

Globalization and the Dynamics of Regulatory Change

**The Delaware Effect, The California Effect, Or The Persistence
Of National Diversity?**

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Competing Perspectives on Globalization and Regulatory Competition

As globalization became a topic of central concern in international political economy during the 1990s, many scholars warned of a “Delaware effect” whereby growing economic integration would exert downward pressure on regulatory standards. Capital mobility and competition from overseas imports were purported to leave advanced industrial countries with little choice but to engage in a race towards laxity to shore-up their international competitiveness (Gray 1998, Rodrik 1997, Scharpf 1995).¹

Many recent studies of globalization and regulation have rebuked the “Delaware effect” hypothesis. Instead, a growing number of scholars now suggest that globalization and regulatory competition actually drive standards up (Garcia-Johnson 2000, Vogel 1995, Wheeler 2000). Vogel, for example, argues that strict regulations sometimes favour domestic producers in large affluent markets when they stand to gain a first-mover advantage from adapting to tougher regulations early (1995, 1998). Hence, domestic producers in one country may lobby for higher standards when they pose a barrier to market entry for foreign firms. Other rich countries may follow their lead, generating a competitive race to the top (the California effect).

Despite some empirical support for the existence of both a “Delaware effect” and a “California effect,” neither a race to the top, nor a race to the bottom, seem to be the general rule. Hence, some scholars argue that globalization has not adversely affected national autonomy and that national diversity in regulatory standards and institutions will continue to be the norm (Berger and Dore 1996, Boyer 1996, Garrett 1998). Yet, to claim either “nothing is new” or “anything is possible” seems unsatisfactory. While good attempts have been made to explain the persistence of national diversity, no empirically tested theory has yet laid out which conditions and mechanisms produce a race to the top, which tend to drive standards downwards, and which enable nations to pursue their policy preferences with relative autonomy. This paper will evaluate existing arguments and provide a new framework to model the process of regulatory change.

¹ For example, some worry that trade liberalization will erode the viability of stringent regulations and generous welfare policies as increased competition from cheap overseas imports place comparatively overburdened domestic producers at a cost disadvantage (Drache 1996, Pierson 1991). Regulatory stringency is also thought to drive mobile multinational producers to seek lower cost locations in newly industrialized countries where weak standards yield significant savings (Reich 1991, Rodrik 1997).

Modelling the Dynamics of Regulatory Change

The starting point for building a model of regulatory change is the growing body of literature on globalization and regulatory competition (e.g., Berger and Dore 1996, Vogel and Kagan 2002). The model developed in this paper builds on previous findings and attempts a synthesis in order to arrive at a more holistic picture of regulatory change. There are, however, several key differences between this model and previous models. First, some analysts still argue a particular regulatory outcome will prevail in all circumstances.² Second, while conceding the possibility of different outcomes, many scholars attempt to identify one master mechanism to explain all instances of regulatory change.³ Third, some models also assume a dominant actor has the capacity to determine the course of change single-handedly, or they discount or ignore the role of other actors.⁴

The view espoused here is that there is no master mechanism and little prospect of a parsimonious account of regulatory change that explains all from one set of assumptions about the preferences and choices of a dominant actor. Instead, the framework below offers a “process view” of regulatory change that models a contest between principles, mechanisms, and actors. Principles are abstract prescriptions that guide conduct. Mechanisms are the tools and processes that actors enact to entrench the principles aligned with their objectives. Actors deploy levers of power to bolster their bargaining strength in the contest of principles and mechanisms.

