The global economy, domestic governance, strategies and transnational corporations: interactions and policy implications

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The article argues that changes in the global economy require that Governments fundamentally reappraise their domestic macro-organizational strategies, especially those that bear on the productivity and competitiveness of the firms and resources within their jurisdictions. The article distinguishes between the competitiveness of firms and nations according to the extent to which they have access to and efficiently utilize resources, based on national and created factor endowments (or assets). It also distinguishes between the productivity with which particular value-added activities are undertaken, and the efficiency with which a diversity of activities under the same ownership is organized.

The article makes a distinction between the intervention in a Government's organization of resource- (or assets-) usage to *(1) counteract market distorting behaviour and (2) help create and facilitate the efficient workings of markets.* It argues that both roles are likely to be critical in the global economy, partly because Governments, direct or indirectly, influence the production and use of created assets (for example, research and development, skilled labour, communications infrastructure), and partly because competition between countries (which is becoming increasingly oligopolistic in character) is not always conducted on a level playing-field.

The article goes on to illustrate the difference globalization and the extensive operations of transnational corporations make to policy-formation by Governments and argues that, in the 1990s, Governments will increasingly behave as strategic oligopolists in each of the main areas of macro-organizational management. It concludes by arguing for a systemic approach to domestic macro-organizational strategy.

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The concept of macro-organizational strategy

The advent of the global economy[1] is requiring national Governments to completely reappraise their domestic macro-organizational strategies, and, indeed, their whole culture of decision-taking. By macro-organizational strategies I mean the actions taken by Governments to optimize the modality by which the resources and capabilities within their jurisdictions are created, upgraded and allocated among different uses, and the efficiency at which these are deployed for any given use. In the 1990s, I believe that such strategies, in addition to sound macro-economic management,[2] are likely to play an increasingly decisive role in the determination of the competitiveness of a country's firms and that of its location-bound assets in the global market place.

The debate about whether Governments should, or should not, have a macro-organizational strategy at all or whether the organization of economic activity is best left entirely to market forces is (or should be) dead. Few economists or policy makers would contend that the international allocation of economic activity is, or should be, solely determined by the forces of unobstructed competition as portrayed in economic textbooks — although some markets for particular goods and services may come near to approaching the "ideal" or Pareto optimal situation.[3] For better or worse, throughout the world, national Governments are fashioning the organization and structure of value-added activities within and beyond their borders in a host of ways. Any Government of the 1990s that ignores this fact and pursues a "hands-off" or "leave-it-to-the-market" strategy is likely to be as negligent in promoting the welfare of its citizens, as were its predecessors of the 1960s and 1970s, that sought to replace the discipline of the market by socialist or centrally planned macro-organizational policies.

The theme of this article is a simple but important one: for the global economy to fulfil its functions properly, and for individual economies to benefit fully from participating in it, national Governments need to take decisive, positive and coordinated action to understand the nature of markets and to help make them work. This does not primarily mean less Government

[1] Defined as an economy in which there is close economic interdependence among the leading nations in trade, investment and cooperative commercial relationships, and where there are relatively few artificial restrictions on cross-border commerce, or discrimination against foreign affiliates.

[2] Which deals with such variables as level of prices, employment, interest rates, the balance of payments and policies that affect these variables.

[3] Defined as a situation in which any reallocation of resources would make at least some people worse off, with the economic welfare of the rest being unchanged.

or less taxation (or for Government to "get off industry's back"), although in certain industries and certain countries, this may be a desirable objective. Nor does it necessarily mean more Government intervention in the decision-taking process of the wealth creators of society, *viz.*, business enterprises. Time and time again, it has been proven that Governments make bad business decision-takers and entrepreneurs.

But what it does mean is that Governments should openly acknowledge that, as an organizational mechanism, markets are *not* a free good; they cost resources to set up, to operate and to maintain. Second, it means that Governments need to recognize that the efficiency of many markets — and particularly cross-border markets — is not solely determined by the transactions of the buyers and sellers in those markets, but by a host of exogenous variables, including the macroeconomic and organizational policies of other Governments, over which they may have no immediate influence or control. And third, it means that any action by Governments that involves the use of scarce resources will, directly or indirectly, affect the structure and efficiency of a whole range of markets, as well as that of the competitiveness of the manpower and physical assets under their jurisdiction.

From multi-domestic to globally oriented economies

In precisely what ways does the globalization of markets and production impinge upon the domestic macro-organizational strategies of Governments? Consider first a *closed and isolated* economy which has no commercial intercourse with the rest of the world. In this situation, the Government of that economy is entirely sovereign to operate whatever economic system it chooses without fear of its constituents (for example, the firms and consumers located within its boundaries), taking counteracting measures by reallocating expenditures or investments to other countries, and foreign Governments reacting in a way that might reduce or nullify the effectiveness of its own actions. In other words, the merits of alternative systems of organizing economic activity rest on the assumption that resources, capabilities and markets are completely immobile between countries, and that the authority of the Governments over the jurisdictions of assets housed within their boundaries is not challenged.

Consider next an economy which is *partially open*, in the sense that there is some trade in goods and services, but not in people or assets, between countries. Assume, furthermore, that the economy's role in the world market-place is a relatively minor one, and that whatever output its

firms produce, or whatever goods and services its consumers buy will not materially affect world supply or demand or, indeed, that of any particular country. In such a situation, an economy immediately surrenders a degree of its sovereignty of decision-taking, in so far as its prosperity is now partly dependent on the decisions of producers and consumers over which it has no jurisdiction. This movement from economic independence to economic interdependence will not only add a new dimension to domestic macro-economic policy; but if the country is to fully appropriate the gains from its participation in the international division of labour, the system by which it allocates its scarce domestic resources must broadly be in line with those of the countries with which it trades.

