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THE STATE AS STRATEGIST IN INTERNATIONAL BUSINESS RESEARCH

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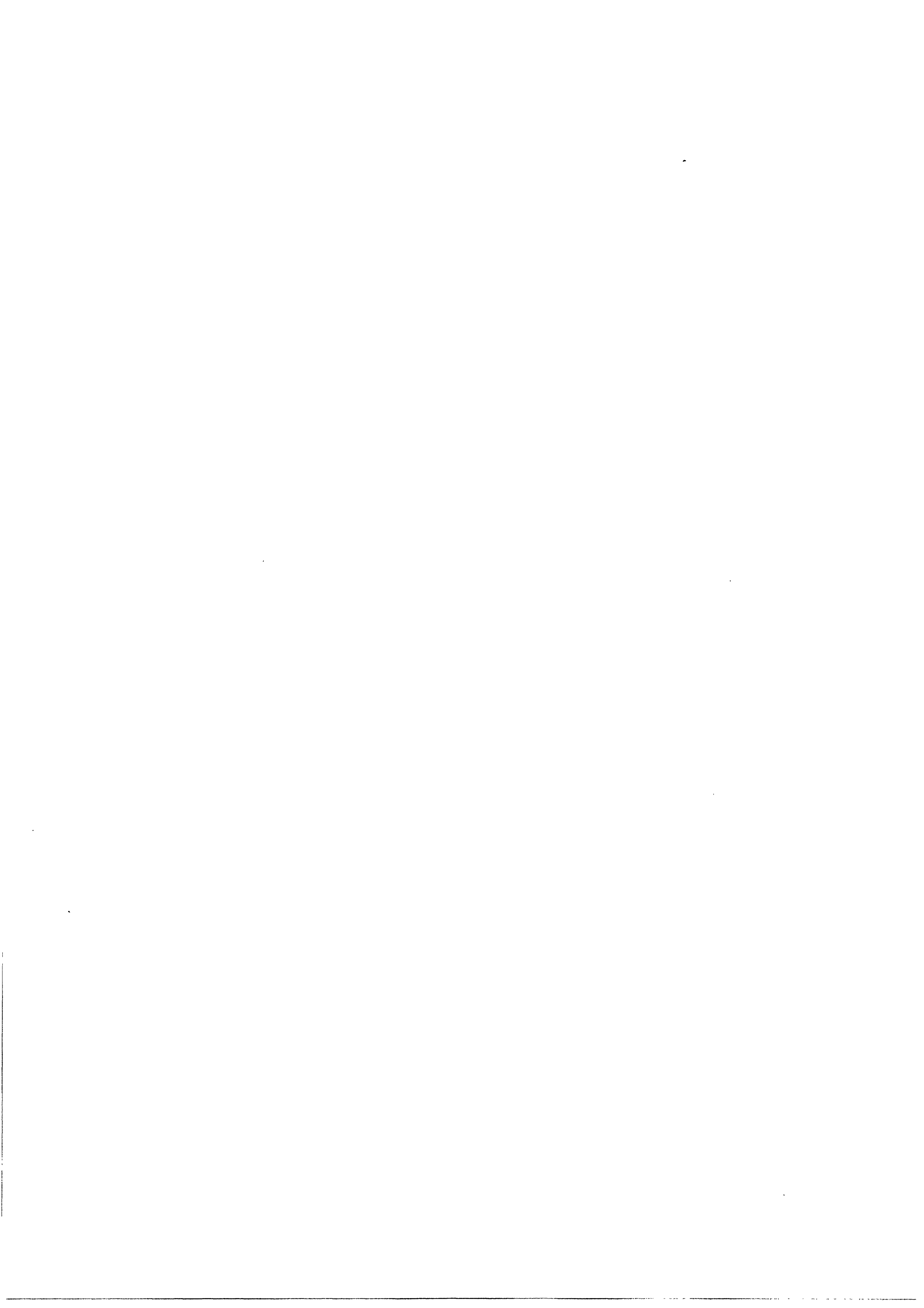

In recent years, management researchers have increased their interest in the international aspects of organizing firms. In doing so, they have amplified themes, such as the intangible asset basis of firms' competitive advantages, that have long fascinated international business (IB) researchers.[1] The organizational impact of firm/state strategic interaction, however, has not been among these themes. This seems surprising, given that the challenge of operating across multiple political jurisdictions creates one of the main distinctions between domestic and international management practice (Kogut, 1985b; 1989; Behrman and Grosse, 1990). International firm/state relations research represents one of several root strands of scholarship within the IB research tradition. As IB issues and scholarship take their places in the mainstream of organizational inquiry, should not international firm/state relations researchers share the opportunity?

The answer, in our view, partly depends on better specifying the linkages within IB between models of firm/state relations and models of international management, strategy and national competitiveness that have captured the attention of mainstream organizational scholars (e.g., Prahalad and Doz, 1987; Bartlett and Ghoshal, 1989; Porter, 1990). We do this in this article, by discussing a framework for understanding states that has a common intellectual lineage and shares concepts with the academic discourse on firms. Our argument relies on classical sociological and political science conceptions of state and society that distinguish between political organization structures and groups of officials who govern (Weber, 1978; Krasner, 1978; March and Olson, 1984; Benjamin and Duvall, 1985). We refer to the organization structures as "states" and to the groups of officials as "governments." State organization structures embody country-specific governance capabilities that, together with national factor endowments, influence the international economic strategies that governments can implement. Thinking of states in this way lets

us consider international firm/state relations as the interaction of organizational strategies and structures, largely driven by the unique capabilities of particular states and firms, their objectives, the teams of officials in charge, and the economic resources at their disposals.