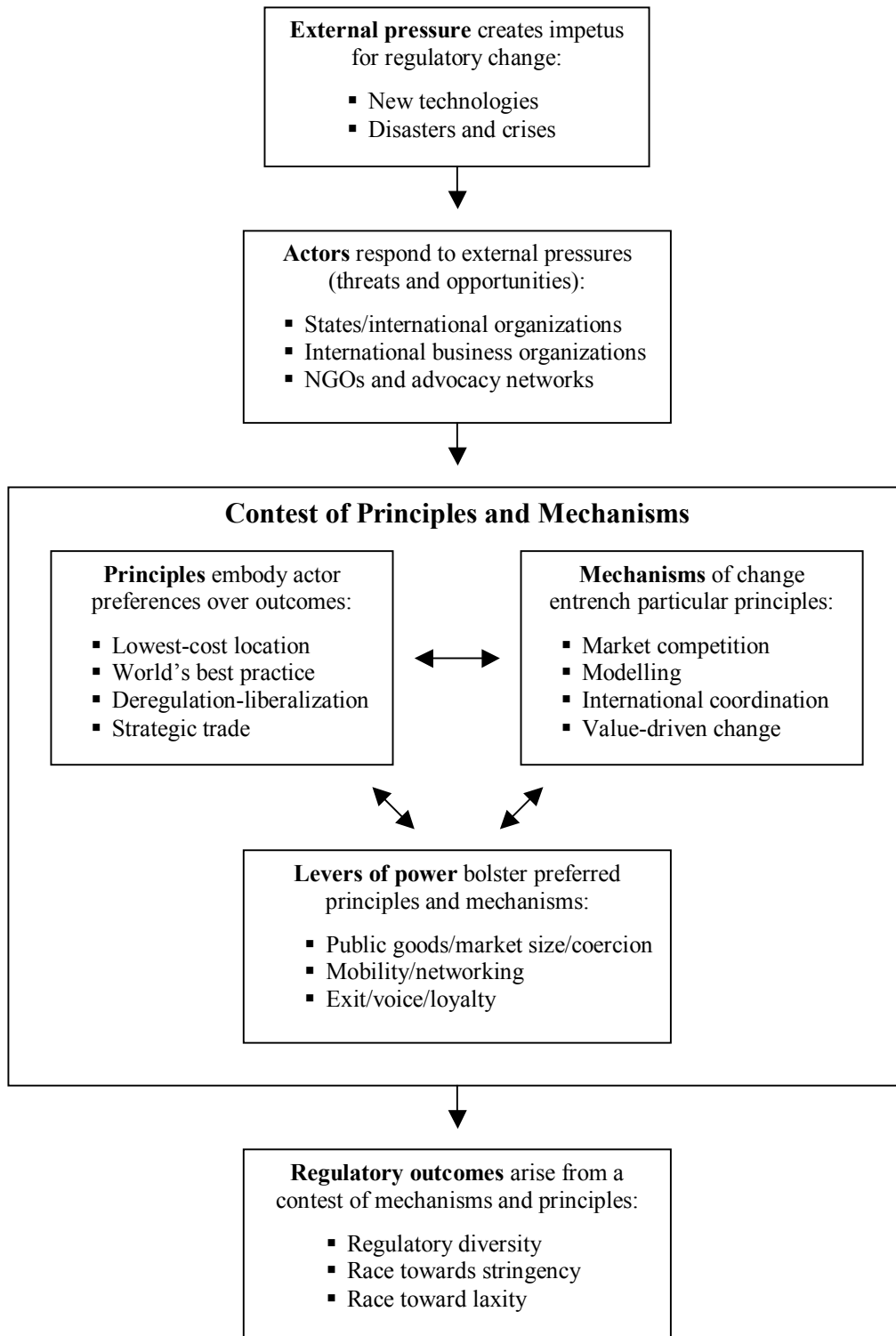
With this approach, we can advance different hypotheses about which principles and mechanisms will be enacted – and the direction of change they are likely to initiate – given our knowledge of the actors and power dynamics at play in a given sector or policy issue. Provided we have accurate inputs (i.e., knowledge of the dominant principles, mechanisms, and actors), a complex set of processes and contingencies can be reduced to a simple sequence of regulatory change. Before proceeding to examine some typical sequences, we will take a closer look at the recurring principles, mechanisms, and levers of power that actors deploy to shape the direction of regulatory change.

² Boyer, for one, argues strongly that regulatory and institutional diversity will prevail over the forces of convergence (1996). Many others concede that various outcomes are possible but channel their analysis into explaining only one of them. Vogel (1995, 1997), for example, focuses on explaining races toward stringency, while Kahler models races toward laxity (1999).

³ Simmons (2002) and Genschel and Plumper (1997) emphasize the role of inter-state cooperation in preventing races toward laxity. Murphy (2002) and Vogel identify market forces as the primary causal mechanism, while Gelb (2000) and Keck and Sikkink (1998) highlight the role of norms or values-driven change.

