1 Thinking Globally – Acting Locally: Multinationals in the Global Political Economy

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INTRODUCTION

This month (August 1992), IBM is running a two-page magazine advertisement entitled 'Thinking globally?' which shows a map of the world dotted with blue pins representing IBM offices. The advertisement says that the world is getting smaller so people are thinking bigger; however, since cultures still differ, international firms face a paradox – how to think global and act local at the same time. IBM thinks local, according to the advertisement, by having offices around the world and manufacturing products that are customised for local markets; it acts global by treating all the offices as part of the same team and by offering consistent services around the world to its customers.

The paradox faced by multinational enterprises (MNEs) – that of negotiating with nation-states so as to balance local tastes and desires for national responsiveness by governments against economic pressures to centralise and integrate functions and products across borders – is at the heart of this book. We live in a global world, one with global products, firms and markets; yet we remain divided into national units, each with its own laws, customs and cultures. National borders are changing, some moving outward (for example, the North American countries sign bilateral and multilateral agreements encouraging freer intra-continental trade and investment flows), some moving inward (for example, Eastern European nations fragment into smaller, often ethnically based, units). Triadic economies are emerging, around which smaller countries cluster (UNCTC, 1991). Where are the borders of a country when information travels instantaneously around the world, when financial capital is completely mobile, when interregional trade barriers are disappearing? Yet cultures continue to differ while rising incomes promote the desires for differentiated products, implying that acting local still matters.

The borders of the firm are also changing as new forms of investment such as strategic partnering and contract manufacturing replace the wholly-owned subsidiary as the main vehicle for penetrating foreign markets. 'Who is us?', asks Robert Reich, when multinationals are global webs made up of firms from many countries, with products and factors flowing around the world. Who is them? What is a domestic MNE, a foreign MNE? Which offers more benefits and fewer costs to a nation, the domestic firm that produces most of its output outside the country or the foreign firm that hires local factors?

Multinationals now function in a global, political economy: global because borders are disappearing between markets, political because national politics and policies still matter. In fact, the increased competitiveness of firms on a global scale as they contend for shares of the world market has forced nation-states to reconsider their policies *vis-à-vis* MNEs. States have moved from confrontation to co-operation with the global firms in their midst, from regulating to encouraging entry, from taxing to subsidising, from opposition to partnership.

The politics of national economic competitiveness in the 1990s has given the term 'sovereignty at bay' a new twist. While the term in the 1970s was (mis)understood to mean that MNEs and nation-states were warring actors locked in a battle where global firms had the upper hand, in the 1990s MNEs and nation-states are now seen as partners in the race to engineer competitive advantage and move up the value chain to higher value added and more technically sophisticated products.

This book deals with the changing relationships between multinationals and nation-states over the 1980s and 1990s, and the research and policy agenda these imply for the upcoming decade. The book takes an international political economy (IPE) approach to state-MNE relations, focusing on the interdependencies, both conflictual and co-operative, between these two primary actors in the global economy. As Raymond Vernon in his chapter, 'Sovereignty at Bay: Twenty Years After' says, '[MNEs and states are] two systems . . . each legitimated by popular consent, each potentially useful to the other, yet each containing features antagonistic to the other'. In what follows, we provide a road map for the reader, outlining the structure of the book, summaries of the individual chapters, and the book's main themes.

STRUCTURE OF *MULTINATIONALS IN THE GLOBAL POLITICAL ECONOMY*

This book consists of eleven chapters written by experts on multinationals and organised around several issues and policy dilemmas in MNE–state relations. Chapter 2 by Raymond Vernon, 'Sovereignty at Bay: Twenty Years Later', sets out the overall theme of the book: the changing nature of state–MNE relations in a global political economy where both the state and the multinational enterprise are key actors. This chapter is followed by Lorraine Eden's 'Bringing the Firm Back In' which reviews the existing theory of the multinational enterprise, as outlined in the international political economy and international business studies literatures, and argues that, in a globalised world, MNE–state relations require a closer examination by both sets of scholars. The 'Confrontation to Co-operation?' chapter by John Dunning expands on the MNE–state relation theme by arguing there has been a shift away from states regulating to co-operating with MNEs as a result of the new competitiveness agenda adopted by nation-states. Alan Rugman's chapter on 'Borders' reinforces Dunning by arguing that the borders of the firm and the nation-state have become more amorphous, creating a paradox for firms, whether to go global or be nationally responsive, and for states, whether to regulate or co-operate with MNEs in their midst.

The next set of chapters focus more specifically on challenges for developing countries. 'Big Business and the State' by Susan Strange looks at the confrontation–co-operation issue, concluding that state regulation of MNEs is less desirable or effective as the underlying production and finance structures have shifted more power to globalised multinationals. Raphael Kaplinsky's chapter 'TNCs in the Third World' provides evidence on the underlying structural shift in production from Fordism to Post-Fordism and what this shift means for multinationals and LDC nation-states. Sanjaya Lall in 'MNEs and LDCs', looks at the shift to more co-operative relations between LDCs and multinationals, and concludes that, given the pervasiveness of market failures in developing countries, regulation of MNEs may be necessary to ensure nations receive net benefits from inward foreign direct investment (IFDI), particularly in the area of high technology. He argues that regulating IFDI can be useful if it is accompanied by pro-market competitiveness policies.

