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The Demise of the Nation State?[1]

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Abstract

The globalization of economic activities that is characterizing many economies raises questions about the future of the nation state. This paper discusses this trend and shows that cross-frontiers spillovers have become more frequent and have increased the need for international agreements and international organizations to deal with them. It concludes that a continuation of current trends would increase the importance of subnational government while reducing (in the economic sphere) the importance of national governments.

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[1]This paper was presented at the 1998 Kiel Week Conference on Globalization and Labor, Kiel, June 24-25, 1998, and it will be published in the conference volume. The ideas in this paper were first presented as a Commencement Address to the graduating economics class at Rochester University, May 26, 1996. A first draft was written while the author was on a sabbatical leave as a Fellow of Collegium Budapest, Institute for Advanced Studies (Budapest), October-December 1997. The author wishes to thank Shahid Yusuf for comments on an earlier draft.

Contents

Summary

Over the past few decades public sector activity in the economic sphere, especially in industrial countries increased sharply. This expansion was largely financed by value-added taxes, social security contributions, personal income taxes and increases in public debts. Most of this expansion occurred at the *national* government level. In relative terms the subnational governments became less important.

In recent years, globalization has been affecting economic relations among countries. It is contributing to the creation of many cross-country externalities and international spillovers. Ad hoc arrangements or unilateral policy reactions may, in some cases, be successful in dealing with these spillovers without creating excessive difficulties, but in other cases these spillovers may create difficulties for, and generate unwelcome reactions by, other countries.

This paper argues that globalization is increasing the need for international agreements—and, in some cases, for a larger role by international organizations—on how to deal with these cross-frontier spillovers. In a globalizing world, increasing pressures must be applied to induce individual countries to behave according to norms agreed in international forums. It is becoming progressively more important to promote behavior consistent with the new reality, and promotion of this behavior will require concrete steps on the part of the international community.

The paper concludes that globalization and international cooperation will in time reduce the degrees of freedom, and perhaps the power, of *national* governments in making particular economic decisions. In particular, if the cooperation is effective, it will limit the power of countries to pursue bad policies, and especially policies that hurt other countries. At the same time, these trends are likely to increase the role and the power of *subnational* governments, especially municipalities.

I. Introduction

Over much of this century government expenditure, expressed as a share of Gross Domestic Product (GDP), rose in all industrial countries. The increase was particularly large in the period after 1960. For all the industrial countries for which data are available, general government expenditure rose from an unweighted average of about 28 percent of GDP in 1960 to about 46 percent of GDP in 1996 (Table 1).

The growth in public expenditure was promoted by technical, social, and political factors. *Among the technical factors,* the discovery or the popularization of concepts such as public goods, externalities, and merit goods gave increasing legitimacy to the government's actions in many areas. *Among the social factors,* growing concern for income distribution, as well as for income maintenance for workers, retirees, or other groups, and for economic stabilization in general, provided additional reasons for increasing public expenditure. In general, governmental activity was directed toward the alleviation of various risks (unemployment, poverty, illiteracy, poor health, foreign domination, etc.) and this alleviation was supposed to be achieved through higher public spending. See Devarajan and Hammer (1997). *Among the more political factors,* there were attempts by governments, who were not always convinced about the virtue of the market, to replace the market in many resource allocation decisions. Governments came to play major roles in promoting industrial and regional development and in employment policies, through the use of tax expenditures, subsidized credits, and budgetary subsidies to enterprises.[2] The assumption was that the government could improve on the results that the market would achieve on its own. See Tanzi (1997).

For a long time, increases in government spending were largely financed by tax increases. However, as the level of taxation rose, countries began to run into taxpayers' resistance and had to rely on borrowing. This in turn led to the growth in public debt and in interest payments. Eventually, this line of financing was also exhausted or became too expensive when the share of debt into GDP reached high proportions and affected the level of real interest rates at which governments could borrow.

The main tax instruments used for financing the higher levels of public spending were: (a) taxes on income and especially on personal income; (b) value-added taxes; and (c) social security contributions paid partly by the workers and partly by the employers. Revenue from these relatively new taxes increased sharply in recent decades. These developments were largely, though not entirely, associated with actions by *national* governments.