⁴ The sceptical account provided by Garrett (1998) focuses on the enduring capacity of autonomous nation-states to co-opt market forces and resist convergence in either direction. Meanwhile, Murphy, and to some degree Spar (2000), focus on MNCs as the primary drivers of change, while sidelining the role of states.

Figure 1: A Process View of Regulatory Change



Principles

Principles are normative prescriptions that actors align themselves with as they seek to incorporate practices or changes into regulatory systems that are consistent with their values, goals, and interests.⁵ As Braithwaite and Drahos argue, they are important for understanding regulatory globalization because much change proceeds through a contest of principles rather than rule systems because rules are too complex to place on the bargaining table (2000: 527). Principles provide an organizing logic around which actors can bargain over the course of institutional development. When principles become entrenched in regulatory systems, they set the direction of change.

Braithwaite and Drahos identify over thirty active principles in their review of global business regulation (2000: 508-9). For the purpose of illustrating this model, four principles stand out as being particularly salient, although more could surely be added.

Lowest-cost-location

The principle of lowest-cost location implies the prescription to locate economic activity wherever it can be conducted most cheaply. Lowest-cost location is the principle heralded by multinational producers with an interest in driving a race towards laxity. Empirical findings suggest that while the threat of moving to a lower-cost location is frequently invoked, it is seldom operationalized because, as discussed later, the mobility of firms is often overestimated (Gilpin 2000), while the lure of public goods and other “non-cost” considerations are often underestimated (Garrett 1998).

World’s best practice

The principle of world’s best practice implies the prescription to conduct economic activity according to rules that substantially exceed the requirements set by present practice or regulation. Firms (and supportive states and NGOs) promote world’s best practice as a standard of conduct when they have an interest in building a good reputation and a competency in fostering continuous improvement as a source of competitive advantage (Porter 1990). Braithwaite and Drahos point out that the principle of world’s

⁵ For the sake of brevity, we avoid a discussion of events and forces that may provide an impetus for regulatory change. We also assume that the key actors require no introduction. Note that the list of actors considered in the model by no means exhausts the potential range of actors that are important in determining the course of regulation. Domestic producers, epistemic communities, and the national and international bureaucrats that manage regulatory agencies are also clearly important, and a more detailed treatment of regulatory change might include these participants as well.

best practice is weakest when the driver of reputation matters less and immediate costs determine all (2000: 519).

Deregulation-liberalization

The principle of deregulation or liberalization implies the prescription to reduce the number, stringency, and/or enforcement of rules and standards. Business actors invoke deregulation to draw attention to the costs of regulations, while states apply the principle selectively when they perceive their national interests are served by less restrictive regulation. While particularly strong in the domains of trade, finance, telecommunications, pharmaceuticals, and labour, the principle of deregulation is not as pervasive as one might expect. Braithwaite and Drahos found that when actors perceive themselves as participants in a shared community of fate, the principle of deregulation tends to weaken, as it is in domains such as property rights, securities, nuclear safety, sea transport, road transport and air safety (2000: 515-18).

Strategic trade

The principle of strategic trade implies the prescription to design the content and stringency of regulation so as to advantage domestic exporters or importers over foreign exporters or importers. Strategic trade is the principle most often entrenched through the mechanism of market competition by states and firms that seek regulatory change to achieve an advantage over their competitors (Vogel 1995). It is worth noting that strategic trade does not necessarily imply a race toward stringency. For example, developing nations often see lax labour and environmental standards as one of few strategic advantages in attracting FDI (Gilpin 2000:308).

Mechanisms

Mechanisms are the social, economic, and political processes by which regulatory standards converge towards higher or lower standards, or don't converge at all. At least four mechanisms are central to regulatory change, including: market competition, international coordination, values-based changed, and modelling.

Market competition

The dynamics of regulatory competition among states, like competition among firms, are powerful forces for driving change. The Delaware effect and the California

effect presume that actors in competition for scarce resources such as FDI or market share will lower or raise their regulatory standards to adjust to competitive forces. Kahler (1999) points out that for the mechanism of market competition to work you must have 1) firms that are mobile and sensitive to variations in regulatory conditions across jurisdictions and 2) governments that seek to attract mobile firms and respond to regulatory choices of other governments. While tax competition and export-processing zones suggest some clear examples of competitive affects, much of the literature on national diversity argues the states (at least those in the OECD) have sufficient leverage to resist the homogenizing forces of competitive pressures (Boyer 1996).