The last three chapters are empirically oriented, providing evidence in support of the themes advanced by the other authors. Magnus

Blomström and Robert Lipsey in 'Competitiveness of Countries and their MNEs' differentiate between sources of competitiveness for countries and multinationals. Since firms combine mobile firm specific advantages with immobile country specific-advantages, and globalisation has made MNE production more mobile, the authors conclude that the balance of power has shifted from the nation-state to the multinationals. Robert Kudrle's chapter, 'No Entry', harks back to the confrontation theme. He examines regulations restricting IFDI in the OECD countries and finds that the primary justification is lobbying by vested interest groups, making it more difficult to liberalise closed sectors. The last chapter, 'Marketing Strategies', by Louis Wells and Alvin Wint, discusses the policy shift from regulating IFDI to image building and investment promotion by state agencies. They ask, when all countries are trying to attract IFDI, which policies are most successful, concluding that personal contact works best. We now turn to more detailed summaries of the individual chapters.

INDIVIDUAL SUMMARIES OF CHAPTERS

Raymond Vernon, 'Sovereignty at Bay: Twenty Years After'

In Chapter 2, Vernon looks look back twenty years to his well-known book *Sovereignty at Bay* first published in 1971 and looks forward to the relationship between multinationals and nation-states in the future. Vernon notes, somewhat wryly, that the book title has become a misnomer, taken to mean the inevitable decline of the state and rise of the global corporation. The purpose of the book, however, was to explain the motivations behind the growth of US multinationals and to explore MNE–state friction points. Rather than asserting the decline of the nation-state, the book argued that MNEs and nation-states were two legitimate systems with potential benefits and conflicts inherent in their mutual existence. Vernon still holds this view.

Twenty years later, in looking at state policies towards MNEs, Vernon notes that the attempts by the OECD and United Nations in the 1970s to develop multilateral codes of conduct for MNEs are still failures. Bilateral treaties, primarily in the tax area, are now the major instrument used to define MNE rights and obligations. Unilaterally, the United States is adopting more restrictive legislation, such as the Exon-Florio Amendment which allows the US president to restrict inflows of foreign direct investment on national security grounds. While the United States is tightening IFDI, most other governments have been liberalising capital markets. This liberalisation has been partly due to the shortage of IFDI in developing countries, already hurt by the debt crisis, but also due to the growing interdependence of national economies which necessitates multilateral co-operation.

Vernon argues that governments are now gradually becoming reconciled to a narrower concept of sovereignty. Points of friction still remain, such as the need to define the rights and assess the obligations of global businesses. As international alliances and mergers increase among the largest MNEs this assignment grows more complicated. At the same time nation-states are demanding more in terms of performance from the firms within their borders. As a result, he believes multilateral approaches are the only way to reduce the 'inescapable tensions' of future MNE–state relations; unilateral approaches, on the other hand, are likely to damage both state and firm interests.

Lorraine Eden, 'Bringing the Firm Back In: Multinationals in International Political Economy'

In 'Bringing the Firm Back In', Lorraine Eden looks at the treatment of multinationals in the international political economy (IPE) literature, summarises current thinking about MNEs by scholars in international business studies (IBS), and then addresses the implications of the IBS literature for state–MNE relations as they are characterised in IPE.

Eden examines 'five faces' of the multinational in the international political economy literature: the product life cycle, sovereignty at bay, the obsolescing bargain, the law of uneven development, and the changing international division of labour, noting that the first three faces were explored by Raymond Vernon in *Sovereignty at Bay*. Eden then turns to the international business studies literature and reviews the OLI (Ownership–Location–Internalisation) paradigm, strategic management theory, the international value chain, and their implications for MNE organisational and locational decisions. She concludes that these 'new style' multinationals are 'giant firms, linked by equity and non-equity relations in clusters, engaged in two-way flows of products, investments and technology within the Triadic economies'.

Eden then addresses 'bringing the firm back in', asking how each of the five faces of the multinational in the IPE literature is altered by the new style MNEs of the 1990s. She argues that insights from the IBS literature imply that IPE must pay more attention to the specificities of global corporations: their goals, strategies, structures and locational choices. The chapter concludes that a clearer focus on the multinational as an institutional actor with goals, strategies and structures is necessary to understand state–MNE relations in the 1990s.

John Dunning, 'Governments and Multinational Enterprises: From Confrontation to Co-operation?'

John Dunning's chapter examines the changing nature of systemic interactions between governments, as they promote national welfare, and MNEs, as they seek global profits, and the future directions of these interactions. His chapter makes three arguments. First, he contends that in the past state policies designed to influence MNEs have not been explicitly related to wider political strategies, either because MNEs were perceived as a small part of the economy or because states believed the consequences of regulating FDI were minor. Secondly, Dunning asserts that governments are now treating the competitive advantage of country resources as a 'national economic objective in its own right', both because economic structures in the OECD countries are converging so that trade is primarily intra-industry, and because global corporations are now more footloose. Thirdly, Dunning argues that MNE locational decisions are increasingly affected by state policies to advance social goals rather than by policies directed at MNEs; these social policies now tend to have an impact on the transactions costs facing MNEs rather than direct production costs.

Direct production costs are defined as the opportunity costs of the resources used in production in the absence of market failure in intermediate product and factor markets, whereas transactions costs arise from the extra costs of organising relationships when markets fail. Dunning identifies two basic types of market failure: structural market distortions arising from anti-competitive activities of market agents, and endemic or intrinsic market failure arising from uncertainty, market externalities, natural monopoly, public goods, and market rigidities. Both structural and endemic market failures generate transactions costs.