The concern with business/government relations in IB has generated a substantial literature covering topics within several broad categories. Among these, the study of MNC/host state bargaining has advanced the farthest in paradigmatic development. Studies within this literature have documented the firm, industry and market conditions that underlie host governments' and MNCs' relative power to bargain for their preferred conditions of affiliate market entry. They have also examined the causes of shifting bargaining power between MNCs and host governments over time: the dynamic that Vernon called "the obsolescing bargain" (see Vernon, 1971; Mikesell, 1971; Moran, 1973; Fagre and Wells, 1982; Lecraw, 1984; Teece, 1986; Kobrin, 1987; Kim, 1988; Grosse, 1989; Gomes-Casseres, 1990; Behrman and Grosse, 1990; Murtha, 1991b; 1993). Another related body of work examines the impacts of government policies on firm strategy, decisions and performance, sometimes incorporating managerial prescriptions for government relations (Boarman and Schollhammer, 1975; Doz and Prahalad, 1980; Robinson, 1983; Doz, 1986; Boddewyn, 1988; Ring, Lenway and Govekar, 1990; Behrman and Grosse, 1990; Lecraw and Morrison, 1991; Brewer, 1993). Evaluating the public policy process toward MNCs (Encarnation and Wells, 1986; Brewer, 1992), political risk (Kobrin, 1979; de la Torre, 1981; Poynter, 1982; Brewer, 1985; Tallman, 1988; Miller, 1992), and managing the risk assessment function (Kobrin, 1982) comprise another important segment of the literature. Murtha (1991a) and Stopford and Strange (1991) have written on the impact of industrial strategies on MNCs' operations. Preston and Windsor's recent book (1992) has renewed the debate on how multilateral political economic arrangements, agreements and norms affect MNC strategy. In short, the literature documents how government policies affect MNCs, taking industry, market, firm, political risk and interstate relations factors into account.

We believe that our perspective contributes, by linking what some IB scholars know about public policy with what some other IB scholars know about corporate strategy. It does this by using the concepts of strategy and organization structure to explain the limits and possibilities of governmental and managerial choice in different settings, and the likely patterns of MNC/state strategic interaction that will result. We provide a framework for analyzing how state organizational attributes systematically associate with different state industrial strategy formulation and implementation capabilities. Knowledge of these state strategic capabilities, in turn, provides MNCs' managers with a basis to forecast the feasibility, likelihood and coherence of public policies, predict the relative consistency of these policies over time, and incorporate these expectations into the corporate strategy process.

Our framework consists of four attribute dimensions that distinguish states from one another in their impacts on competitive advantage and international coordination within MNCs. In the next section, we explain how we derived these dimensions by synthesizing sociological, political scientific and economic views of the state with IB perspectives on MNC/state relations. The following section shows the dimensions' relevance to practice, by examining their implications when incorporated within strategy frameworks that have reached broad audiences that include IB, corporate strategy and organizational studies researchers, as well as practicing managers. We conclude by discussing the benefits for IB scholarship of drawing upon underlying disciplines to explicitly specify assumptions concerning the state.

STATE ORGANIZATION, POLITICAL INSTITUTIONS AND STRATEGIC INTERACTION BETWEEN STATES AND MNCs

Exhibit 1 displays four dimensions of state organizational attributes that interact to affect national industrial strategies. Dimension 1 concerns the domestic legal institutional basis and scope of states' strategic capabilities to attain long term economic objectives. Dimension 2 concerns the impact of ideology and of domestic political interest groups'

EXHIBIT 1:

STATES' ORGANIZATIONAL CAPABILITIES: ELEVEN ATTRIBUTES IN FOUR DIMENSIONS.

1) *domestic policy capabilities*

   a) specification of property rights, including the mix of public and private sector discretion in macro- and microeconomic governance;

   b) ultimate authority to make and enforce laws, including those of contract;

   c) control of the courts, police and armed forces.

2) *domestic autonomy*: the ability of the government to act independently of domestic interest groups, taking into account

   a) ideology concerning the relative importance of individual vs. community interests;

   b) mechanisms of interest group formation;

   c) the nature of the policy network that links interest groups to the executive and legislature.

3) *international autonomy and foreign policy capabilities*, including

   a) sovereign control of access to a territory;

   b) sovereign prerogatives in managing inter-state relationships;

   c) power and responsibility for safeguarding national security and autonomy within the international system.

4) *legitimacy*, which for any given state depends substantially on the degree to which the dimensions above

   a) embody its society's *political culture;*

   b) balance its economic objectives with its *non economic values.*

relationships to their states. Dimension 3 pertains to states' foreign policy capabilities, particularly as these relate to national territorial integrity. Dimension 4 concerns state legitimacy. In the next four sections, we discuss each of these dimensions in turn.

Dimension 1: Domestic Capabilities: Authority vs. Markets

States' capabilities to implement industrial strategies rest largely on domestic policy instruments. Policy instruments range in specificity from macroeconomic tools of monetary and fiscal policy that affect entire economies to micro tools such as loans or subsidies tied to specific transactions. States vary in the specificity of the policy instruments most readily available to them. This variation reflects cross-national differences in the relative importance of political authority vs. market decision-making in domestic resource allocation (Lindblom, 1977).

Chalmers Johnson's influential taxonomy of "regulatory" and "developmental" states (1982: 19) condenses key underlying aspects of these differences. Developmental states have significant capabilities to pursue "a strategic, or goal-oriented, approach to the economy." Regulatory states have minimal capabilities to formulate strategies, and few policy instruments with which to implement them. In practice, the distinction reflects two endpoints of a continuum; all states' policies display aspects of both regulatory and developmental approaches. We can categorize states only on the basis of their dominant tendencies.[2] Johnson (1982: 19) identifies the U.S. and Great Britain as examples of regulatory states, and Japan as an example of a developmental state.

The economic capabilities of regulatory states reside in state agencies that set the rules of economic competition within countries. In the U.S., these agencies arose beginning in the late 19th century as a reaction to public perceptions that emerging large corporations were exploiting the *laissez faire* economy to gain market power and reduce competition. While these agencies developed capabilities to impose *ex post* sanctions on firms that overstepped the rules, they were not formed to lead economic development nor

to directly influence corporate strategies. Regulatory approaches to national economic management assume that the competitive interplay of market forces ensures economic growth. States' roles are ideally limited to running monetary and fiscal policies, and to regulating private economic activity only when markets fail.

Developmental states, in contrast, have organizational capabilities to formulate and implement national economic strategies that target home firms to build their international competitiveness. Johnson's (1982) characterization of the developmental state has much in common with Gerschenkron's (1962) analysis of states' economic roles in European countries that entered relatively late into the industrial revolution. Gerschenkron argued that late industrialization demanded that states play active economic roles, because capital could not finance the large investments needed to simultaneously start up and catch up to the leaders in production technologies. Only states could amass the necessary resources through sovereign borrowing and imposing taxes. State agencies financed development using such tools as subsidies and equity ownership of enterprises in key economic sectors.