International coordination

The mechanism of international coordination provides another explanation for why races toward laxity are not more common. When a race toward laxity seems likely, states may act collectively to coordinate their regulatory strategies so as to avert a downward spiral in regulatory standards. Genschel and Plumper (1997) argue that coordination strategies are only available in cases where a critical mass of states can be easily compelled to engage in a “cooperative turnaround.” In a given policy issue, the heterogeneity of interests, size of the minimum winning coalition, and the external effects of cooperation on non-cooperators will play a critical role in determining the possibility of international collective action.⁶

Value-driven change

Values and norms create informal constraints that shape the perceptions and behaviour of actors in a manner that influences the direction of regulatory change. Value-driven change is often overlooked as a mechanism of change in a game where raw self-interest and competitive forces figure prominently. However, the ability of NGOs, advocacy networks, and mass consumer movements to give force to normative frameworks as a mechanism to ratchet standards upward is attracting growing attention (Florini 1999, Kaldor 2003, Keck and Sikkink 1998). While the mechanism of value-driven change rarely works on force of persuasion or moral values alone, NGOs have

⁶ Genschel and Plumper explain that the success of international cooperation depends on there being a relatively small coalition with homogeneous interests that can profit from cooperation all by itself, despite the existence of a dissenting faction. If there are network effects, and the effect of cooperation is self-stimulating, other dissenting factions will be compelled to join the winning coalition. If the effect of cooperation is self-limiting – i.e., the benefits for non-cooperators grow as more players join the coalition – then international cooperation will be hard to sustain (1997).

become increasingly sophisticated in their use of levers such as market power to change the cost/benefit calculus of powerful states and firms (see below).

Modelling

Modelling is a mechanism whereby regulatory change is achieved through a process of observational learning (Braithwaite and Drahos 2000). The widespread use of modelling shows that convergence of de facto standards of practice (if not de jure laws and regulations) is perhaps more likely to occur through a benign process of imitation, learning, and idea diffusion than it is through a ruthless and unyielding competitive process. Many multinational firms, for example, regularly adopt industry best practices because they adhere to Porter's management philosophy of continuous improvement (Porter 1990). States also model one another's best practices. Indeed, how else can one explain, for example, the nearly simultaneous emergence of environment ministries in all OECD countries during the 1970s?

These four mechanisms rarely work in isolation. For example, the mechanisms of modelling and value-driven change may combine to further the principles of transparency and world's best practice in a race toward stringency. The principles of deregulation and lowest-cost location may become entrenched in domains where the mechanism of market competition undercuts the mechanism of international cooperation. Alternatively, strategic trade and a process of homeostatic adjustment among states and firms may allow for the persistence of national diversity. Will any of these sequences of regulatory change reign supreme? The answer is not yet clear. But, examining the levers of power that actors deploy to gain leverage over regulatory outcomes provides further insight into how firms, states, and NGOs compete or cooperate to shape the direction of change.

Levers of Power

In the final analysis, the direction and pace of regulatory change is a function of bargaining strength. Actors use their "levers of power" to bolster their bargaining strength in the contest of principles and mechanisms. The levers discussed below are those repeatedly deployed by the three main actors considered in this model – states, international business firms and associations, and transnational advocacy networks.

States

Recent studies that suggest that globalization critics have vastly overestimated the constraints economic integration places on the capacity of national societies to pursue distinct regulatory strategies (Berger and Dore 1996, Garret 1998). States may not retain equal autonomy and regulatory discretion in all issues and sectors however. Rather, the strength or weakness of national autonomy depends critically on the existence of strategic trade advantages, the provision of public goods, and the potential to apply coercion or incentives in international decision-making forums.

Public goods and stable institutions. While some analysts see interventionist state policies as a cost, there is considerable evidence to the contrary. For example, firms often regard regulation as a benefit (Kahler 1999, Stigler 1971). Indeed, many scholars point out that firms profit from a rich supply of public goods and stable institutions that lower the costs of transacting (Garrett 1998, North 1990). These assets provide states with considerable bargaining power, suggesting that in most domains regulatory diversity will persist into the foreseeable future.