II. Recent Challenges

The situation described above characterizes developments in the post-World War II and, especially, in the post-1960 period. By the 1960s, the Keynesian revolution and the

[2]Regulations also played a major role.

Table I. The Growth of General Government Expenditure, 1870-1996
(In percent of GDP)

	Later 19th Century	Pre World War I	Post World War I	Pre World War II	Post World War II			
	About 1870 1/	1913	1920	1937	1960	1980	1990	1996
General government for all years								
Australia	18.3	16.5	19.3	14.8	21.2	34.1	34.9	36.6
Austria	...	...	14.7 2/	20.6	35.7	48.1	38.6	51.7
Canada	...	...	16.7	25.0	28.6	38.8	46.0	44.7
France 3/	12.6	17.0	27.6	29.0	34.6	46.1	49.8	54.5
Germany	10.0	14.8	25.0	34.1	32.4	47.9	45.1	49.0
Ireland 4/	...	...	18.8	25.5	28.0	48.9	41.2	42.0
Japan	8.8	8.3	14.8	25.4	17.5	32.0	31.3	36.2
New Zealand 2/	...	...	24.6	25.3	26.9	38.1	41.3	34.7
Norway 4/	5.9	9.3	16.0	11.8	29.9	43.8	54.9	49.2
Sweden 3/	5.7 2/	10.4	10.9	16.5	31.0	60.1	59.1	64.7
Switzerland	16.5	14.0	17.0	24.1	17.2	32.8	33.5	39.4
United Kingdom	9.4	12.7	26.2	30.0	32.2	43.0	39.9	41.9
United States	7.3	7.5	12.1	19.7	27.0	31.4	32.8	33.3
Average	**10.5**	**12.3**	**18.7**	**23.2**	**27.9**	**41.9**	**43.0**	**44.5**
Central government for 1980-1937, general government thereafter								
Belgium	...	13.8	22.1	21.8	30.3	57.8	54.3	54.3
Italy	11.9	11.1	22.5	24.5	30.1	42.1	53.4	52.9
Netherlands	9.1	9.0	13.5	19.0	33.7	55.8	54.1	49.9
Spain	...	11.0	8.3	13.2	18.8	32.2	42.0	43.3
Average	**10.5**	**11.2**	**16.6**	**19.6**	**28.2**	**47.0**	**51.0**	**50.1**
Total average	**10.5**	**11.9**	**18.2**	**22.4**	**27.9**	**43.1**	**44.8**	**45.8**

Sources: Compiled by Tanzi and Schuknecht based on Acha (1976); Andic and Ververka (1964); Australian Bureau of Census and Statistics (1938); Belgium Institut National de la Statistique (1952); Bureau of Census and Historical Statistics, USA (1975); Butlin (1984); Central Bureau of Statistics, Norway (1969, 1978); Delorme and Andre (1983); Flora (1983); IMF *Statistical Appendix*, New Zealand; IMF *Switzerland: Recent Economic Developments* (1996); Japan Statistical Association (1987); Mitchell, *International Historical Statistics* (various issues); The Netherlands Central Bureau of Statistics (1956); New Zealand Official Yearbook (1938); OECD, *Economic Outlook* (1996,1997); Republica de Italiana Instituto (1951); Statistisches Jahrbuch, Oesterreich (1935).

1/ Or closest year available for all columns. Pre-World War II data sometimes on the basis of GNP or NNP instead of GDP.

2/ Central government data for this year, New Zealand: 1960=1970, and 1994/95 = 1996.

3/ 1996 data; calculations are based on the "Maastricht" definition, and are smaller than that published by the INSEE, the national statistical agency.

4/ 1995 instead of 1996, because of break in data calculation.

ideology associated with central planning and socialist thinking were having a strong influence on the actions of many governments in industrial countries. See Tanzi (1997). The prevailing intellectual climate led to: (a) policies that gave a growing role to the government, especially as measured by the share of government spending and taxes into GDP; and, because of the nature of the new activities or the new spending, led to (b) a growing importance of the *national* government in the total activities of the public sector. In terms of economic functions, in many countries the national governments became more important than the subnational governments.

More recently, and especially since the early 1980s, the social and economic environment started changing as it became less friendly toward governmental action. The reasons were several.

