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Position Paper VI

The question of importance and necessity of the state is raised again and again throughout the history of humanity. There are different types of states from less powerful and liberal governments to more controlling ones, such as welfare states and nation states. With the arrival of capitalism and ubiquitous globalization in the last few centuries, the economic effects of any particular system or regime, such as the nation state whose authority is observed to be in decline nowadays, are highlighted. Thus, it is essential to analyze the rationale and the necessity of nation states within the context of modern capitalism and globalization.

Since the emergence of the modern nation states around 18^{th} – 19^{th} centuries, there has always been a debate between the opposing ideas about the rightful economic system. Lal (1985) states that there were two main opposing sides criticizing each other: orthodox and conventional economists, recalling the Classical school of thoughts with Marshall and Pigou, supporting deregulation of the state in contrast to unorthodox and *dirigiste* economists, referring to Keynesian economics, which supported the government regulation. Initially, the ideas of the Classical economics were prevailing in the policies of nation states; however, after the interwar years, the Great Depression and the World War II, as a remedy to existent economic difficulties, the newly formed Keynesian school of thoughts became highly popular around the world. At the same time, the Bretton Woods monetary system was established, which empowered the states with the monetary authority and restrained capital mobility, allowing them to efficiently use the fiscal policy within a particular country. Moreover, many countries had numerous barriers to trade in those times. Such system enabled a number of nation states to develop from the inside domestically, but it did not last long.

After the demise of the Bretton Woods system, the international monetary system has changed, allowing flexible exchange rates with free mobility of capital. After a while, being allowed by the new system, people started to invest more in financial sector leading to increased global financialization of markets, making government's fiscal policies less efficient than before. It was stated that the state did not only lose its power in controlling the exchange and interest rates due to open financial markets but also was stripped of the trade and commercial policy tools due to requirements of newly established organizations, such as World Trade Organization (WTO) and its General Agreement on Tariffs and Trade (GATT), leaving the nation states with less autonomy in policy making (Adelman & Yeldan, 2000). As it can be seen in Figure 1, the average world tariff rate has been hitherto decreasing. It is a result of GATT/WTO agreements, any renouncement of which might invite retaliation from other member countries. Moreover, Chang (1998) and Strange (1996) notice that the increased influence of transnational corporations (TNCs) as a result of globalization makes it difficult for the governments to make strategic industrial policies, because they try to make concessions to attract Foreign Direct Investments (FDIs). According to Figure 2, the quantity

Figure 1. **Source: World Bank.**

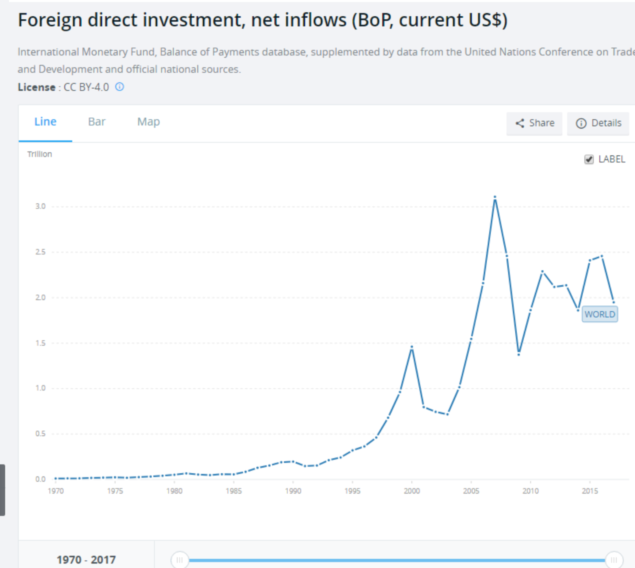

Figure 2. **Source: World Bank.**

of FDIs increases globally since 1980s, demonstrating more dependence of nation states on them.

The main problem that arises from these economic changes in last decades is the ability of nation states to impose policies for the nation's benefit and to finance the expenses for social security system. Within the globalized world and current international economic system, the room for policies of nation states is very limited, as seen in the examples above. Not only the autonomy and authority of the states are limited, but also the government revenue is shrinking due to openness to trade. Rodrik (1997) suggests that the global demand for workers, especially the unskilled and semiskilled ones, has decreased due to trade liberalization, making a large portion in the population dissatisfied with the free trade, leading to social tensions. No one desires the social tensions; therefore, the nation state should compensate the losers with the social insurance.

To conclude, the nation state is a necessary apparatus to balance the capitalism and its consequences. Without the redistributive policies aimed at making societies more equal, the market forces of capitalism would lead to social unrest. Furthermore, some protectionist policies of nation states might be useful initially to develop domestic industries before opening to international trade.

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