Market size. In a similar fashion, nations with large affluent markets gain considerable leverage over regulatory change. No large multinational firm can credibly threaten to exit a market with millions of wealthy consumers. Thus, as Vogel (1995, 1997) has argued extensively, market size is the decisive factor that enables states to pursue the principle of strategic trade, and is often a key force for ratcheting standards upward by disseminating higher regulatory standards from leading states to laggards.

Coercion. Finally, for only the most powerful states, coercion provides a potential form of leverage over regulatory change. Simmons (2002) argues that coercion and/or systems of reward may provide a means to achieve international coordination in cases where interests are heterogeneous and a powerful state actor, or coalition of actors, is sufficiently motivated to pursue regulatory change through less diplomatic means (perhaps through formal or informal sanctions). Braithwaite and Drahos, on the other hand, find that while military and economic coercion play a significant role in the history of business regulation prior to 1945, coercion has been much less decisive in the contemporary era, partly because it is a costly lever to deploy, even for the US (2000).

International business

The alleged power of multinational corporations over regulatory outcomes is assumed by many to have grown significantly in recent decades (Hertz 2000). This analysis suggests those accounts considerably exaggerate corporate power, while discounting the leverage of other players such as states and NGOs (Garret 1998, Gilpin 2000). Nevertheless, large multinational firms do deploy some potent levers of power to achieve their preferred outcome.

Mobility. The ability of firms to enact the mechanism of market competition presumes, in part, their capacity to rapidly and costlessly shift resources in search of local cost advantages. Several scholars have shown this to be a dubious assumption because transaction costs often weigh heavily along side production costs in a firm's cost-benefit calculus (North 1990, Williamson 1985). Furthermore, labour cost differentials between countries, for example, may not be wide enough to compel a manufacturer to forgo considerations such as proximity to key markets (Gilpin 2000, Gitterman 2002). Thus while liberalization has enhanced the mobility of capital, firms must weigh the cost of compliance against both sunk costs and transaction costs in their decisions to relocate production (Kahler 1999, Murphy 2002, Spar 2000).

Scale and networking. Perhaps more important than mobility is the sheer scale of multinational firms and their well-established networks of associations and specialized service providers. These levers ideally position business interests to influence the direction of regulatory change by modelling best practices and promoting self-regulation. Indeed, the globalization of a new standard of business practice is often a precursor to formal legal adoption (Braithwaite and Drahos 2000). For this reason, industry associations such as the ICC deliberately pursue a private ordering strategy whereby the best practices of members are recorded and disseminated; while business dominated standard-setting bodies such as the ISO produce hundreds of product and technical business standards.

Citizens and transnational advocacy networks

Hirschman's (1970) framework of "exit, voice, and loyalty" suggests three levers of power available to ordinary citizens who wish to influence regulatory outcomes.

Exit. First, like firms, some citizens may vote with their feet by moving to jurisdictions with their preferred bundle of taxes and public goods (Tiebout 1956). Since, the ability of citizens to engage in international “jurisdiction shopping” is still considerably constrained by the state, it is more common for regulatory outcomes to be influenced by the activities of organized groups using voice and loyalty.

Voice. Second, citizens may organize into interest groups to influence regulatory deliberations.⁷ The ability of citizens to exercise voice has been greatly assisted by the Internet, which enables vast coalitions of groups and individuals to join together in principled causes. Keck and Sikkink point out that it is precisely the non-hierarchical nature of these networks that allows them to form just-in-time organizations, disseminate information quickly, and popularise new ideas and norms as they seek to affect value-driven change (Keck and Sikkink 1998).

Loyalty. Third, citizens may change their buying behaviour in consumer markets, thus withholding their loyalty from firms that adopt dubious standards of behaviour. In the 1990s, the overseas activities of multinational firms came under increasing scrutiny by NGOs who exposed rapacious behaviour to affluent markets in order force changes in corporate behaviour. Rather than drive standards down, many firms have since adopted global codes of conduct whereby they commit to apply uniform standards of business practice around the world (Garcia-Johnson 2000, Haufler 2001).