First, the Keynesian revolution lost much of its steam. Many intellectual and practical developments challenged some of its basic premises and showed some of its shortcomings.

Second, growing knowledge about developments in Eastern Europe and in the Soviet Union sharply reduced the attraction that socialism and central planning had on Western intellectuals and policymakers. There was less talk about the virtue of developing a "mixed" economy. In the 1990s, most of the centrally-planned economies started a difficult transition to become market economies.

Third, the growing burden of taxation made taxpayers progressively less willing to support additional taxes and stimulated the growth of the underground economy. The underground economy has become a major concern for many policymakers.

Fourth, high public debts led to increases in interest rates and in interest payments to service the debt.

Fifth, there was a growing perception on the part of the citizens of many countries that the money raised through high taxes or through higher fiscal deficits was not contributing in any appreciable way to enhancing the indicators that determine social welfare. While spending went up, many of the problems remained. Recent research has provided some empirical backing to these perceptions. See Tanzi and Schuknecht (1997). That research has suggested that higher public spending has not contributed to better results as measured by various socio-economic indicators. The countries that kept total public spending relatively small did as well, or even better, in terms of many of these indicators than those that allowed government spending to reach high levels. Concern about inefficiency in government expenditure and about corruption and underground activities associated with the higher role of the government also grew.

Sixth, many came to believe that in recent decades governments had been distracted by the new, ambitious functions that they had assumed. As a consequence, they tended to pay less attention to the more traditional and more important core activities of the state. See

World Bank (1997) and Tanzi (1997). Because of this, markets and economic activities suffered.

Finally, a phenomenon generally referred to as globalization started affecting economic activities and policies. Through its many ramifications and effects, this phenomenon has started to influence what governments do and the division of responsibility between national and subnational governments. The next two sections will address more directly these issues.

III. Globalization and Government Functions

In all aspects, globalization and accompanying technological developments are generating a gradual but major revolution in economic activities and economic policies. Economic activities that in the past had, often, characteristics that linked them to specific places (for example, through the use of local inputs such as coal or energy or through other factors) and that, over the years, might have progressively become *national* in character, are becoming *global*. So far, this change is more apparent in some areas, such as financial markets, and less so in other areas, such as labor markets but, to some extent, it is affecting most areas.

Economists continue to use traditional concepts such as "traded" and "nontraded" goods although, to some extent, all goods are now traded. If the goods or services do not go to the places where the buyers are, then the buyers go where the goods or services are. For example, in the past health services were mostly nontraded. Now they are becoming traded goods because, with increasing frequency, patients from many countries are going to hospitals and doctors in foreign countries to receive specialized medical treatment. An increasing number of hospitals are specifically aiming their services at distant, rich customers. In time, the market of highly specialized medical services may become truly global. In such a case, the regulations imposed on medical treatment by the authorities of the countries from which the patients come will have little effects on the treatment that the patients receive. Already, medicines not authorized in one country, can easily be obtained in other countries. The same is happening in education. Some of the best schools are attracting students from all over the world. A large proportion of the students in the U.S. graduate schools is made up of foreign students. This process will accelerate when education and medicine come to rely more on available modern technologies.[3]

The revolution in information technology, which has dramatically reduced the cost of transmitting or accessing information and has increased the speed at which information can be

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[3]The University of Phoenix is now one of the largest American universities, is fully accredited, and relies almost exclusively on instruction provided through the Internet. Oxford has just announced that it will start giving some degrees through the Internet. It is conceivable that in the future some medical treatment may be received from foreign doctors through the use of specialized communication channels.

transmitted, has eliminated or is eliminating the importance of location for many activities.[4] The computer and the Internet network have given enormous freedom to economic operators as to the locations from which they operate. For example, financial market operators no longer need to live in major financial centers such as New York, London, Frankfurt, or Tokyo. They can and do now operate from almost anywhere.