When multinationals replace external markets by hierarchical structures, the purpose may be to increase market power (creating a structural distortion) or replacing a missing or imperfect market (reducing endemic market failure). As a result, when states intervene to reduce market distortions they may be undertaking actions which MNEs see as conflictual (for example, anti-trust policies to break up monopoly power) or complementary (for example, pro-market interventions to reduce endemic transactions costs). Dunning argues that over the past thirty years MNE–state interactions have shifted from primarily conflictual, as states sought to reduce anti-competitive behaviour by firms, to co-operative, as states now see MNEs as the means by which national competitive advantage can be generated and sustained. In the 1990s, he sees the main cause of market failure in the OECD countries as not structural distortions but endemic distortions due to unstable, integrated and interdependent markets. State policies, as a result, are now focusing on reducing endemic transactions costs.

Up until the 1980s, Dunning argues, most countries treated inward and outward FDI flows as unrelated economic phenomena. In terms of IFDI, states sought to remove or lessen the perceived adverse effects of oligopolistic foreign MNEs, focusing on their structural market power. In terms of outward FDI, there was much less concern and policies primarily focused on double taxation, dividend repatriation and extraterritoriality issues. In the 1980s, however, globalisation and technological advances have meant that most developed economies are both inward and outward investors and multinationals are increasingly mobile, major actors in national economies. This has had three consequences: it has lessened the desire and ability of both firms and states to adopt policies that raise structural market imperfections, increased MNE bargaining power relative to nation-states, and caused governments to reappraise the political consequences of FDI policies and modify their treatment of MNEs.

States are therefore shifting from a focus on removing domestic structural distortions to facilitating the supply capabilities of their domestic firms through lowering endemic transactions costs. Governments are starting to play a positive and co-ordinating role in upgrading industry resources and capabilities. Inward and outward FDI are seen as complementary to domestic investment. As a result, states are developing policies to encourage IFDI and to improve the competitive advantages of domestic MNEs in foreign markets. A fundamental reorientation of the role of government appears to be occurring, one that changes MNE–state relations from confrontation to co-operation. States now see the creation of domestic competitive advantage as a pressing national policy goal, and state regulation of

MNEs is increasingly being driven by the competitiveness agenda. As a result, state policies are now more generic, applying to both domestic and foreign firms, creating a symbiotic relationship between governments, hierarchies and markets.

Alan Rugman, 'Drawing the Border for a Multinational Enterprise and a Nation-State'

In his chapter, Alan Rugman poses the questions: 'What is sovereignty? What is a multinational enterprise?' He argues that globalisation forces are blurring the borders of the nation-state, creating the three regional economic blocs now known as the Triad. At the same time that economic integration is occurring, however, there is increasing political fragmentation. As a result the relevant borders for MNEs are now being defined by cultural areas rather than national boundaries.

Globalisation forces are also causing MNEs to lose their home country identity as they move towards integrated production strategies within each Triadic bloc. He argues that Triadic and non-Triadic multinationals will emerge, with the Triadic MNEs distinguished primarily by their differing cultures and social-political-historical roots rather than by their behaviour. For all firms the most important business decision will be the trade-off between thinking global (i.e. focusing on economic efficiency) and acting local (i.e. being responsive to non-economic issues).

Rugman provides three current examples of the trend towards decentralisation: the shift of power from Canada's federal government to its provinces; the fragmentation of economic power in the United States as the US government becomes more protectionist and responsive to special interest groups; and the revolution and restructuring in East Europe; and contrasts these cases to the centralised home market economy of Japan. He concludes from these cases that sovereignty is of growing importance in the Triad.

Decentralisation of political power in the Canadian case, Rugman argues, raises the costs of doing business and can lead to MNEs investing where climates are more congenial and simpler. Rising economic nationalism, as in the US case, requires foreign multinationals to be sensitive to neoprotectionist restrictions. While national responsiveness is required in the European Community, Rugman contends that efficiency, not sovereignty, will attract IFDI in Eastern Europe. Lastly, the centralised home market of Japan facilitates integrative strategies by Japanese multinationals, making them less aware and perhaps less sensitive to sovereignty issues abroad. He concludes that the most successful multinationals in the 1990s will balance the trade-off between thinking globally and acting locally.

Susan Strange, 'Big Business and the State'

In this chapter, Susan Strange addresses two puzzles associated with MNE–state relations. The first puzzle is a theoretical one: why has international relations theory not incorporated the MNE into the analysis of the international system? She notes that MNEs are treated as an addendum in most textbooks, and argues that solving puzzles in international relations theory requires putting the MNE, together with the state, at the centre of theory. The question of power in the world system, who has it, who does not – all central issues in international relations – demand a focus on big business as an international actor.

The second puzzle is a normative one: how should states respond to big business? The state does have the power to regulate MNEs within its borders, to give or withhold domestic market access. However, this is only a negative power since 'the gate can be barred, but when open, it is up to the TNCs, not the state, to decide whether they should enter. Therein lies the rub'. Strange notes that over the 1980s states have become more accommodating towards the MNEs in their midst. She argues this is not a temporary policy shift due to LDC indebtedness but rather a permanent response to changes in underlying world production and finance structures. The technological revolution and integration of capital markets are more closely interlinking developing countries and multinationals and 'the genie cannot be put back in the bottle'.

She contends that saddling the MNEs with controls is more likely to damage the long-run health of developing countries than to be a successful development strategy. LDCs with fewer controls over FDI have done better than highly protectionist states. Noting that 'protectionism is like smoking cigarettes. It is apt to be habit forming and it does risk damaging your health', Strange concludes that the policy shift towards liberalised treatment of MNEs is permanent. 'The [new] game of diplomacy is triangular', with bargains being struck between states, between big business, and state to firm. As a result, both states and firms need to better understand the web of international bargains through which they are linked in the globalised economy of the 1990s.