This historical experience provided developmental states with institutional capabilities to directly participate in many strategic decisions made by firms. These capabilities reside in state organizational subunits, such as Japan's Ministry of International Trade and Industry (MITI),[3] that collaborate with firms while enjoying substantial independence from popular political oversight. This independence provides considerable discretion to implement economic policies that discriminate among property rights holders on the basis of industry, nationality or other criteria. This ability and an accompanying ideological propensity to discriminate creates one of the most important, yet subtle, distinctions between regulatory and developmental states.

The distinction is subtle because all states offer inducements, such as tax holidays, training allowances, and tax increment financing for infrastructural development, to both domestic and foreign firms to influence facilities location decisions (See Lecraw and Morrison, 1991; Moran, 1992; Murtha, 1993). The regulatory approach, however, makes

such opportunities available to any firm that can show that a project fits generally agreed objectives for the overall economy, such as increasing employment. Discrimination against foreign firms, where it has arisen, has primarily resulted from interest group pressures, and not from programs to help domestic firms or industries meet national strategic objectives.[4]

Developmental states, in contrast, have the institutional capabilities to discriminate either against or in favor of multinational investors to ensure that inward foreign direct investment (IFDI) supports their economic development strategies. Japan's MITI, for example, officially discriminated against IFDI in the years between World War II and the late 1960s, except where MNCs provided Japanese firms with key technologies.[5] Developmental host states have capabilities to unbundle the MNC package of capital, technology and managerial skills, by targeting value chain activities[6] that best suit national strategy. For example, host countries may offer tax write-offs for research and development that MNCs might have performed elsewhere, subsidize local suppliers of critical inputs that MNCs might otherwise have produced themselves, or offer incentives that encourage MNCs to license technology to locally owned firms rather than establish owned facilities (Murtha 1991, 1993; Wade, 1990: 151-157).

One important common characteristic of such programs is that they lack contractual enforceability, since states control their own court systems and are not subject to higher authority (Boddewyn, 1988). Some probability always exists that governments will terminate programs on political or other grounds, perhaps without notice, leaving MNCs high and dry.[7] Consequently, a state's credibility and its reputation for following through on announced policies become critical issues in responding to a government offer or demand. State credibility depends critically on the structures of the policy networks that link interest groups and political actors (Murtha, 1991a; Cowhey, 1993). The next section discusses this dimension of our framework.

Dimension 2: Policy Networks and State Autonomy:
Individualism vs. Communitarianism

Many studies have associated countries' strategic capabilities with social cohesiveness, public/private intersectoral collaboration, (Johnson, 1982; Katzenstein, 1985), state dominance (Gerschenkron, 1962), or some combination of these factors (Doner, 1991). Johnson's developmental state, for example, relies for strategy implementation on societal consensus in favor of high speed economic growth (1982). Katzenstein's edited volume (1977) anticipated this research stream by asking whether variations in the "policy networks" that link countries' political institutions with private interest groups explain variations in their economic strategies.

Lodge (1990) synthesized these and many other studies in a bipolar typology of "individualistic" vs. "communitarian" political ideologies. Lodge (1990: 15) argues that in an individualistic society, the state exists primarily to "protect property, enforce contracts, and keep the marketplace open so that competition among firms may be as vigorous and as free as possible." States intervene in market transactions primarily in response to crises. Communitarian states, in contrast, "define and ensure the rights and duties of community membership, and play a central role in creating -- sometimes imposing -- consensus to support the direction in which they decide the community should move" (Lodge, 1990: 16). These ideologies respectively inhibit and enable states' capabilities to forge domestic consensus around economic strategy. Consensus increases the credibility of states' policies, because it voluntarily unifies all political elements behind decisions, rather than creating winners and losers. This smoothes implementation and reduces the probability of unforeseen changes brought about by intransigent minorities or by marginal shifts in preferences that cause small groups to change sides.

In Lodge's synthesis, individualism encompasses the political motivations of Johnson's regulatory state and the interest representation mechanisms of pluralist democracy.[8] In pluralist political systems, interest group conflicts strongly influence and often retard economic policy formulation and implementation. The United States serves

as Lodge's primary example. In the U.S., majoritarian, winner-take-all politics and adversarial public/private-sector interactions characterize the relationship between state and society. Narrow interest groups proliferate and compete with each other to lobby the congress and executive branch for outcomes that favor their causes and disfavor those of others. These factors, the constitutional reservation of substantial power to the states, and the separation of federal powers among executive, legislative and judicial branches result in an exceptionally decentralized political structure. In addition to these internal obstacles to consensus on economic strategy, this structure offers multiple points of access for diverse economic interests to influence the policy process. As a net result, policies rarely emerge that target specific economic activities, firms or industries, except as consequences of the political ascendance of particular interest groups. The lack of broad-based support for such policies detracts from their credibility, and fuels the organization of competing interest groups to oppose them. Such policies are also politically vulnerable on the basis of their fundamental conflict with individualist ideology. In general, the credibility of an individualist state covaries negatively with the specificity of the policies it attempts to implement. But, on the other hand, individualist states intervene relatively infrequently. Communitarian states display a greater variance in their abilities to make credible policies affecting both home firms and local affiliates of foreign firms.

Communitarianism has authoritarian and democratic variants. Authoritarian communitarian states impose their views of the national interest on society, often through corporatist political arrangements. Corporatist, authoritarian states charter interest groups and regulate their numbers by giving them exclusive franchises to represent particular constituencies, such as labor or industry. These groups then enjoy formal standing to join with state bureaucracies in collaborative economic decision making processes. Democratic communitarianism also restricts competition among interest groups, but on a voluntary basis driven by corporatist norms of inclusiveness. Policy in democratic corporatist states derives from the "voluntary and informal coordination of conflicting

objectives through continuous political bargaining among interest groups, state bureaucracies, and political parties" (Katzenstein, 1985: 32).

Relationships between interest groups and state bureaucracies within democratic corporatist states range from informal to state-mandated. These relationships often provide a forum for direct negotiation of compensation for groups forced to adjust to international competitive pressures. These corporatist policy networks also allow states to formulate and implement highly specific economic strategies, and in some circumstances to intervene directly into firms' strategic decision making processes. In Japan, for example, MITI and the association of business enterprises (*Keidenren*) work together to address issues at economy, sector, industry, product market and enterprise levels (Hart, 1992). The resulting "visions" indicate what MITI expects and may include financial incentives for those firms that internalize official objectives within their own strategic planning processes (Anchordoguy, 1989).