The *physical* content of much of what is produced and sold in the market is also changing. An increasing share of the currently "produced" value (such as software) does not have significant physical or tangible properties. Or putting it differently, the value of the unprocessed physical input for many of the commodities or services produced is now often a small or insignificant share of the market value of these commodities or services. In part, this is a consequence of the growing role that knowledge and information play in the modern world. Ideas and knowledge have replaced tangible resources.[5] Now, more than in the past, the well being of a given area depends far more on the human capital of the individuals that live in that area than was the case in the past when natural resources were far more important. Knowledge and information now contribute a significant part of the value of many traded goods. Even when these goods have tangible characteristics, transportation costs have fallen so much that location has become much less important than it used to be in determining the places where they are produced.

Enterprises have been adapting to and exploiting this new environment. Some enterprises whose activities had initially been tied to specific cities and, as they grew, had become national are now truly multinational.[6] They may acquire raw material in country A, process it in country B, and produce a final product in country C. The management of the enterprises may be located in yet another country, D. The capital and the know-how may come from still other countries. Research and development may be carried out in various other places, and accounting and data processing work may be done elsewhere.[7]

As a result of the developments described above, there is a growing divergence between the political areas represented by the nation states and the economic areas of particular markets. The latter are progressively less identified with specific nation states. When enterprises operated only or mostly in one country, that country's policies were of

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[4]However, for some activities clustering in a specific area may have become more important. This is the phenomenon of Silicon Valley in California or of Biella for textiles in Italy.

[5]Probably the total weight of each million dollars of GDP produced in advanced countries has been falling especially if inputs in the form of energy products are excluded. This may be a reason why the prices of many commodities have been falling.

[6]See, for instance, Parmalat and Benetton in Italy.

[7]The data processing work regarding scheduling and reservations of some U.S. airlines in now done routinely in India.

overwhelming importance for the enterprises. When enterprises become multinational, the policies of specific countries become less important. This, of course, was not so when most countries were relatively close and when markets and nations largely coincided. See Ohmae (1995). Many new markets are no longer constrained by political frontiers and have developed in economic areas that encompass regions from different countries. Some economic regions may have more in common with a particular market area in another country than with the country to which they legally belong.[8] In some cases, the relevant market is fast becoming the whole world.

Globalization and technological developments have brought many benefits to mankind. Because of it: (a) world resources, including savings, are better allocated, therefore, leading to increases in world standards of living; (b) individuals enjoy a much greater range of goods and services at lower prices than they did in the past; (c) many individuals can now travel to faraway places because of the opening of frontiers and the fall in the cost of travel; (d) the amount and the range of information available to them has increased enormously, and the cost of getting information has fallen dramatically. Thus, the stock of knowledge of the world is more easily available to all those who can access it.

However, globalization and related technological developments have also brought some costs and problems. For example:

(a) it has been argued that globalization has reduced the relative wage of unskilled workers in industrial countries, thus leading to more uneven income distributions in these countries. See, inter alia, Rodrik (1997) and Wood (1995);

(b) the tremendous increase in the volume of trade has made it more difficult for border authorities to scrutinize it for illegal imports, such as illicit drugs and weapons;[9]

(c) globalization has reduced the discretion that countries have in imposing the tax burden and the tax structure that they wish. See Tanzi (1995 and 1996);

(d) it has increased the likelihood that negative externalities (i.e., costs) will spill over to other countries. Think of the potential for exporting products with potential health hazards, including nuclear materials;[10]

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[8]See, for example, the border region between Mexico and the United States. In many cases, almost 100 percent of the output of that region crosses the frontier. See also the market for Nokia products in Finland.

[9]Trade has been growing at about twice the rate of growth of world GDP.

[10]The experience with the mad cow disease is a case in point.

(e) unrestrained movements by individuals and goods, and penetration by large numbers of individual into previously virgin areas (rainforests, etc.) have increased the chance that unknown and dangerous viruses or bacteria could move out of these closed areas and contaminate the rest of the world. The Ebola outbreak and the potential effect of that outbreak on the world are cases in point;

(f) globalization has increased the likelihood of international financial crises through "herd" and "contagion" effects; [11]

(g) it has also made possible an acceleration of the rate of growth of poor countries by allowing them to exploit the stock of knowledge available to advanced countries and the markets that these countries provide. Without globalization, there could not have been an East Asian miracle growth. While growth is a desirable objective, poorer countries are likely to be less concerned about environmental spillovers that, in the absence of corrective measures, tend to accompany growth. Some of these problems are purely domestic so that the countries' choices between faster growth and cleaner environment are their concern. Others, however, are international in nature (e.g., acid rain, global warming). Thus, in a globalizing world, fast growth by developing countries may aggravate some of these problems. Just imagine the effect on the environment if two billion Chinese and Indians bought cars and refrigerators,[12]

The important point of the above examples is that in all its ramifications including technological developments *globalization is contributing to the transformation of some national problems into international ones.* Actions that in the past had mostly domestic effects, now tend to have larger effects on other countries. These problems may bring frictions, and eventually even open conflict, between countries unless they are somehow contained.