Understanding more about how and when these levers are effective allows us to make generalizations or predictions about the direction of change. Firms prescribing the principle of lowest-cost location, for example, deploy the lever of mobility to foster a competitive race toward laxity. NGOs prescribing the principle of world’s best practice deploy the lever of market power to compel market leading firms to set industry best practices that will be modelled by other firms in an “evolution” toward stringency. Affluent nations prescribing the principle of strategic trade deploy their large markets, public goods, and stable institutions as leverage to retain control over domestic policy agendas. Having now outlined the principal elements of the model, we consider some “typical” sequences of regulatory change and then draw some final conclusions.

⁷ Citizens, no doubt, are often at a disadvantage here in relation to the superior resources and organizational capacity of business interests. Many cite collective action problems (i.e., the cost of acquiring information and the imperceptible difference that individual votes make in a national election) as a formidable barrier to “citizen sovereignty” (Olson 1965) while others also cite agency problems in ensuring that political principals are not captured by special interests (Stigler 1971).

Ratchets and Regulatory Diversity: Sequences of Regulatory Change

The process view of regulatory change outlined above provides a generic framework for understanding how institutional development proceeds through patterns of conflict and cooperation among actors. The principles, mechanisms, and levers of power discussed above, however, are not static determinants of particular outcomes in a “billiard ball model” of regulatory change. Rather, regulatory change is determined dynamically as actors engage in a contest of mechanisms and principles through which perceptions are shaped, interests are redefined, and strategies are enacted and counter-acted to shape the direction of change. Figures 2- 5 below illustrates how various principles, mechanisms, and levers coalesce to drive ratchets and regulatory diversity in several typical sequences of regulatory change.