Raphael Kaplinsky, 'TNCs in the Third World: Stability or Discontinuity?

In this chapter, Raphael Kaplinsky addresses the changing role of FDI in the Third World in the manufacturing sector. He looks at the dynamics of international competitiveness, the economic and political determinants of location, scale economies, and the unevenness in the world economy.

Kaplinsky argues that the dynamics of international competitiveness are shifting as manufacturing firms move from Fordist to Post-Fordist strategies in the 1990s. In the 'golden age' Fordist period of 1945–73, firms used mass production methods where products were standardised, the division of labour pursued, work organised hierarchically, machines used for special purpose automation, and interfirm relations conducted at arm's length. For production stages where unskilled labour was a major cost determinant, MNE affiliates or local firms in low wage economies were subcontracted to produce labour intensive intermediate products. This export-oriented FDI, located in developing countries, came to be known as 'the new international division of labour (NIDL)' since developing countries were integrated into MNE global strategies via their roles as sources of low-cost labour inputs. The success of the newly industrialising countries (NICs) encouraged many states to reorient their development policies to replicate NIC strategies in the 1980s.

Kaplinsky notes, however, that just as LDCs were engaging in this policy reorientation, the basis of global competition in manufacturing was shifting from Fordism (competition on price) to Post-Fordism (competition on product innovation). Post-Fordism requires product flexibility, which necessitates work flexibility and thus a multi-skilled labour force. At the same time product flexibility requires flexible automation techniques, just-in-time inventory systems, and simultaneous engineering. In Post-Fordism, the economics of location are different. Proximity and reliability of supply are more important than low labour costs, thus reducing the need to spread production across the globe. Product flexibility also allows firms to fine tune their products for final markets, implying greater benefits from locating in those markets. Labour is no longer 'seen as cost of production which has to be minimised (the essential premise of the NIDL), but rather as a central resource whose potential has to be maximised'. As a result, the Fordist strategy of producing standardised world products in low wage world factories is becoming obsolete, paradoxically just as developing countries are reforming their IFDI policies to encourage Fordist inflows. The 'open door' policies of many LDCs are also being offset by the changing politics of location, as the proliferation of managed trading arrangements and non-tariff barriers erected by the First World makes it even more difficult for LDCs to follow successful NIDL-based strategies.

Kaplinsky believes that Post-Fordism offers both opportunities and potential pitfalls to developing countries. Since economies of scale at the level of the plant are less important, there are new possibilities for niche strategies and renewed import substitution industrialisation. On the other hand, Post-Fordism is less labour and natural resource intensive, two of the traditional comparative advantages of the Third World, and a new drive for market oriented FDI is causing MNEs to shift production from LDCs to First World final markets. This shift, while generally unfavourable to LDCs, will be nuanced by increased South–South trade and regional differences as MNEs favour some LDC sites close to members of the Triad (for example, Mexico to the United States). Kaplinsky concludes that the gap between the newly industrialising countries and the least developed countries is likely to widen.

Sanjaya Lall, 'Multinationals and Developing Countries: Some Issues for Research'

Sanjaya Lall notes the warmer climate MNEs face in developing countries over the past decade and offers several explanations for this warming trend: developments in the theory of the MNE, historical experience, better LDC negotiation skills, the debt crisis, faster technological change, and a greater belief in market efficiency. In the 1990s he sees greater liberalisation of capital markets being accompanied by more state controls designed to offset market failures. Lall argues that examples of missing and fragmented markets, high transactions costs, poor information, economies of scale, risk and uncertainty plague developing countries. Multinationals may have conflicting effects on such markets, improving efficiency of some while worsening it in others. In the 1990s he expects there to be an offsetting reaction to the excessive free market ideology of the 1980s as LDC states realise that market failures are widespread and costly if left untreated.

Lall states that the MNE literature, particularly the theory of internalisation, emphasises the beneficial impacts of the transfer of capital, resources and technology that accompany MNE entry into LDCs. However, while such benefits clearly exist, the potential for the internalised markets of globalised multinationals to distort or retard development also exists. He illustrates his thesis with reference to technology, arguing that MNEs can transfer either 'know-how' and/or 'know-why' knowledge to LDCs. While 'know how' enables countries to master existing operational procedures, 'know-why' capabilities are crucial for upgrading the long-run technological capabilities of developing countries. MNEs generally transfer the former but much less often the latter, causing Lall to argue that a strategy based on IFDI restrictions, accompanied by other market-strengthening policies, may be a superior policy mix to total liberalisation of FDI regulations. He concludes that policy-makers should adopt a more pragmatic attitude towards multinationals, look for domestic market failures rather than taking market efficiency for granted, and allow for the possibility of efficient government intervention instead of assuming governments are incompetent.

Magnus Blomström and Robert Lipsey, 'The Competitiveness of Countries and their Multinational Firms'

Magnus Blomström and Robert Lipsey deal with the comparative advantages of countries relative to the competitive advantages of firms. Countries are geographic entities, but multinational firms have headquarters in one country and produce in many countries. Thus the basis for comparative advantage for a country is its immobile factors; whereas the basis for a multinational is its firm specific advantages, which are mobile throughout the corporation, in conjunction with the immobile country-specific advantages of the various locations in which it produces.

The authors test the differences between national comparative advantage and MNE competitive advantage, using data on manufactured exports from the United States, Sweden and Japan over the 1965–89 period. In each case they compare exports by the countries with exports by multinationals headquartered in these countries.