Pigouvian economics taught us that externalities *may* justify public intervention.[13] If successful, this intervention would reduce the negative externalities or, at least, would make those who generate them bear the cost. This is, for example, the aim of the "polluter pays principle" which could be applied within a country or across countries. Public intervention uses instruments such as taxes, subsidies, and regulations to achieve the above objective. However, these actions can be taken only by a government within its national territory. When externalities or spillovers cross frontiers, there is no world government that can deal with them. And, it is often difficult for independent countries to work out solutions which are acceptable to all and enforced by all. A conflict can be seen developing over time between the

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[11]See the experiences with the Mexican and the East Asian economic crises.

[12]Also imagine many relatively poor countries getting access to the technology and the materials that would allow them to make atomic bombs.

[13]But see Coase (1960).

increasing internationalization of markets and of many externalities and spillovers and the lack of a political body with the mandate and the power to deal with them in a satisfactory manner.

A keen observer must have noticed the growing role that international institutions (such as the IMF, the OECD, the WTO, the WHO, the World Bank, the BIS, the United Nations, and so on) are playing in connection with some issues with international ramifications. For example, the IMF attempts to reduce the international effects generated by poor macroeconomic policies on the part of particular countries. The WTO attempts to reduce the international effects associated with particular actions linked to trade. The EU and the OECD are trying to reduce some of the international effects associated with unfair tax competition. This ongoing process is somewhat messy, random, and, at times, confused. It continues to be opposed by groups who feel that these institutions are inefficient; or that national sovereignty is being eroded by them; or, even, that the existence of these institutions produces moral hazards. European countries have created a supranational political institution, the European Union, which in many areas (such as regulations and monetary policy) will operate as a genuine supranational government.

These international institutions do not have the same legal power as national governments so that their ability to deal with cross-frontier spillovers is constrained and limited. However, their actions may still be effective in influencing the behavior of particular countries and in reducing the cross-frontier spillovers mentioned above. One should think of these institutions as clubs which are joined at the discretion of the members. On balance, most countries find it difficult or disadvantageous *not* to join these institutions and, once they are in, they become subject to increasing education and pressures to behave according to the agreed norms.[14]

IV. The Future Role of the Nation State

In the previous section we briefly described the globalization process that is bringing growing divergence between relatively static legal jurisdictions (such as nations) and highly dynamic markets. We mentioned that this process is reducing the power of national governments over some economic actions by individuals and enterprises. In this section, we develop this aspect a bit further.

As mentioned above, in all its ramifications globalization is creating or is contributing to many cross-border externalities or spillovers. This is leading to an increase in the number, or, more often, in the functions, of international and regional organizations. Such an increase may be seen by some as implying some reduction in the *discretionary* power of national authorities. For example, the creation of the World Trade Organization (WTO), to deal with cross-border externalities connected with trade policies, will reduce some of the power that national governments have to interfere with trade through tariffs, subsidies, quotas, or other

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[14]It is interesting that with all the criticisms of the IMF in recent years, practically all countries have found it convenient to join that institution and none has threatened to leave it.

means. The European Union is reducing the powers of the national governments of the member countries in monetary policy, exchange rate policy, in regulatory policies, and in other areas.