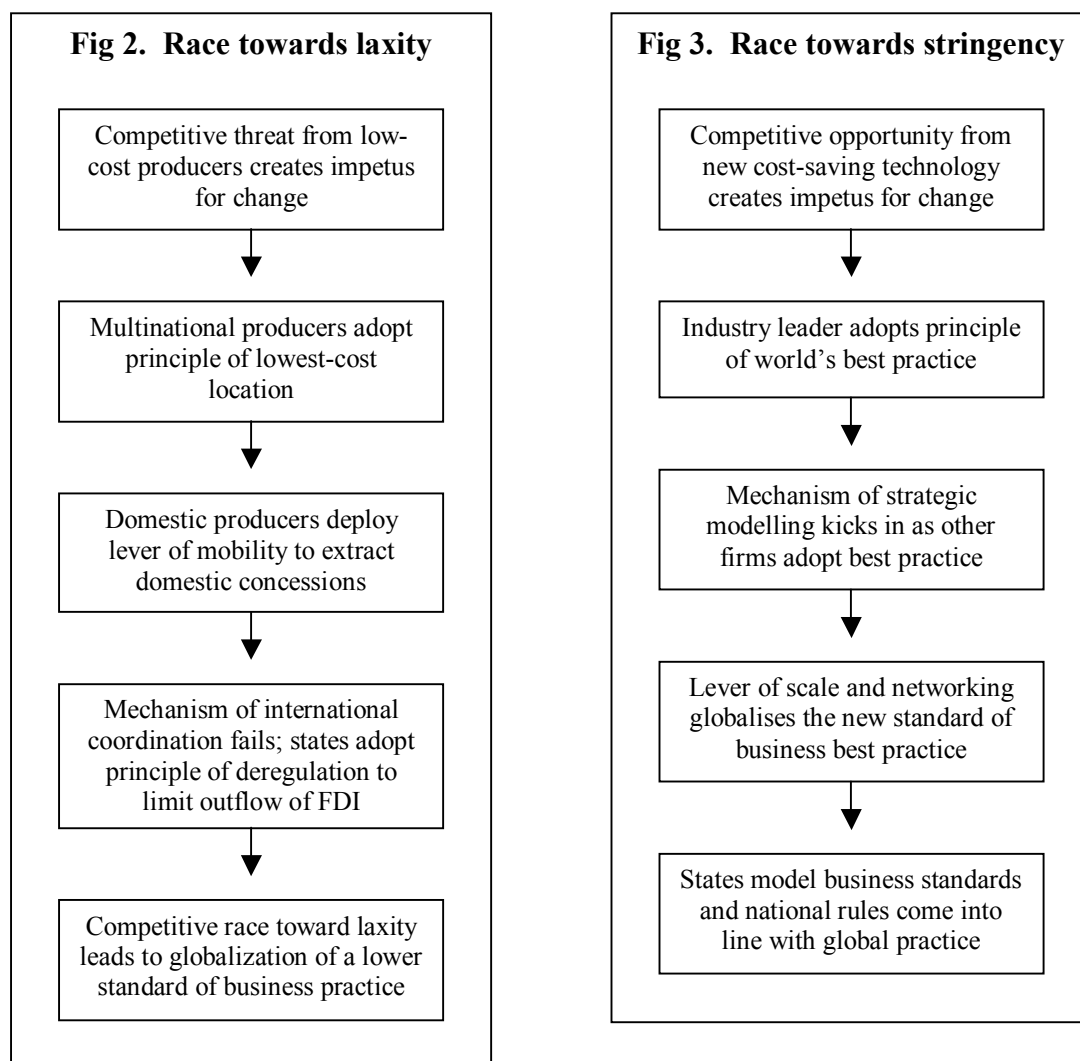


Fig 4. Race towards stringency

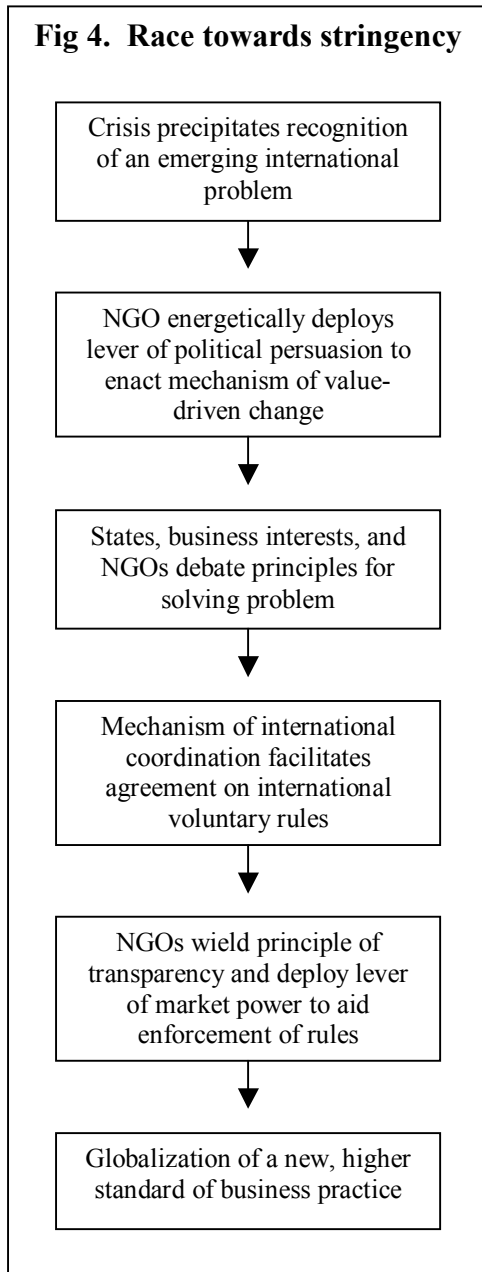
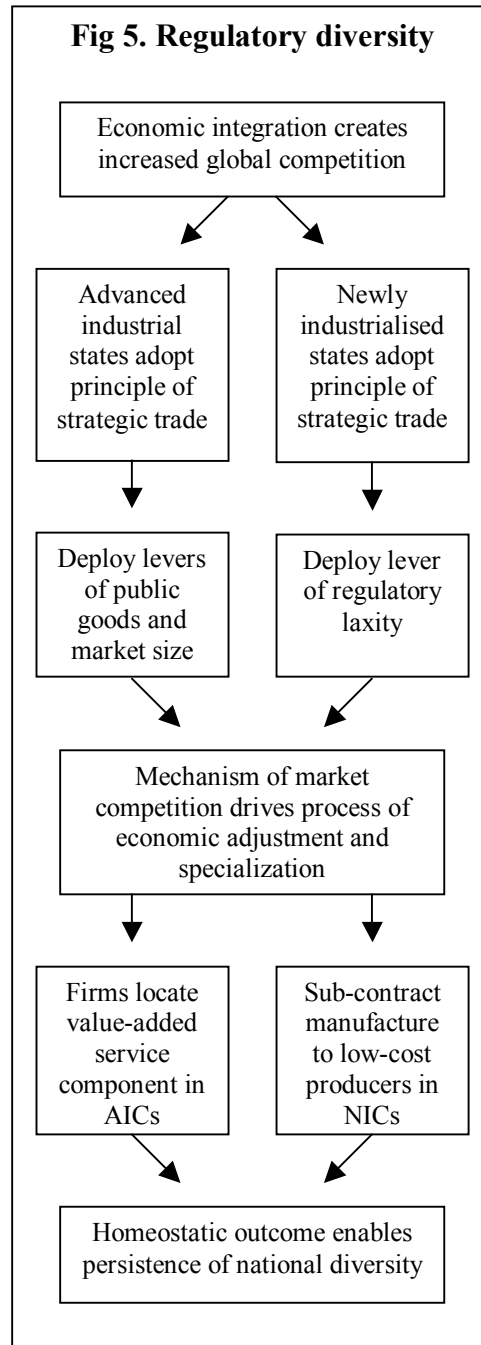