The targeting policies permitted by corporatist policy networks affect MNCs in at least two ways. First, they influence the investment decisions of domestic firms that act as MNCs' suppliers, competitors, and partners. Second, corporatist states' offers may require particular MNCs to comply with state strategic objectives in such areas as plant location, local purchases, local ownership, and exports. They may also provide incentives for firms to make investments to establish the local relationships necessary to compliance. But MNCs that take advantage of these incentives may lose strategic flexibility by creating hostages that states can use as bargaining chips to leverage additional demands.

The theory of MNC-host state bargaining suggests that interactions over new investments take place within a range of solutions determined by each side's bargaining power and preferences (Kobrin, 1987; Gomes-Casseres, 1990; Behrman and Grosse, 1990:7-8).[9] Once established on states' territories, however, MNCs' facilities may function as hostages, strengthening governments' hands in renegotiations that typically emerge over such issues as local ownership (Vernon, 1971; Fagre and Wells, 1982;

Lecraw, 1984; Behrman and Grosse, 1990), or the continuance of benefits such as tax holidays (Murtha, 1991b; 1993; Moran, 1992). Recent empirical research has also suggested that MNCs' relationships with subsidized suppliers can play out a similar dynamic, particularly when they involve difficult-to-replace inputs, or when MNCs rely on the subsidies to support a strategic price advantage in world markets (Murtha, 1991a; 1991b; 1993). What explains managers' willingness to commit resources to investments or relationships that are susceptible to host government intervention, given this anticipated shift in bargaining leverage from MNCs to states?

Over the years, several studies have offered implications that shed light on this question. They share a degree of skepticism toward the classical IB assumption that managers fail to anticipate the potential for bargaining power to shift from MNCs toward states over the lifetime of an project. As early as 1973, Moran suggested a variety of tactics that extractive MNCs can use to reduce the efficacy of expropriation threats. These included precommitting output sales, encumbering host states with loan guarantees in world capital markets when funding new projects, and operating as management contractors rather than equity owners (Moran, 1973; see also Bergsten, Horst and Moran, 1978). Numerous empirical findings have shown that MNCs have rarely responded to governments' investment and sourcing incentives, unless the prescribed behavior matched actions they would have taken anyway (Guisinger and Associates, 1985; Grosse, 1989; Moran, 1992). Robinson's (1983) survey evidence suggested that managers net out the effects of government inducements, so that MNCs do not undertake projects that depend on government requirements for economic viability.

These studies present much evidence that suggests that governments have little capacity to affect MNCs' strategies. Murtha (1991b; 1993) found statistical support, however, for propositions suggesting that governments' capabilities to affect MNCs' strategies vary with their states' reputations for following through on announced policies. Reputations, in turn, depended on the organizational characteristics of national policy

networks. Policy network attributes that associate with corporatism, such as electoral rules that place a high value on legislative consensus, positively associated with managers' perceptions that government policies tended to persist in time. Where existing policy networks displayed attributes of interest group competition, managers placed high values on self-enforcement mechanisms that serve as credible commitments[10] for any bargains that involved governments (Murtha, 1991a). Examples included up-front payments of subsidies or tax breaks, site-specific infrastructural investments, and transaction-specific investments by subsidized local input suppliers. Moran (1992) has argued that a government's capabilities to make such credible commitments depends on its state's financial capacity, as determined in part by the country's stage of development.

Our discussion of dimensions 1 and 2 has focused on how domestic political institutions create and constrain states' industrial strategy capabilities, and on how these capabilities affect MNCs' strategies. The structure of the international system also affects states' capabilities, as well as their objectives. MNCs act as principal factors linking states' jurisdictions together. Their cross-border transactions offer tempting foreign policy levers, while at the same time constraining governments' abilities to impose their visions on the international order. In the next section, we discuss how states' foreign policy capabilities affect and are affected by MNCs' strategies.

Dimension 3: International Autonomy and Foreign Policy Capabilities: Political vs. Economic Objectives

The existence of a state, in the classical view, requires a national territory and the "availability of physical force for its domination" (Weber, 1978: 902). This condition derives from sovereignty, which precludes the existence of any superseding authority within states' territories and defines them as autonomous, juridical equals in the international community. In practice, however, power asymmetry (Morgenthau, 1971), economic interdependence (Keohane and Nye, 1977), and common interest (Keohane, 1984) may bring about either cooperative arrangements or *de facto* relationships of

dominance and dependence among states. MNCs' activities can contribute to each of these three types of impairments to sovereignty.

MNCs pose a challenge to sovereignty. Because they operate in multiple countries, their networks can act as transmitters of states' policies to others' jurisdictions (Vernon, 1971). MNCs can also evade an individual state's authority by transferring operations among countries, shopping for the policies that best suit their strategies. States can counterbalance these MNC capabilities by cooperating in multilateral regimes in which they cede some sovereignty to pursue joint policy objectives (Vernon, 1971; 1981; Behrman and Grosse, 1990; Preston and Windsor, 1992).[11] In the General Agreement on Tariffs and Trade (GATT) Uruguay round provisions on trade-related investment measures (TRIMs), for example, states would agree to not to impose local content, export quota or import offset requirements on MNCs' affiliates. But cooperation may not, on average, dominate either economic or political power as a motivation for governments' policies toward MNCs. In addition to prosperity goals, states use MNCs to pursue international autonomy and security objectives (Kudrle and Lenway, 1991; Kudrle, 1991).

The United States, for example, continues to use MNCs to implement embargoes against adversaries. Kobrin (1989) has argued that sanctions have lost effectiveness as U.S. policy, in part because host countries do not recognize U.S. claims of extraterritorial jurisdiction over its MNCs' foreign affiliates. U.S. sanctions depend to a greater degree than before on allies' voluntary cooperation in controlling their own firms and in permitting local affiliates of U.S. firms to comply. In the absence of cooperation, sanctions reallocate international market shares, and expose the foreign affiliates of participants' MNCs to countervailing sanctions from non-participating governments. Even if sanctions enjoy broad support in the international community, however, they subordinate national prosperity interests to security goals, by reducing economic activity. Jacobson, Lenway and Ring (1993) show that sanctions also raise MNCs' internal coordination costs, reducing the efficiencies of their organization structures.

