Session 14
Do Borders Play an Economic Role?

The openness of borders is not a given

Helen V. Milner
Princeton University

Borders have profound political and economic importance. And this is true even today when we have a very open world economy and deeply integrated national economies.

Borders increase the costs of economic exchange. And they do so very powerfully. Borders reduce the flows of goods, services, capital and people across countries. The "border effect" among OECD countries has been estimated; it shows that trade flows are at least 15% less dense between countries than within countries (and across their provinces). Borders reduce the density of exchange among people, whether it be for goods and services, capital, or people.

Why? National borders mark differences in institutions, policies and regulations that have enormous economic significance. And borders are also places where differences in languages, cultures, and customs impose barriers to exchange and flows of goods and people. The importance of these policies and differences becomes clearer when comparing countries to regions within countries that are not separated by national borders. Regions within countries are more integrated than are countries: they trade more with each other, they have more population movements, their growth rates converge faster, and they have more synchronized business cycles.

Economic integration and globalization are all about reducing the costs of borders. A huge effort in past decades has been made to reduce trade barriers and hence the costs of borders. The WTO, PTAs, BITs and unilateral trade and capital market liberalization have brought barriers to trade and foreign investment down to very low levels throughout most of the world now. The end of the Cold War and collapse of the Soviet Union, the entry of China into the world economy, and the liberalization of policies by developing countries in the 1990s ushered in a period of rapid and deep globalization. Most countries are now highly integrated into world economy and depend a lot on exports and imports as well as on flows of foreign capital.

In addition, the world economy has become more integrated as multinational firms have built vast networks of trading and investment relations. These global value and production chains span the world. Firms look for the cheapest places to produce each part of their value chain and then ship goods and services around the world for adding value and then for sale. This is a highly complex process that relies on open borders in trade and capital flows. Protectionism would disrupt this greatly and hurt many big multinational and exporting firms a lot. Much of the pressure for openness these days comes from these large and powerful multinational and exporting firms. In the US we know that they are the leading lobbyists on trade policy issues. Were Donald Trump to become president and try to erect barriers to trade, as he has proposed, he would hurt these large American firms badly.

Many economists expected the economic crisis of 2008 and onward to lead to the closure of national markets and to rising protectionism. The world economy has remained open however, despite the many shocks it experienced. International trade dropped sharply after the financial crisis in 2008, rebounded in 2010, but has grown only about 3 percent a year since, compared to a roughly 6% annual rate from 1980s to the crisis in 2008. In that period world trade grew faster than the world economy as a whole. Now however it is growing more slowly. The worry is about what happened in the early 1930s. As the famous spiral graph of economic historian Charles Kindleberger shows, world trade declined by over 60% between 1929 and 1933. That was nearly double the 35% decline in world production. This downward spiral was exacerbated by protectionism, starting with the United States’ Smoot-Hawley Tariff Act of 1930, which induced higher trade barriers in Europe and globally. Nations tried to protect themselves but ended up hurting the world as a whole, as well as themselves.

Closure of the world economy by and large hasn’t happened. Trade and capital flows have remained strong. But the focus of attention now is on migration and the movement of people. Many political leaders now call for increasing restrictions on migration. What should rich, developed countries do about the immigration of unskilled labor? Does it hurt their own workers? Does it increase inequality at home? But data show that the biggest gains from global integration could be had from more migration, more flows of people, and not from more flows of capital or goods and services. Much inequality across nations could be reduced with more migration, but this might induce more poverty within some countries.

Borders also have a political impact that is important. There are benefits to borders. Some of the benefits of borders are institutional. Borders are institutions that coordinate individuals’ and governments’ political and economic behavior and improve social welfare when they are widely accepted and clearly demarcate states’ jurisdictions. They can act as coordination devices. When well defined and mutually agreed upon, borders coordinate beliefs about where one jurisdiction ends and another begins and thus reduce uncertainty about the likelihood of changes to these boundaries. Borders are a means of cooperation among states as well as their populations; they generate mutual gains by enabling and regulating the flow of people and goods. And in a world of states providing social welfare, they demarcate who is a citizen of the state and who is not, and hence who can rightfully receive such welfare benefits. They thus have distributional effects.

Borders delineate which political entity will profit from the resources located in a given territory and which one can tax and conscript the people living there. For the inhabitants of the region, the border defines the political community to which they belong. It determines which political institutions, laws, and regulations govern them, which other people share the same polity, and which do not. Borders thus have significant distributional consequences for the states involved but also for individuals and groups within them. The optimal size of a country and which borders it desires depend on many factors. But the expansion of borders is not always desired. States will prefer to limit their size if expanding borders increases the heterogeneity of the population, complicating governance and creating internal chaos. The distributional aspects of borders show why they are so often contested and why disputes over their location sometimes persist for decades.

In international politics, since World War II we have tried to make borders inviolate. Part of the UN’s function is to safeguard borders and prevent changes in them. For instance, in Sub-Saharan Africa there has been much international pressure not to change borders. It is not clear if this has helped or hurt. It seems to have dampened some disputes. Recent events have led to less insistence on this norm of stable borders. Sudan is the case where borders have been changed, and this has led to increased conflict and violence.

But there are political costs as well. Most conflict has always occurred over territory, and most of the time this is at or about borders. Both inter-state war and civil war are often conducted at or about borders. The desire to change borders is a leading cause of conflict and violence. Why? Borders often separate ethnic kin, or are the site of economically valuable resources or strategic military assets, all which encourage more dispute behavior. Political leaders can then use these factors to provoke disputes along the border.

Such disputes reduce trade and capital flows across those borders and tend to depress economic growth generally. Uncertainty over the stability and location of a country's borders has political consequences that can reduce trade and other economic flows. Ironically, then, although countries might want to make the location of the border moot, deep economic integration has in fact occurred only after borders have been settled. On the other hand, border and other territorial disputes often lead to increased movements of people across the borders, as we have seen today in Syria, Iraq, Libya, and parts of Africa. The flight of people out of zones of conflict and into other states are common events. This implies that the distributional and institutional functions of borders interact. Resolving the distributional conflicts around borders through the adoption of mutually recognized boundaries reduces uncertainty and makes possible cooperation that can deliver joint gains; and, the prospect of these gains may provide incentives needed to overcome distributional conflict. But more well-defined borders may inhibit exchanges across them. Borders thus have double-edged effects. Why don't all borders have conflicts then? Some borders are very settled and very open, alleviating the pressure for politicians to enflame the border. Creating disputes is especially easy if the border is new or has seen violence in the past. Repeated border conflicts –as between France and Germany in the late 19th and early 20th centuries– are prominent contributors to war. But again as we have seen with Trump in the US and in parts of Eastern Europe, demands for building walls to fortify borders and close them are not all in the past and can be directed at old, settled borders as well. In fact, there is some evidence that erecting greater barriers at borders is becoming increasingly common and that the main factor driving this is economic inequality between neighbors, rather than security concerns.

The openness of borders and the existence of an integrated world economy is not a given. It can be reversed. We see many processes and political movements today that seem to aim at such a reversal or resistance to globalization. The Brexit debate and vote in the UK is a leading example. Rising nationalism across the globe is also a worry. It is politics that may lead to challenges to this world order and to the re-creation of higher borders. And this can have very bad economic consequences, as much of it did in the 1930s.

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