They find that countries and their multinationals have different comparative advantages. First, MNE shares and country shares of world exports behaved differently over 1965–89: the export shares of the United States and Sweden fell while Japan's rose; export shares for Swedish and Japanese MNEs rose while the US MNEs share rose until 1985 and then declined. Blomström and Lipsey argue that multinationals can shift production out of high cost home countries to lower cost host countries, and thus protect their competitive advantage by moving offshore. This was true for both US and Swedish MNEs; the parent firm's export share fell while that of their offshore affiliates rose. In Japan after the appreciation of the yen in the mid-1980s this also happened with Japanese MNEs.

The authors then look at the impact of technological intensity on export shares and competitiveness. They find that the United States comparative advantage is shifting out of medium-tech to high-tech exports, while its comparative disadvantage in low-tech exports increased over the 1966–86 period. US multinationals, on the other hand, had much higher shares of world exports than did the United States as a whole, and the MNE share of high-tech exports rose over the period. One reason for this could be that MNEs are less sensitive to exchange rate changes than are all US firms, and the authors provide some evidence in support of this, particularly for high-tech products.

Blomström and Lipsey conclude that the competitiveness of US multinationals is due to different factors, or to the same factors in different degrees, than is the competitiveness of the US economy as a whole. This they attribute to the firm specific assets of US multinationals which are mobile and thus not part of the comparative advantage endowment of the United States. US competitiveness, they argue, depends on immobile factors and macroeconomic policies; firm competitiveness depends on firm specific assets and the country-specific advantages where MNE affiliates locate. Thus parent firms and their foreign affiliates may have differing sources of competitive advantage; firm specific assets are the same, but their country based advantages differ.

The implications of this research relate to our overall themes of MNE–state relations and the shift from confrontation to co-operation. Blomström and Lipsey conclude that 'the balance of power has shifted away from governments' as the flexibility of firms increases relative to nation-states. States are less free to impose regulations on MNEs and are more likely to engage in competition to attract inward FDI. A second implication is that measures to increase national comparative advantage should focus on immobile factors that are part of the national endowment, not on mobile advantages specific to multinationals. For example, subsidising R&D may increase the competitiveness of high-tech local firms, which then shift production offshore if other complementary assets for production are not available locally, raising the MNE's competitiveness but not overall country comparative advantage.

Robert Kudrle, 'No Entry: Sectoral Controls on Incoming Direct Investment in the Developed Countries'

Robert Kudrle's chapter focuses on the conflictual relations between states and multinationals, looking specifically at state regulations in the developed market economies which close or explicitly control IFDI in so-called key sectors. He asks, 'What are the commonalities and differences among the developed countries in their restricted sectors? What are the characteristics of those sectors most commonly restricted? What are likely future developments in international co-operation?'

Kudrle notes that several motivations for sectoral restrictions have been discussed in the literature. These include national security, infant industry protection, control of the national patrimony, and mercantilism. He contends that most protected sectors have nothing to do with national security; simple producer protection, as sought by vested interest groups, is the main reason why restricted sectors exist.

He reviews the statistical data on IFDI restrictions among the OECD countries and then narrows the data to six clusters: (1) banking, insurance and finance, (2) broadcasting, (3) post and telecommunications, (4) other public utilities and energy production, (5) transportation, and (6) land and natural resources. After reviewing each of these clusters, he concludes that national security is not an important reason for the existence of closed sectors. A few regulations, such as Canadian and Australian media controls, do appear to be generated by national autonomy motivations. On the other hand, most of the controls do relate to national prosperity grounds; however, since vested producer groups play important roles in policy formation it is hard to distinguish national from producer prosperity motivations. Even if the motivation is national prosperity, Kudrle notes that deadweight economic losses usually follow from such IFDI restrictions.

Kudrle's policy conclusions are provocative. He argues that unilateral pursuit of liberalising IFDI restrictions is unlikely to go very far since the benefits to vested interests are concentrated while the costs to consumers are diffuse. A GATT code on IFDI he also sees as unlikely given differing national attitudes towards FDI inflows, the complexity of IFDI policies and fears of free riding in the GATT. Bilateral reciprocity, however, is seen as 'fair' by many industries around the world and particularly so in the United States. Hence he concludes that sectoral reciprocity – 'I'll open my sectors if you open yours' – is the only feasible route for liberalising sectoral restrictions on inward FDI flows. Thus IFDI flows are most likely to be liberalised within regional trading blocs, as a result of agreements like the Canada–US Free Trade Agreement, the proposed North American Free Trade Agreement and EC 1992.

Louis Wells Jr and Alvin Wint, 'Marketing Strategies to Attract Foreign Investment'

Noting the new shift from confrontation to co-operation between multinationals and nation-states, the chapter by Wells and Wint focuses on government attempts to attract inward foreign direct investment and what makes some attempts successful and others failures. They ask: 'If states and MNEs are to co-operate what policies should state agencies adopt to attract IFDI? What policies work for first time investors? repeat investors?'

They note that states use three basic types of IFDI-attracting techniques: investment incentives, improvements to the general investment climate, and marketing techniques. This chapter focuses on the third strategy, marketing or investment promotion techniques. The purpose of investment promotion is 'to inform investors about a country's potential as an investment site, and to persuade them to set up operations in that country'.

During their research, Wells and Wint interviewed investment promotion agencies in ten countries: Britain, Ireland, Scotland, Canada, Costa Rica, Jamaica, Indonesia, Malaysia, Singapore and Thailand. They also interviewed managers from US multinationals about thirty investment decisions made in these ten countries. The interviews were used to determine what investment promotion techniques were used, and why, by the country agencies, and then to compare these results with the firms' views on what factors influenced their locational choices.