Dimension 4: Legitimacy and the Balance of Economic and Non-economic Values: Equity vs. Efficiency

States, in the classical view, require legitimacy (Weber, 1978). Benjamin and Duvall (1985: 36) suggested that the legitimacy of states' policies derives, in part, from "the organizing principles addressed to the resolution or management of the tensions among conceptions of freedom, equality, order, and justice." They explain alternative approaches to resolving these tensions with examples that highlight the interrelatedness of political and economic development as countries pass through different stages of industrialization. Contemporary states in early stages of rapid industrialization, they argue (p. 39), "resolve the tensions unambiguously in favor of economic freedom and social order" (e.g. Singapore, Taiwan). In order to maximize the speed of economic growth, developing states may try to avoid the dampening of economic incentives that occurs when property rights are subordinated to income redistribution through the tax system. Okun (1975) called this dilemma the equity vs. efficiency tradeoff.

As countries develop toward advanced stages of industrialization, demands for income equality, political freedom and social justice offer increasingly potent challenges to order and property rights (e.g., Korea, Thailand). Political orders that place a greater value on economic growth than on equitable distribution of the gains have often sacrificed political freedoms. Industrialized states, however, preserve their legitimacy only by responding to claims for a fair distribution of wealth. Middle class expansion brings demands for more comprehensive enfranchisement. Political freedom and social, political and economic justice assume greater salience. So also do claims for compensation by society members who are adversely affected by international competition. As time passes, the equity/efficiency tradeoff offers increasingly similar implications for industrialized and industrializing countries. Economic growth in the rapidly industrializing countries has spread demand for political openness and more broad-based sharing of wealth.

This dynamic has implications for MNCs. States in rapidly industrializing countries must strike a balance between the interests of local and foreign capital owners,

as domestic interests increase their claims on the gains from growth (Evans, 1979). MNCs often face restrictive entry and regulatory regimes that require local partners, technology sharing, licensing, local content, or other arrangements that give host country nationals access to their firm-specific advantages (Tang and Yu, 1992). Industrialized countries, on average, have placed fewer restraints on IFDI. Increasing openness, however, altered the structure of investment flows among the developed countries in the late 1980s. In the U.S., where inflows substantially exceeded outflows, this change led to increased political calls for restrictions (Graham and Krugman, 1989; Kudrle, 1991). These developments increase the complexity of global patterns of regulation and the political sensitivity of MNCs' operations, complicating managers' strategic tasks.

APPLYING THE DIMENSIONS

In the next two subsections, we apply our four attribute dimensions within strategy frameworks that address strategic phenomena at the managerial, organizational and country levels of analysis. First, we examine the relevance of our dimensions to international managers and organizations, by considering some of the political content of international strategy and organization frameworks offered by the process school of international organizational researchers (See Doz and Prahalad, 1991). These mutually consistent frameworks are most comprehensively presented in books by Prahalad and Doz (1987) and Bartlett and Ghoshal (1989), although they have many important antecedents. Then we examine the country level of analysis to suggest ways in which our framework intersects with Michael Porter's "diamond" model of country capabilities (1990).

Global Management and the State: States and MNCs as Interacting Authority Systems

Contemporary international management theory characterizes the principal task of multinational managers as a continual process of reconciling efficiency pressures for global integration with political and market forces that demand local responsiveness (See

Prahalad and Doz, 1987). Governmental and managerial authority interact in the administration of national economies, as states and firms seek to balance local and global criteria for successful international strategy implementation.

Domestic Capabilities: Authority vs. Markets. States and firms seek to optimize the same criteria, but for different objectives. Efficiency enhances social welfare in countries, and creates the basis of international cost leadership strategies for MNCs (See Porter, 1990). MNCs and states have historically conflicted over efficiency, however, because minimum efficient scale production for many activities exceeded the size of most national markets. Responsive MNCs established inefficient plants in many countries to meet governments' demands for employment. MNCs could bury any resulting cost disadvantages in high prices made possible by product differentiation and/or protected markets. Local responsiveness and global integration seemed to function as a tradeoff.

In a globalizing world economy, however, the interaction between efficiency and responsiveness has shifted in character away from tradeoff and conflict between MNCs and states, toward synergy and collaboration. The boundaries of market segments rarely match the boundaries of countries, and even differentiated products have become subject to price competition. Governments still demand responsiveness, but any plants that MNCs establish must meet global standards of efficiency in order for countries to stay competitive (Stopford and Strange, 1991). The allocation of efficient production sites among countries and the pattern of trade that emerges to meet international demand for their outputs depends, in part, on firm/state interaction. Historically given political institutional arrangements influence states' capabilities to make credible, discriminating choices that influence the outcomes of these interactions.

International management process frameworks suggest that MNCs can accommodate variation in states' capabilities and policies by differentiating management processes, headquarters/subsidiary relationships and organizational structures across affiliates. The functions and businesses within each MNC vary in the degrees of

integration and coordination necessary to efficiently conduct their activities. Most MNCs can maintain efficient networks that assign global responsibility for some activities to their home country operations, assign other activities to every country where they operate, divide responsibility for others among just a few countries, and assign global responsibility for still others to single affiliates outside of the home country. The combination of decentralized production with global networking allows MNCs to satisfy multiple states' demands for facilities, but recover coordination and responsiveness costs through learning and information-cost economizing (Bartlett and Ghoshal, 1989; Prahalad and Doz, 1987).

Organizational differentiation and decentralization broadens the scope for local responsiveness in the context of integrated operations. As Kogut (1985b) points out, multiple siting also provides MNCs with organizational flexibility to hedge against state interference in any one country, by retaining discretion to shift production. Multiple siting, however, has limitations. These include redundancy costs and the need to maintain stable local labor relations over the lifetime of an affiliate's operations. More importantly, optimal activity assignments match MNCs' global requirements with the organization-specific resources of national affiliates. These resources build up over time from the interaction of local factor endowments, MNCs' technologies, and affiliate management team capabilities, as well as from the organizational imprint of states' strategies on MNCs' local operations. Arbitrary shifting of activities can waste these resources.

Our framework suggests that MNCs will judiciously design their networks to avoid exposing strategic activities to disruption by arbitrary government policy shifts. The complex networks envisioned in process models of MNC organization allow strategists to structurally accommodate government policies that widely differ across countries. But network implementation requires public policies to vary within relatively narrow ranges, within countries. National institutions define these ranges and determine their stabilities.