The IMF was recently asked by the Interim Committee to study the possibility that it could play a larger role in capital movements. This new role could presumably and eventually reduce the power of national governments in controlling capital movements. In April 1998, the Interim Committee, i.e., the committee of ministers of finance, that supervises the activities of the IMF, endorsed a "Code of Good Practices on Fiscal Transparency" that would encourage member countries to conduct fiscal policies that in conception, implementation, and results are as transparent as possible. If this code of conduct were followed and was subject to some monitoring, it would limit the discretion of countries to use nontransparent instruments (such as quasi-fiscal activities) to conduct their fiscal policy. In a previous meeting the Interim Committee endorsed a policy that encouraged member countries to generate and make available to the public a set of essential or basic economic data. This Data Dissemination Standards Initiative would limit the discretion of countries to generate poor data or to keep confidential data that are useful to the international capital markets in making decisions as to where to allocate financial capital.

Recently, a meeting of ministers at the OECD agreed to a common policy vis-à-vis the treatment of bribes paid by companies to foreign officials. Various codes of conduct are now being prepared or have been prepared for taxation, for financial markets, for good governance, for environmental policy, for labor standards, and so on. For example, the Financial Action Task Force, created by a decision of the G-7, has developed standards for banking and other activities aimed at reducing money laundering. All of these activities can in some ways be seen as reducing the freedom of individual countries to behave in particular ways. Of course, the basic objective of these activities is to be encourage better policies and to reduce undesirable spillovers.

The above are examples of an important trend: formal or informal international agreements or understandings are reached at occasional meetings of heads of states or of other high level policymakers representing specific countries or groups of countries. Agreements are also reached at regular meetings of international institutions. These agreements, understandings, or codes of conduct are supposed to guide the future actions of national governments. Or, looking at it from another angle, they are supposed to limit the discretionary actions of governments especially when these actions affect other countries in a negative way. Thus, in a way they proxy for the corrective action of a world government if such a government existed. Whether this development is considered good or bad depends on the importance that one attaches to the negative spillovers mentioned earlier and to the loss of some national sovereignty vis-à-vis specific actions.[15]

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[15]Of course, it also depends on how well the international organizations perform their tasks or how efficient are the rules imposed by them. Thus, the issue of market failure vis-à-vis

(continued...)

In a globalizing world, it would be naive to believe that the pursuit of selfish or national interests would somehow result in some Pareto optimum for the whole world. It is unlikely that in a world context, the unregulated and, at times, self-serving actions of individual countries would lead to results similar to those achieved by the working of the invisible hand in a perfectly competitive market. In such a world, free riders and those who may try to benefit at the cost of others may be active. For this reason, some constraints on countries' actions seem desirable. These constraints must aim at promoting some collective optimum and must be jointly agreed by countries. They must also agree on explicit or implicit penalties to be imposed on those who do not play by the rules. At times, the penalties are simply the criticism or the moral suasion imposed by other countries. This may be seen by some as a sign that the nation state is loosing its reason d'être. However, it is the inevitable outcome of responsible participation in a globalizing world.

Globalization is also forcing countries to abide more than in the past by the rules of the market. Countries that ignore these rules are now likely to pay a much greater price than they did when the economies were close. This was clearly shown by the 1997 financial crises in South East Asia and by the 1994 crisis in Mexico. Globalization is reducing the degrees of freedom that national governments had in many areas of policy in the past. In a way, this process also represents a transfer of some powers or functions from the policymakers of national government to market forces. The net effect is once again a reduction in the relative role of national governments and in the raison d'être of the nation state.

National governments are likely to see their economic role reduced because of the effects of globalization on tax revenue. A recent study that attempted to forecast the long run effects of globalization (and accompanying tax competition) on taxation concluded that it: (a) will lead to lower tax revenue; and, more importantly, (b) it will lead to major changes in the tax structure. See Tanzi (1996a). In particular, revenue from income taxes are likely to fall. Thus, the ability that governments have in sustaining high levels of public spending will be reduced.

The taxes that will fall the most are those of the *national* governments. For many national governments it will be difficult to replace these losses because their other major revenue sources--value-added taxes and social security taxes--will also be subjected to downward pressure. Thus, there will be a reduction in the ability of national governments to pursue particular policies.