Wells and Wint found that agency marketing techniques have three short-run objectives: image building, investment service activities, and investment generating activities. The agencies tend to concentrate their promotional activities on either the first or third objective. Six of the ten agencies studied started with image building and then shifted to investment generation.

The authors argue that image building is an impersonal, information-providing technique, whereas investment generation by necessity involves direct contact between agency representatives and MNE investors. From their interviews with US multinational managers, Wells and Wint conclude that personal promotion techniques are most useful in influencing firm investment decisions, particularly when the investment is for export promotion reasons. They conclude that, where all states are now attempting to attract inflows of FDI, governments that want to be successful at attracting and expanding multinational investment should view the marketing of a country as a type of industrial marketing and use personal contacts with firms to encourage the development of co-operative MNE–state relationships.

MAIN THEMES OF *MULTINATIONALS IN THE GLOBAL POLITICAL ECONOMY*

From the chapter outlines we can see at least five themes that are carried throughout the book. The first theme is *the shift to more co-operative MNE–state relations over the past decade.* How have they changed? Why? Is this a permanent or temporary shift? The chapters all conclude that relations between governments and firms are now less confrontational and more co-operative than in the past. This theme is explicitly drawn in Dunning's chapter, but also appears in the Vernon, Eden, Rugman, Strange and Lall pieces. Dunning traces the direction of this shift from the 1970s to the present, arguing that governments are now more concerned with improving efficiency through reducing transactions costs rather than with focusing on monopoly distortions. More co-operative relations are due to states now seeing FDI as complementary to domestic investment and as necessary for engineering long-run competitive advantage in the world economy. Strange says that globalisation and technological changes have caused the underlying production and finance structures to shift permanently in a way that favours the MNE and requires more co-operative responses from nation-states. Kaplinsky fleshes out Strange's argument with his chapter on the shift from Fordism to Post-Fordism. While Lall and Rugman both observe this trend, they have reservations. Rugman notes that political fragmentation raises the need for firms to be nationally responsive, while making it more difficult for states to develop centralised co-operative policies. Lall wonders whether the pendulum has swung too far and that MNE–state relations may be less co-operative in the future.

A second theme relates to the *theoretical implications of more co-operative multinational–state relations.* Eden in particular focuses on this topic, but Strange also looks at the MNE in the international relations literature. Both authors argue that insufficient attention has been paid by international political economy (IPE) and IR scholars to the MNE as a powerful actor and institution in the global economy. Both make suggestions for future research directions.

A third theme is *the policy implications for the firm of more co-operative MNE–state relations.* What should the MNE do? How should it strategically manage its assets in the globalised world of the 1990s? Rugman deals explicitly with the paradox facing the MNE: choosing a strategy that is globally efficient (that is, economics dominates) versus one that is nationally responsive (that is, politics dominates). Eden explains how this can affect multinational choices for locational decisions (such as product range, plant function, intra-firm trade, investment choices) as well as organisational choices (for example, ownership, degree of vertical and horizontal integration, types and number of strategic alliances). The borders of the firm are changing in both a geographic sense as firms have expanded their core networks of affiliates and do a larger percentage of their business outside the home country, and in a structural sense as they make alliances, mergers and various non-equity investments.

A fourth theme is *the policy implications for the nation-state of more co-operative MNE–state relations.* In terms of policy directions for the nation-state, most authors like Dunning, Rugman, Strange and Lall see a need for states to unilaterally intervene in a pro-market sense to make markets work more efficiently. However this means different things to different people. Dunning focuses on individual countries eradicating transactions costs due to endemic market failures, Strange argues for liberalising capital markets and key sectors, while Lall believes IFDI should continue to be regulated by LDCs as long as such regulation is accompanied by pro-market policies. Kaplinsky notes that LDCs face both opportunities and pitfalls in a Post-Fordist world as both the economics and politics of location are different. Developing countries close to large markets in the developed countries, like Mexico to the United States, may have more options than marginalised LDCs not located near a Triad member.

Kudrle draws our attention to the difficulties of unilaterally liberalising key sectors where vested interests hide behind the skirts of national security. He also notes that treatment of IFDI in the United States is moving in the opposite direction to most other countries, with regulations increasing rather than being liberalised. In terms of the potential benefits to a state if it does liberalise, Wells and Wint offer a caveat. They show that even if a country establishes an open door policy towards IFDI, the policy may not be successful; marketing a country has as many pitfalls as marketing products. Blomström and Lipsey offer an even more telling caveat: if the sources of comparative advantage for a firm and a country are not the same, some policies that appear to be pro-market may in fact make the firms more competitive while production and high valued jobs are transferred offshore. They implicitly suggest, similar to Robert Reich, that engineering country comparative advantage requires attention to nationally immobile factors rather than subsidising firms.

In terms of co-operative policy directions among nation-states, some authors like Vernon continue to support multilateral solutions to the interdependencies generated by the shifting borders of the firm and the nation-state. As states create preferential trading areas and Triadic economic 'hubs' emerge around which smaller countries cluster as the 'spokes' around a wheel, the need for at least regional solutions to the problems Vernon identified in 1971 (for example, double taxation, extraterritoriality, transfer pricing, intellectual property rights) grows stronger. Eden notes that there is some evidence, from the Canada–US Free Trade Agreement at least, that regional groupings may be able to move further in terms of extending the GATT-based rules on arm's length commodity trade to today's issues of services, technology transfer and intra-firm trade. Kudrle also argues that sectoral reciprocity is seen as fair by most countries so that bilateral negotiations may be able to liberalise sectors where unilateral and multilateral solutions are unlikely to work.