Policy Networks and State Autonomy: Individualism vs. Communitarianism. Unique and common attributes of national political institutions become easier to

distinguish and less prone to distortion, when they are evaluated with appropriate ideological lenses. Both individualist and communitarian ideologies exert a normative influence on the strategies and organizational structures of home and incoming MNCs, because political enfranchisement requires the firms to take part in national policy networks. Corporatist policy networks hold all participants, including MNCs, accountable for consultation with other participants and for meeting communitarian norms of social performance. Accommodation to local political realities may slow MNCs' decision-making processes and reduce their discretion over production location decisions. Home MNCs also face pressure to implement integrated strategies that centralize production and concentrate FDI on downstream value chain activities. The returns, in theory, include access to workforces that have been socialized, through entitlements such as retraining allowances and relocation assistance, to cooperate in industrial adjustment (Katzenstein, 1985; Freeman, 1989). MNCs' affiliates in corporatist host countries may face difficulties developing local relationships to gain full access to the political process and may experience unequal treatment compared to domestic counterparts. Strategic alliances with local partners, and indigenization of local top management may help MNCs integrate into host policy networks. None of these strategies, however, can substitute for trust and relationship-specific knowledge that take time to accumulate.

The pluralist policy networks that emerge in individualist political economies offer relatively open, equal access to the political process to both foreign and home MNCs. But individualist states rarely target specific firms, so the individual returns to political action may be lower than in communitarian systems. It is consistent with individualist ideology, however, for states to implement policies that have economy-wide impact, such as support for education or basic research. The competitive benefits of such programs accrue to the firms that make the best choices in response to market signals in such areas as human resources and product development.

The relative non-interventionist posture that typifies individualist states does not mean, however, that MNCs can overlook the potential impacts of pluralist policy networks on their businesses. The regulatory systems that define the rules of the game in most individualist states provide ample opportunities for interest groups, including home- and foreign-based firms, to exercise influence through petitions, litigation, hearings and lobbying for new regulations. Pluralist interest group competition means that MNCs must monitor not only governments' policies, but also the political strategies of their competitors and of non-governmental interests such as consumers. MNCs have used political processes, (particularly technical administrative procedures such as those provided in U.S. anti-dumping legislation), to raise their international competitors' costs, disrupt their production and marketing programs and divert their managerial resources and attention . The opportunities to benefit from such strategies have emerged as firm-specific advantages, based on MNCs' international value chain configurations and the constellations of national regulatory regimes that affect their activities and those of their competitors (Milner, 1987; Yoffie, 1988; Lenway and Schuler, 1991; Salorio, 1993).

Foreign Policy Capabilities and Targets: Political vs. Economic Objectives. MNCs' network configurations correspond to patterns of leverage for both home and host governments who might use embargoes on intrafirm transactions as policy instruments in foreign policy crises. Understanding these patterns requires a systemwide perspective, not just pairwise analysis of the national interest of the home state as it relates to the interests of host states. As a firm becomes more internationalized, the potential effects of embargoes become more difficult to anticipate, as well as to evaluate for magnitude. Intrafirm flows between non-belligerent countries may take on political significance because they affect business in third countries. The disruption of interdependencies with affiliates or with suppliers in an embargoed country may create systemwide effects within an MNC, involving friendly countries with no obvious geopolitical linkage to a given set of belligerents (See Lenway and Crawford, 1986).

Understanding these exposures poses an increasing challenge to global strategy formulation. In the 1990s, superpower nuclear confrontation was replaced by a search for new instruments of control over proliferating small conflicts. Security policies to deal with these new realities have not taken shape. As long as policy-makers prefer economic pressure to military intervention, the threat of sanctions will retain a considerable potential to disrupt MNCs' operations. In sourcing and location decisions, MNCs need to consider affiliates' abilities to function independently of parents or other affiliates that provide technologies and inputs (Jacobson, Lenway and Ring, 1993).

Non-economic Values: Equity vs. Efficiency. Each state's legitimacy has an historical basis in actions that successive governments have taken to sustain a social order consistent with the nation's values. Economic values and the maintenance of prosperity are important for all countries. But as more countries reach threshold levels of prosperity, non-economic values assume greater importance. Applying the process framework suggests that managers must do more than respond to these values on a country-by-country basis. They must also search for themes and criteria that cut across countries, create interdependencies, and demand a coordinated approach. Themes of equity, environmental sustainability, and social justice encompass major areas of concern.

The years since World War II have seen increasing international economic openness, in part as a reaction to damage that protectionism caused to global prosperity in the 1930s. The parallel development and diffusion of Keynesian economics also increased the importance that states place on domestic social welfare, including considerations of equity. States' support of global openness was set on a collision course with their domestic equity concerns, when rapid increases in imports were perceived as "a threat by various national governments whose social and economic policies were upset by rising import penetration" (Bartlett and Ghoshal, 1989: 10). In many countries, interest groups will continue to pressure governments to adopt policies to spare them the discomfort of adjustment to international competition. Such policies, unless governments can resist

implementing them, detract from MNCs' managers' discretion to internationally allocate activities to optimize efficiency. Our discussion of Dimensions 1 and 2, above, is relevant to the analysis of these prospects and of the demands they make on firms.

The areas of environment and social justice offer MNCs greater scope for proactive policy choices that can enhance competitive advantage. Commitments to gender equality, racial equality and workforce diversity increase MNCs' discretion in local labor markets, and ensure their capabilities to draw on global talent pools to fill positions. Although MNCs may implement country-specific social responsibility programs, they can generalize and internationally transfer policies that guide them. As international environmental and safety standards converge, empirical evidence suggests that MNCs that coordinate policies and technology have gained first mover advantages that raised their profits relative to those of more reactive competitors (Nehrt, 1993).

Between the Nation and the Firm: Where does the State fit?