Nothing that has been said above indicates in any way a reduced role for *subnational* and especially municipal governments. If anything, the reduction in the functions of the national governments will create more space and more need for an intensified activity on the part of local governments. In a more open world, many enterprises and managers will have freedom as to where they carry out their economic activities, but they still will have to choose

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[15](...continued)
government failure is highly relevant in this discussion.

where to live. In a way, globalization, the information revolution, the Internet, and other trends, such as the increasing number of retirees with high pensions and large assets, will make it possible for many individuals to choose more freely where to live. This means that local jurisdictions will have to compete harder to retain or to attract, especially, individuals with high incomes, be they executives, managers, free professionals, rich pensioners, or simply rich people looking for an attractive place to live.[16]

Local communities can contribute a lot to making a particular location an attractive place to live. A clean environment, safe streets, orderly traffic, good parking facilities, attractive parks, good cultural activities, an efficient and honest local administration, reasonable local tax rates applied with low compliance costs, good health facilities, and local regulations that do not create excessive red tape that strangle economic activities and promote corruption, are all elements that increase the attractiveness of a locality. Perhaps, in some way, globalization will increase the relevance of the Tiebout hypothesis, to the effect that taxpayers will vote with their own feet in choosing the places to live which better match their own desires. That hypothesis may acquire relevance in an international context.

Local governments should welcome the trends that are influencing economic development and should prepare for them. Globalization will reduce local tax revenue less than it will reduce national tax revenue. However, tax competition at the local level could also limit the use of particular taxes. The need for more attention to be paid to the core activities of the governments means that the role of local governments will have to increase. These core activities are as much the responsibility of local governments as they are of national governments.

V. Concluding Remarks

Under current and likely future trends, the total role of the government in the economy would be reduced. Total tax revenue will probably fall and, given limitations to public sector borrowing, public spending must also fall. If taxes had been too high, this fall might encourage more growth provided that spending were reduced correspondingly. Globalization may also reduce the use of regulations imposed at the national level, often used as proxies for taxing and spending, while increasing those imposed at a global level. Globalization will have its greater effect on the role of *national* governments for the reasons explained above and because the taxes most affected will be those collected at national levels. Local governments will be less affected on their tax revenue and will be required to play a larger role in creating a living environment that attracts investment and higher-income individuals.

Local governments may also face problems which, if allowed to become significant, could constrain them and reduce the benefits that may come with the new environment. Here we can only mention some of these problems.

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[16]Pensioners are especially showing a lot of freedom as to where they retire often going to live in foreign countries; the number of pensioners is growing at a fast pace.

Tax competition among local governments might intensify, thus leading to revenue losses and to possible misallocation of resources. This is important because the larger role played by local governments would require larger spending on their part and thus larger revenue than in the past. The greater assignment of spending responsibilities to the local governments would not automatically be matched by a greater assignment of tax revenue.

Corruption by local officials--in zoning decisions, in licensing, in inspecting, in authorizing certain activities, in discouraging others, and so on--can be significant and can increase the cost of doing business in a given area. Recent literature has shown that corruption can play a role similar to that of high tax revenue in discouraging foreign investment. See Wei (1997) and Mauro (1995). Arguments have also been advanced that corruption may be more prevalent at the local level than at the national level. See Prud'homme (1994) and Tanzi (1996b).

National markets may become fragmented if local governments put obstacles on some activities or on the movement of people (e.g., through licensing, residency requirements, and so on). This is likely to happen if those who are getting rents from protected or monopolistic positions at the local level are able to influence the decision of the local policymakers or officials. Local protectionism (through the use of regulatory instruments) is definitely a danger worth worrying about.

Perhaps it is important to reiterate the basic point of this paper: that the absence of a world government to deal with many allocative issues at the international level is creating the need to expand the role of the international institutions. Two points are worth making in this connection. First, because of the lack of *taxing* power on the part of these institutions, their role will be largely played through their regulatory power and their power of persuasion. In some cases, regulatory tools may not be the most efficient tools. Second, in their attempts to address market failures at the international level, these institutions will undoubtedly experience some failures similar to those commonly referred to by the public choice literature as government failures. Hopefully, these government failures will not become as important as the market failures that the institutions attempt to correct.

This speculative paper has analyzed some of the recent trends in the world, and particularly those associated with globalization and related technological developments, to draw inferences about the future role of national governments and, to a lesser extent, the assignment of fiscal responsibilities between national and subnational governments. The conclusions reached are highly suggestive and important, but much more thinking and work will be necessary before they can be considered as definitive conclusions.

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