Fig 5. Regulatory diversity



Conclusion

The association between globalization and the dynamics of regulatory change is clearly a complex one. However, the web of relationships and elaborate processes is not so thick and intricate as to impair the visibility of a few distinct strands and patterns. Indeed, a number of important conclusions can be drawn from the forgoing analysis, three of which are singled out as most outstanding.

First, the theoretical framework developed here suggests regulatory change be understood as a contest between unequal actors pursuing strategic advantages within the institutional framework that governs the global economy. Much of the conflict unfolds in the regulatory arena as actors deploying various levers, principles, and mechanisms vie to shape the direction of regulatory change. There is no empirical foundation for simplistic claims that globalization has shifted the balance of this conflict towards a race to the bottom in regulatory standards. Nor can we generalise about races to the top, as there are examples in which the principle of lowest-cost-location combined with the mechanism of market competition have trumped the ability of other actors to resist the erosion of regulatory standards. And, while the case for the persistence of national diversity is warranted in most policy areas, a strong case for national autonomy in setting regulatory standards is surely undermined by numerous examples of convergence in both directions.

Second, sorting out the upward and downward ratchets from the genuine cases of regulatory diversity entails a careful analysis of the process of regulatory change in a given sector or policy issue. While we can discern how particular principles, mechanisms and levers coalesce to drive ratchets and regulatory diversity, no master principle or mechanism is responsible for all of the unique instances of regulatory change. Hence, it is difficult, if not impossible to create a parsimonious model that predicts a general sequence of regulatory change with equal applicability across all issues and sectors. A process-view illustrates how regulations change in a global economy, while the “levers of power” analysis helps explain why various actors are able to entrench certain mechanisms and principles in some issues areas and sectors, while not in others. More careful sector and issue-based comparative institutional research could yield some new insights into deeper causal mechanisms that support generalisable theorems.

Finally, states remain potent actors in determining regulatory outcomes, but they are by no means the only actors with the capacity to globalise regulatory standards or the power to shape the direction of regulatory change. Multinational firms and business

associations disseminate best practices, negotiate standards, and implement global codes of conduct, not to mention the behind-the-scenes influence they exert on government regulators with campaign dollars and tacit and not-so-tacit threats of capital flight. NGOs and transnational advocacy networks shape perceptions and normative frameworks, catalyse mass publics into action, and propagate regulatory models and principles that advance their objectives. In the big picture, the distinction between principals and agents is continually reconstituted in a multi-layered game in which states act as agents for corporations, corporations act as agents for NGOs, NGOs act as agents for states, and so forth. Indeed, the optimistic story emerging in at least some policy areas is that networks of actors can get beyond competitive dynamics and collective action problems to jointly supply the resources, competencies, and diverse perspectives needed to create effective regulatory solutions for a range of complex problems.

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