Regulation Under Economic Globalization

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International Political Economy Society
November 15, 2008
The conventional wisdom on regulation under economic globalization predicts a race to the bottom or a race to the top.
Introduction

The conventional wisdom on regulation under economic globalization predicts a race to the bottom or a race to the top.

Key problems:

1. **Empirical accuracy**: failure to explain variation in regulatory policies.
2. **Implausible logic of regulation**: policy coordination is artificially excluded.
Plan of Attack

1. A Ricardian model of trade and investment.
2. A game-theoretic model of regulation as coalition formation.
3. The impact of regulation within and outside a regulatory coalition.
4. Empirical conditions for systematic upward or downward pressure.
A Ricardian Model

Fix \( n \) countries and \( m \) goods.

- Exogenous budget constraints and well-behaved consumer preferences.
- Capital is the single factor of production.
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2. Consider unregulated (cheap) and regulated (expensive) variants.
   - Unregulated variants produce more negative externalities.
   - Production of each variant is concentrated in the most productive state.
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   - Production of each variant is concentrated in the most productive state.

   - Process standard: domestic producers are regulated.
   - Product standard: domestic consumers are regulated.
States choose regulations simultaneously under complete information.
1. States choose regulations simultaneously under complete information.

2. Payoff is a weighted sum of negative externalities, consumer surplus, and returns to capital:

\[
\text{PAYOFF} = \text{SURPLUS} + \text{CAPITAL} - \text{EXTERNALITY}
\]
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Coalition-proof Nash equilibrium: coordinated deviations are possible.
The effect of coalitional regulation on payoffs:

<table>
<thead>
<tr>
<th>Payoff component</th>
<th>Within</th>
<th>Elsewhere</th>
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<tbody>
<tr>
<td><strong>Negative Externalities</strong></td>
<td><strong>Process</strong>: +/-</td>
<td><strong>Process</strong>: -</td>
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<td></td>
<td><strong>Product</strong>: +/-</td>
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</tr>
<tr>
<td><strong>Consumer Prices</strong></td>
<td><strong>Process</strong>: - (C)</td>
<td><strong>Process</strong>: - (C)</td>
</tr>
<tr>
<td></td>
<td><strong>Product</strong>: -</td>
<td><strong>Product</strong>: 0</td>
</tr>
<tr>
<td><strong>Returns to Capital</strong></td>
<td><strong>Process</strong>: +/-</td>
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*C*: applies only to goods produced by the coalition.
Focus on negative externalities:

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The effect of regulation on negative externalities and returns to capital is conditional.
Implications

1. The effect of regulation on negative externalities and returns to capital is conditional.

2. Coalition formation permits flexible regulation.
   - Economic globalization can improve the quality of regulation.
   - Simultaneous cooperation and conflict.
Does economic globalization create systematic downward or upward pressures?
Equilibrium Analysis

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⇒ Necessary conditions:
Equilibrium Analysis

Does economic globalization create systematic downward or upward pressures?

⇒ Necessary conditions:

1. **Race to the bottom**: countries that cause it should not benefit from *re*-regulation.

2. **Race to the top**: countries that cause it should not benefit from *de*-regulation.
Focus on the critical countries:

1. OECD for a race to the bottom
2. Rapidly growing developing countries for a race to the top
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<td>Ineffective regulation OECD countries</td>
<td>Effective regulation Growing countries</td>
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<tr>
<td>Consumers</td>
<td>Cheap unregulated Costly regulated</td>
<td>Costly unregulated Cheap unregulated</td>
</tr>
<tr>
<td>Capital</td>
<td>No protectionism OECD countries</td>
<td>No regulatory competition Growing countries</td>
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Implausible
Plausible

⇒ Race to the bottom is unlikely.
Downward or Upward Pressures?

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1. OECD countries can effectively regulate negative externalities.
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1. OECD countries can effectively regulate negative externalities.
2. Growing countries can effectively regulate negative externalities.
Regulation as coalition formation is flexible and reduces the pressures created by economic globalization.
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2. Distributional conflict, not enforcement, is the dominant theme of economic globalization.