Most strategy-oriented IB studies have adopted managers, firms and industries as principal units of analysis. Recently, however, interest has increased in studies of the contributions that country capabilities make to MNCs' international competitiveness (e.g. Porter, 1990; Kogut, 1991; Shan and Hamilton, 1991; Murtha, 1991a). The best-known among these studies, Porter's *The Competitive Advantage of Nations,* addresses the question, "Why does a nation become the home base for successful international competitors in an industry" (1990: 1)? After comparing multiple industries across 10 countries, Porter's research team concluded that, "Competitive advantage is created and sustained through a highly localized process. Differences in national economic structures, values, cultures, institutions, and histories contribute profoundly to competitive success" (1990: 19). The graphic visualization of the theory presents four principal determinants of country competitiveness as the points of a diamond. These determinants include factor conditions, demand conditions, related and supporting industries, and industrial

organization as defined by firm strategy, industry structure and rivalry. The study refers to two additional determinants -- government and chance -- as outside forces.

Porter's new paradigm stands as a significant, empirically grounded critique that rejected monocausal explanations of competitiveness, among them government policy, in a world knit together by MNCs rather than trade among unaffiliated parties. Government targeting, the study pointed out, had created meaningful global competitive positions for only a few countries in a few industries. Even successful targeters had also experienced failures. Government influence lacked any systematic pattern. Public policy appeared able to affect the elements of the diamond, but was not part of it.

Several studies have suggested that the Porter team erred by not including government policy as an element in the diamond (See Rugman, 1991; Stopford and Strange, 1991). Our framework suggests that a methodological issue may underlie this debate. The diamond's integrity as a causal framework, as opposed to an illustrative heuristic, depends on demonstrating a systematic association between its elements and competitiveness as a dependent variable. In our view, the diamond has, so far, failed to demonstrate systematic government effects because it included public policy at a different level of analysis from the other elements of the diamond, resulting in both misspecification and fallacies of aggregation (See Roberts, Hulin & Rousseau, 1978: 81-109). The study drew its conclusions from an institutional analysis of national economies, industries, and firms. As the research team examined the influence of relatively lasting economy, firm and industry structures rather than of management teams' transient policies, consistency required that it examine the influence of lasting state organization structures, rather than of government policies. Put another way, just as corporate resources for international competition do not arise from general policies of governments and firms, but from "the outcome of thousands of struggles for competitive advantage . . . ," (Porter, 1990: 9), so do the political resources that matter accumulate in the decisions made within gradually evolving institutions that maintain the consistency of contemporary preferences with

nations' historic values. In the discussion that follows, we apply the four dimensions of our framework to demonstrate how cross-national differences in political institutional structures and state industrial strategy capabilities can help to systematize the effects of governments' policies within the context of the diamond model.

Domestic Capabilities: Authority vs. Markets. Our framework explains cross-national variations in industrial strategies as outcomes of differences in the organizational capabilities that political institutions provide to governments. By the same logic, these differences also limit the transferability of specific strategies from one country to another. As institutions and economies evolve over time, the range of implementable strategies also changes. Any given country's success with a particular industrial policy (say, providing export subsidies to heavy industries such as steel) depends on the match of strategy, organizational capabilities and timing, as well as on exogenous circumstances. No one policy can succeed for every country, and certainly not all at the same time.

The Porter team's evolutionary stages theory of the competitive development of national economies (Chapter 10) provides an interesting tableau on which to frame testable propositions that highlight synergies between our framework and the diamond. According to the study, government policies should help to "deploy a nation's resources (labor and capital) with high and rising levels of productivity," to build an economy that is "continually upgrading." Productivity improvement increases skills, incomes and living standards for a country's population (p. 617-18). As countries upgrade, they incrementally build up and engage the sources of competitive advantage in the diamond, passing through successive stages of factor-, investment-, and innovation-driven development. At a final, wealth-driven stage, competitive advantage ebbs. Obstacles to progress arise at transitions among the first three stages, in maintaining the innovation-driven stage, and in returning dynamism to economies at the wealth-driven stage. During such times, economic change threatens a relatively high proportion of a country's established firms.

Our framework suggests that developmental states may have a strategic advantage over regulatory states at the factor-driven development stage, and in implementing policies to promote transitions from the factor-driven to investment-driven stages. This transition implies a change from extractive, labor-intensive and commodity-producing industries toward large-scale industries that perform downstream processing, and manufacturing industries that employ existing technology to make standardized products. At this stage, countries can acquire international competitive advantage only in industries that require large capital investments, retain a large labor cost component, and use production technology that can efficiently meet world demand with relatively few plants (p. 551).

The criteria for competitive industries in investment-driven development closely match those for targetable industries in new international economics models of strategic trade policy. In these models, government targeting of domestic firms constitutes a credible commitment that deters international competitors from retaliating, for fear of provoking a price war in which the state's deep pockets predetermine the winner (Spencer and Brander, 1983; Brander and Spencer, 1985; Krugman, 1984). Developmental states may succeed in identifying industries to effectively target at the investment-driven stage, because there are relatively few industries to choose from that meet the criteria. This does, however, guarantee against mistakes. Gomes-Casseres documented misjudgments in the Korean Government's attempt to imitate the success of Japan's early developmentalist policies targeting heavy industries (1988a; 1988b). Korean labor costs had already risen too high, and its investments added out-of-date plant to existing global excess capacity. Subsequent efforts to leapfrog the investment-driven stage to enter the innovation-driven stage required more regulatory approaches to economic management.

Regulatory states may have a strategic advantage in transitions from investment- to innovation-driven growth. Innovation-driven growth depends on responding to market signals in fast-changing high technology industries. Optimal policies to support high technology industries fund workforce education, infrastructural development, and basic

research, while keeping markets competitive so that they reward entrepreneurship and innovation. The Porter study advocated these policies for all countries. This implies that the team saw the global economy as a whole shifting toward innovation-driven growth.

Policy Networks and State Autonomy: Individualism vs. Communitarianism. When transitions and dynamism confront a high proportion of a country's firms with change, they also threaten a high proportion of its entrenched political interests. Governments face increased levels of political conflict, as their policies promote the flow of resources from declining industries toward emerging industries.

Corporatist policy networks may have strategic advantages in factor-driven development, and in resolving conflicts in transitions from factor- to investment-driven stages. These advantages associate with two types of state capabilities. First, corporatist networks enhance the target specificity of states' capabilities to direct public resources in support of economic development. Second, tripartite corporatist wage/price bargains help to maintain low labor costs, which are critical to success in both stages. These same capabilities become liabilities in transitions to innovation-driven development. Annual tripartite bargains obstruct adjustment in fast-changing high technology industries, by reducing firm discretion and labor market flexibility. The complexity and dynamism of innovation-driven development far outstrips the abilities of government decisionmakers to choose winners and losers. Governments' capabilities to target at high degrees of specificity increase the likelihood that they will intervene with consequences that distort markets. Pluralist policy networks may have strategic advantages in innovation-driven development, as they tend to minimize states' economic roles.