The last theme running through this book is the importance of Vernon's *Sovereignty at Bay*. The book not only drew attention to the importance of the multinational enterprise as an actor in the global economy, but also conceptualised MNE–state relations in a bargaining framework that continues to dominate theoretical and policy work in this area. All the chapters in this volume bear relation to the themes developed in this original work, and give testimony to its influence on current and potential scholarship in the field of multinationals in the global political economy.

2 Sovereignty at Bay: Twenty Years After

Raymond Vernon

Twenty years after the publication of *Sovereignty at Bay*, I feel justified in offering a solid kernel of advice to aspiring young authors: If you want to draw public attention to your opus, find an evocative title. But if you want readers to remember its contents, resist a title that carries only half the message.

Sovereignty at Bay did not foretell, as is commonly supposed, the decline of nation-states and the emergence of a world of stateless global corporations. My conviction two decades ago was 'that the manifest technical advantages of large enterprises and of strong governments will lead men in the future to insist on both'. I saw two systems, therefore, each legitimated by popular consent, each potentially useful to the other, yet each containing features antagonistic to the other. A considerable literature already existed on how multinational enterprises and national governments had sometimes been enlisted to advance one another's goals, a literature ranging from the oil embargo on Japan which preceded that country's attack on Pearl Harbor to Mexico's pressure on the foreign subsidiaries of international automobile companies to increase Mexican exports. What seemed to be lacking in the literature, however, was a systematic account of the motivations that dominated the strategies of such enterprises, along with an exploration of the points of frictions between such networks and the governments of the countries in which the units of the network were located. The principal objectives of *Sovereignty at Bay*, therefore, were to fill in those lacunae.

The message of the book proved unappealing in many quarters. Managers of large multinational enterprises, juggling the sometimes irreconcilable demands of many different sovereigns, took no joy in being reminded of the difficulties of their assignments. The head of America's largest international bank, Walter Wriston, fulminated in public over academic scribblers who suggested that the interests of multinational enterprises might occasionally be at odds with those of the countries in which they operated.

The reception of the book in academia was hardly more friendly. Most economists, having been nurtured by the neoclassical paradigm of a world composed of distinct national economies, each with its separate endowment of land, labour and capital, saw research on the multinational enterprise as largely irrelevant to their discipline; if the operations of the multinational enterprise had to be addressed, it was sufficient to analyse them like any other international investment – for instance, like a Japanese insurance company's purchase of a US Treasury bond.

Political scientists were only a trifle less hostile to the emphasis on multinational enterprises as significant actors in international relations. True, a sometimes lurid literature of an earlier generation had occasionally assigned them a central role as political actors. More recently, some serious studies of their position in international affairs have briefly commanded the attention of specialists in political relations. But as a rule political scientists in the 1970s, having built their models of the political economy on the assumption of the absolute sovereignty of the nation-state, saw the multinational enterprise as an irritating anomaly to be wished away. More appropriate than *Sovereignty at Bay*, suggested one reviewer, might be a book entitled Multinationals at Bay.

As events developed in the middle 1970s, that reviewer's perception of the future seemed rapidly on the way to being realised. The extraordinary success of OPEC's member countries in quintupling the price of oil led many developing countries to believe that they had entered a new era, freed from the hegemony imposed by the multinational enterprises that produced and marketed their oil and minerals. Suddenly, developing countries were found expropriating foreign-owned enterprises by the hundreds. Although foreign-owned manufacturing enterprises were usually spared, those in oil, copper, and other raw materials industries suffered a high mortality rate.

In the years to follow, some developing countries would discover that the ownership of raw materials sources was no guarantee of profits, so long as there was no control of downstream markets as well. But one of the more immediate effects of the expropriations was to interest the governments of some of the advanced industrialised countries in defining the rights and obligations of multinational enterprises, and in reconciling the points of conflict between such enterprises and the governments with which they interacted.

Until that time, efforts to define the rights and obligations of multinational enterprises had been confined to a network of bilateral agreements between governments, whose very name – Treaties of Friendship, Commerce, and Navigation – suggested their anachronistic character. These had purportedly endowed such extensive rights on foreign-owned enterprises and their owners as to carry the seeds of their own impotency. That fact was already obvious in the 1950s and 1960s, as some developing countries began to show signs of hostility toward such enterprises. It became crystal clear in the 1970s, when developing countries took the bit in their teeth and began nationalising foreign properties in large numbers.

Accordingly, the Organisation for Economic Co-operation and Development (OECD), an organisation whose membership was confined to relatively rich industrialised countries, launched an ambitious effort in 1976 to define the rights and obligations of multinational enterprises in terms of some general principles. Even before the mid-1970s, the OECD had sponsored some efforts to clarify the rights and obligations of multinational enterprises; but these efforts had been confined to one or two narrow fields, including notably the reconciliation of national tax codes in their application to the income of foreign-owned subsidiaries. With the support of the multinational enterprises themselves, these efforts had borne fruit in the form of a network of bilateral tax treaties devoted to the objective. The new initiative, its sponsors hoped, would go much further, laying down a set of norms that eventually even the developing countries might be prepared to accept.

But the interest of the governments in the advanced industrialised countries in clarifying the rights and obligations of foreign-owned enterprises through multilateral agreements was short-lived. In 1982, the Mexican government defaulted on its international debt, and with that default developing countries lost their ready access to the international credit market. For the decade following, most developing countries proved eager to accept help from the developed world in almost any form in which such help was offered, including the investments of multinational enterprises.

