996). Many economists and political scientists heavily influenced by the idea of economic efficiency, have assumed that elected politicians in democratic political systems are not credible. The idea of delegating political authority to a non-elected agency for achieving effective policy making and implementation is never new. But, the idea is finally extended to the state' political authority itself.

The nature of European regionalism cannot be understood without considering this idea. More importantly, the increased significance of credibility in public policy making requires a change in the concept of legitimacy from in Scharpf's distinction, input-legitimacy to output- legitimacy. It is important to remember that there is a general tendency to converge toward output-legitimacy

among democracies. For Asian states, however, the problem of achieving credibility does not have political significance as much as in European states, as they have long relied on output-legitimacy rather than input-legitimacy.

My intention is not to argue that input-legitimacy is more normatively desirable. Rather, I wish to suggest we rethink the source of output-legitimacy. The notion of efficiency or effectiveness assumes the absence of distributional conflicts in society because it is meaningless once we are forced to ask *whose efficiency?* In other words, the notion of efficiency assumes that there is a consensus concerning what is good for society and what is the public interest among all social interests. In this sense, output-legitimacy is more difficult for the state to achieve. However, whenever there is no consensus regarding what is public interest, output-legitimacy is always in danger of degenerating democracy. The political history of Asian states reminds us of this. Therefore, if we agree over this political implication of European regionalism, the conventional belief of European success and Asian failure in terms of regional cooperation should be reconsidered.

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APPENDIX
DATA SOURCE

VARIABLES	INDICATORS AND SOURCES
Economic Growth	GDP at constant price, IMF, <i>International Financial Statistics Yearbook</i> . Washington D.C: IMF, selected years; For some European countries, the data set of European economies collected by Larry D. Neal (at the University of Illinois). http://www.cba.uiuc.edu/l-neal/econ339.html
Total Tax Revenue and Direct Tax	IMF, <i>Government Financial Statistics</i> , Washington D.C: IMF, selected years; direct taxes include taxes on income, profits, and capital gains; For some countries, <i>World Tax Database</i> , www.wtodb.org .
Regionalization	National interest rates: IMF, <i>International Financial Statistics Yearbook</i> . Washington D.C: IMF, selected years.
Political Institutions	Beck, Thorsten, George Clarke, Alberto Groff, and Philip Keefer. 2001. "New Tols and New Tests in Comparative Political Economy: The Databases of Political Institutions" <i>World Bank Economic Review</i> 15: 165-176. http://econo.worldbank.org/staff/pkeefer
Polity Score (Combined Polity Score)	Polity IV Project, <i>Political Regime Characteristics and Transitions, 1800-2001</i> , Monty G. Marshall and Keith Jagers (principal investigators). http://www.cidcm.umd.edu/inscr/polity/
Economic Openness	Export as a percentage of GDP: IMF, <i>International Financial Statistics Yearbook</i> . Washington DC:IMF, selected years.
Public Investment	Government Capital Formation, IMF, <i>International Financial Statistics Yearbook</i> . Washington D.C:IMF, selected years.
National Income Level	Brune Nancy, Geoffrey Garrett, Alexandra Guisinger and Jason Sorenson. 2001. "The Political Economy of Capital Account Liberalization" A paper presented at the 2001 Annual meeting of the American Political Science Association, San Francisco, August 31.
Capital Market Development	Farrel, Diana and Susan Lund. 2000. "The End of Monetary Sovereignty" <i>The Mckinsey Quarterly</i> .
Credit Market Regulation Capital Market Regulation Labor Market Regulation	Gwartney, James and Robert Lawson. <i>Economic Freedom of the World: Annual Report</i> . Vancouver, Canada: Fraser Institute. http://www.freetheworld.com/release.html .
Exchange Rate System	IMF, <i>Annual Report on Exchange Arrangements and Exchange Restrictions</i> . Washington D.C: IMF, selected years.
Inflation	Consumer Price Index (1990=100). IMF, <i>International Financial Statistics Yearbook</i> . Washington D.C: IMF, selected years.

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"Government Stability, Public Debt, and Italian Electoral Reform: An Intervention Time Series Analysis" Paper for Presentation at the 2002 Political Studies Association Annual Meeting, Aberdeen, UK.

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