Foreign Policy Capabilities and Targets: Political vs. Economic Objectives. Unlike our first two dimensions, states' foreign policy capabilities do not associate with competitiveness in a systematic way. Neither national security contingencies nor governments' policy responses to them can ever be fully anticipated (Lenway and Crawford, 1986; Jacobson, Lenway and Ring, 1993). It is possible, however, to

retrospectively demonstrate the historical impacts of global security arrangements on the contemporary pattern of international competitive advantage. After World War II, the victorious allies pressed for free trade, in the belief that strong economies in Europe and Japan would stop the spread of communism. The U.S. benefited from its leadership status in the early post-war era, as its MNCs expanded to provide capital goods for reconstruction and to support military forces based abroad. Inflows of foreign-made goods enriched U.S. consumers' choices and subjected domestic firms to stiff competition. But U.S. foreign policy has also compromised U.S. firms' competitiveness, at times, through export controls on high technology products and trade prohibitions with political adversaries (Lenway and Crawford, 1986). Other countries' firms expanded in the gaps. Bartlett, for example, argued that a U.S. embargo on a Caterpillar pipe-laying equipment sale to Russia ceded a long-term advantage to a Japanese competitor (1992: 323).

Non-economic Values: Equity vs. Efficiency. It is difficult to distinguish causal order between the non-economic value dimension of our framework and the elements of the diamond. Equity generally requires redistribution, which becomes easiest under economic conditions of growth (Okun, 1975). These are the conditions that the Porter study's prescriptions were intended to foster. Competitiveness at advanced stages of development, however, requires flexibility. Workforce members may experience shorter hours and greater transience in employment than has typified advanced industrialized economies in the past (*New York Times*, 7/10/93: 17 and 29). The expectation of equity, seems a necessary condition for individuals to collaborate in a process that increases career uncertainty. The legitimacy of state institutions will play an important role in creating the necessary good will among groups and individuals to tolerate the dynamism of advanced industrial development.

CONCLUSION

Contributions to the literatures on sociology and political science have focused on "bringing the state back in" to models of social and political phenomena (Skocpol, 1985).

International business scholarship, as applied social science, places a benchmark value on efficient international markets and tends to regard states as causes of deviation from this ideal. But the international economy links together domestic economies in which varied institutional arrangements govern exchange. Given these differences, states seek either to accommodate or shape MNCs' organizations, in light of the national interest.

Although MNCs often bring innovation and growth to countries, this does not mean that states can ignore the political consequences of economic change. Just as effective MNCs optimize competing, interdependent values of efficiency, responsiveness and learning, (Bartlett and Ghoshal, 1989), states must optimize efficiency, equity and security. Institutional arrangements whereby countries manage or fail to manage the political consequences of economic growth make a difference for the management of MNCs' relations with host and home states, and for internal MNC management.

Political organization creates the context for economic organization (Lindblom, 1977; Freeman, 1989), as the transitions in Asia and Central Europe make evident. Countries vary in their capabilities to implement new economic strategies without significant changes in social and political organization structures. National social and political structural evolution moves slowly, barring cataclysmic social revolution (Skocpol, 1979). Consequently, the attributes of such structures make powerful predictors of countries' economic strategies, and implementation capabilities.

Incorporating political institutional attributes into IB frameworks lets us model state and government on a level of generality comparable to that of firm and management, using mutually consistent terminology and concepts. It strengthens an area of distinction for the IB research tradition, and creates opportunities for IB and underlying disciplines to contribute to each others' development. It also improves our understanding of how state and corporate strategies interact to shape international business outcomes.

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ENDNOTES

1. This is a point that Bruce Kogut has made in public and private remarks.

2. A dominant regulatory orientation does not exclude the possibility that a state will intervene in economic affairs. Johnson (1982) suggests, however, that regulatory states may not have the institutional capacity to make this intervention effective.

3. MITI has the responsibility for devising and implementing Japan's industrial policy.

4. Bergsten and Graham listed notable discriminatory U.S. policies, including FDI restrictions in broadcasting, coastal shipping, nuclear energy, oil pipeline, and domestic transport industries (1992: 30). These policies, however, have rarely associated with state-led investment strategies.

5. For example, Japan permitted IBM to establish a wholly owned affiliate only after it agreed to locally license technology (Encarnation and Mason, 1990: 26-29).

6. The terms "value chain" (Porter, 1985) or "value-added chain" (Kogut, 1985a) have been widely adopted among strategy researchers to refer to the sets of linked organizational activities that firms perform in bringing their products to market. The generic value chain consists of primary and support activities. Primary activities include inbound logistics, production, marketing, outbound logisitics; and service. Examples of support activities include human resources and finance. In practice, individual firms' value chains consist of any number of particular activities that fit into these categories. International strategies are often analyzed as a process of coordinating value chain activities matched to countries on the basis of cost and product differentiation opportunities (See Porter, 1990, Ch. 2).

7. In 1982, for example, Taiwan's economics minister withdrew a promise of import protection for a General Motors truck plant, citing efficiency concerns. Although the plant had just opened, GM pulled out (Wade, 1990: 155).

8. Pluralist models assume that competition among interest groups yields public policies acceptable to all participants in the political process. States exist as interest group forums, with little independent policymaking capacity (see Krasner, 1984: 226-230).

9. Behrman and Grosse (1990: 8) list host government bargaining power sources as control over market access, resource endowments, low-cost production factors, and government contracts. MNCs gain bargaining power from access to funds, technology, managerial skills, information, foreign inputs, and global markets.

10. The concept of a credible commitment is due to Schelling (1960) and may be defined as a self-evidently irrevocable action.

11. Preston and Windsor (1992: 4) argue that international policy regimes facilitate and regulate trade and investment flows as well as regulate the activities of domestic and multinational enterprises that participate in the global economy. They suggest (p.7) that the critical features of regimes include: 1) decision-making procedures and rules that allow the implementation of international agreements that may or may not involve formal institutional arrangements; 2) agreements on legitimacy and founding principles, e.g., the multilateral reduction of tariff barriers in the GATT; and 3) expected norms of behavior that support these principles.