Not surprisingly, then, business groups and governments in the advanced industrialised countries allowed the OECD code to languish. When developing countries, operating under United Nations (UN) auspices, sought to develop their own version of such a code, the project was never allowed to get beyond the talking stage. Instead, governments in the advanced industrialised countries reverted to the use of bilateral treaties to define the rights of multinational enterprises, notwithstanding that such treaties skirted all the difficult problems in the tensions between enterprises and governments and were demonstrably unhelpful in any serious dispute.

By the 1990s, the issue of reconciling the conflicts associated with the multinational enterprise might safely have been consigned to the 'inactive' file, were it not for the persistent tendency of large enterprises in most countries to create and extend their multinational networks all over the world. The latter 1980s saw a resumption of high growth rates in these networks. And in this wave of growth, in a reversal of earlier patterns, the United States proved to be the principal recipient country, attracting investments from the leading firms of Europe and Japan.

In this unfamiliar role, the US public predictably reacted very much as the French had reacted to the establishment of US-owned subsidiaries in the 1960s, and as Mexico, India and Brazil had reacted to such subsidiaries during most of the postwar period. Foreign-owned enterprises were seen in some US quarters as moles, agents of their home governments, to be used in some unspecified scenario of the future to compromise the interests of the United States. And enterprises owned by Japanese business interests were regarded as especially suspect.

That xenophobic streak has been manifest in many ways, including the unprecedented adoption in the United States of the Exon-Florio amendment to the 1988 trade act, an amendment that empowers the president to block some acquisitions by foreigners of US enterprises. Yet, despite such manifestations of acute unease on the part of the US public, my expectation is that governments in the advanced industrialised countries are unlikely to increase their restrictions on the growth and spread of multinational enterprises.

Gradually, almost imperceptibly, governments are becoming reconciled to a modified concept of sovereignty in the economic field. They are aware, for example, that without international co-operation none of them is any longer capable of ensuring the existence of secure banks or of policing their securities markets against fraud. They accept, however reluctantly, the need for some co-operation among central banks in the maintenance of an orderly foreign exchange market. Under the compelling power of the computer, they are creeping up to creating global standards in the various branches of telecommunications activity. National safety standards, health standards and environmental standards are beginning to converge, the process having been greatly accelerated by the European Community's 1992 exercise. In short, as governments respond to the functional problems that crop up in an increasingly crowded universe, they redefine the scope of the autonomy that sovereignty demands. And as the process goes on, the sovereignty at bay metaphor begins to lose what currency it once possessed.

Yet so far, one must agree, governments have been extraordinarily reluctant to tackle some of the most important points of friction that are associated with the operations of the multinational enterprise. One can sympathise with their reluctance, given the complexity of some of the problems. And the issues are not getting any easier as a result of the new wave of international alliances among enterprises, such as those among the giant producers of telephone equipment and aircraft parts. These alliances, by avoiding transfers of stock ownership, often complicate the process of defining rights and assessing obligations.

Yet the problems of jurisdictional conflict slowly build. Consider the basic question of taxation. By one means or another, enterprise managers must assign the global profits of any multinational enterprise to the various taxing jurisdictions in which the network's units do business. For some multinational enterprises, the allocation presents no serious problems. But for many, there is no escape from the managers making arbitrary decisions in any such allocation. When subsidiaries located in several different countries have collaborated in the sale of a big-ticket item, such as the sale of a supercomputer to a Brazilian buyer, it is not always clear in what tax jurisdiction the sale was consummated. When the parent's expenditures on behalf of all the units in the network, such as expenditures on research, are charged out to each of the subsidiaries, the allocation is inescapably based on arbitrary rules. When products and services that have no open market price are transferred between affiliates in a multinational network, such as made-to-order components or specialised technical services, the price used in the transfer can never be free of challenge in the absence of some agreed rule.

Consider, too, the demands that different governments make on the various units of multinational enterprises. Every government would like to see the units of the network in its jurisdiction export more and import less. The only available response for some multinational enterprises is to engage in an occult game of beggar-thy-neighbour by reshuffling the flows in their logistical networks, expanding their output and jobs in one country and shrinking them in another.

Beyond such obvious issues lies a thicket of other problems: how to generate the information required for governments, consumer groups, labour unions and other stakeholders that have a legitimate interest in the strategies of a multinational network operating on their national turf; how to deal with conflicts of national jurisdiction in such areas as antitrust and export controls; how to define the political rights and responsibilities of the foreign-owned subsidiary in the country whose laws created it, including its rights and responsibilities in relation to the national defence base; how to avoid the destructive effects of competition among governments to attract foreign-owned enterprises, including a kind of Gresham's law in such areas as pollution control and factory safety.

History offers plenty of evidence for the capacity of governments to live with acute ambiguity in their international relations over extended periods of time. It may well be, therefore, that governments will postpone indefinitely any serious effort at collaboration aimed at reducing the tensions associated with the operations of multinational enterprises. On a showing of hands, the enterprises themselves would probably choose indefinite postponement as their preferred course; like the King of Siam when invited to make treaties with the Great Powers, they may find themselves wondering if they might come out at the short end in such collaborative exercises.

Yet it would be folly on the part of enterprises or governments to assume that the endemic tensions associated with their relationships will go away. The communications revolution is inexorably intertwining national economies, confusing national identities and redefining the limits of national sovereignty. As governments try to apply unilateral responses to their emerging problems, they stand an excellent chance of damaging both their own national interests and the interests of the multinational enterprises on which they depend. The challenge is to find the multilateral approaches that can reduce the inescapable tensions to manageable proportions.