However, if the same country perceives that there are obstacles (that is, costs) to entry into international markets, its Government may intervene to help its firms overcome some of these obstacles. In doing so, it plays a market-enabling or supportive role. It is also possible that, for social and other reasons, a Government may not wish to accept the international division of labour that is determined by global consumers and producers. Should this be the case, it may seek to influence this division of labour by such means as import tariffs, quotas, controls, taxes, subsidies and the like. Moreover, over time, a Government's economic development or growth strategy might be inward or outward looking, according to how it perceives the costs and benefits arising from its intervention in the international markets.

The debate about the role of Government in a partially open economy is well rehearsed, and it is fair to assume that all the participants in the debate recognize that, whatever organizational form of resource allocation was made in a closed economy, some modification of domestic policy is required once a country opens its borders to trade. At the same time, it is by no means clear that, even in the partially open scenario, Governments have fully appreciated the magnitude of the changes in the form and pattern of trade (and, in particular, the growth in intra-industry trade) that have taken place over the past twenty or so years. I shall return to this point later.

But it is the third scenario — the *completely open (or global) economy* —that is the one which has the most dramatic and far-reaching consequences for the macro-organizational strategies of national Governments. First, I shall describe its characteristics and, second, highlight some of its implications.

The main feature of today's global economy is the close interdependence between the constituent nations in respect of trade in goods and ser-

vices, investment, the movement of people and a range of inter-firm transactional relationships. A typical global *firm* will own or control foreign affiliates and engage in value-added business alliances on each of the continents and in each major economy and pursue a geocentric governance strategy towards its foreign affiliates. It will source its inputs of manpower, capital, raw materials and intermediate products from wherever it is best to do so; and it will sell its goods and services in each of the main markets of the world. Similarly, a *country* that is fully open to the forces of globalization is likely to be geographically diversified in its trading, investment and transactional relationships; the value-added associated with these relationships is likely to constitute a significant part of its gross national product (GNP).[4]

The distinction between a partially open and a global economy is partly one of the *extent* of cross-border transactions, and partly one of the *organization* and ownership of these transactions. In recent years, the fastest growing form of cross-border commercial intercourse has been that of direct investment by transnational corporations (TNCs) and the non-equity relationships (for example, strategic alliances and subcontracting) forged between firms located in different countries. According to the Transnational Corporations and Management Division (TCMD) of the United Nations, global foreign direct investment (FDI) in the period 1980-1988 rose 1.5 times faster than trade; there are now up to 35,000 companies which, between them, own or control a minimum of 150,000 foreign affiliates.[5] The number of strategic alliances runs into tens of thousands; and the number of subcontracting agreements into hundreds of thousands. The majority of these arrangements involve TNCs; indeed, such companies also account for about three quarters of world trade. Trade, FDI and alliances are all interconnected in an increasingly complex web of transactions. Although the primary factors of production and the final products of firms continue to be bought and sold in the open market, an increasing proportion of intermediate goods and services are produced and traded within the same TNCs.

The consequences of the changing pattern of international business, and especially that of the growth of TNC activity, for the organization of domestic economic activity are little appreciated by national Governments. There

[4] "Significance" in this context is difficult to define as the internationalization ratio of a country (for example, as measured by the ratio of trade or FDI to its GNP) obviously varies with the size of the country; compare, for example, the ratios of Singapore with those of the United States.

[5] See United Nations, TCMD, 1992. Elsewhere (Dunning, 1992), I have estimated a considerably lower figure of TNCs (17,500 to 20,000), partly because the United Nations figure includes foreign affiliates of TNCs which, themselves, own foreign affiliates.

are two critical differences between trade and FDI as cross-border transactions. First, trade does not normally imply any movement in resources and capabilities; second, unlike trade, FDI implies no change in ownership or control. I shall deal with each of these differences in turn.

A new mobility of economic activity

The fact that some assets[6] are *mobile* across national boundaries immediately introduces a new element into the response of firms to the domestic policies pursued by Governments. If it is economically feasible for a firm to produce a particular good or service in two or more countries, then it follows that the actual location chosen will depend on its (perceived) strategic value to the firm. In general, anything that raises costs or taxes and lowers revenues in one location tempts a firm to produce in another location; anything that lowers costs or its net tax burden or increases revenue has the opposite effect. Clearly, the extent to which enterprises — be they foreign or domestically based TNCs — are able and willing to switch locations varies according to industry, firm and country-specific differences. However, for some countries, particularly those that are part of large integrated markets, for example, the European Community, and for some activities, there is ample evidence that such re-siting has occurred and continues to occur.[7]

In several countries — both developed and developing — the contribution of domestic and foreign-based TNCs to the GNP of a country is a significant one (United Nations, TCMD, 1992). For example, adding the actual value-added of foreign-based TNCs in a country to that of the foreign output[8] of its home-based TNCs and expressing the result as a percentage of private GNP,[9] the resulting percentages currently exceed 50 per cent in the cases of such economies as Belgium, Canada, Hong Kong, Netherlands, Singapore, Switzerland and the United Kingdom; more than 30 per cent in the cases of Australia, France, Germany and Italy; and more than 20 per cent in the cases of Brazil, Japan, Nigeria, Taiwan Province of China and the United States. No less important is the fact that these ratios have been rising over the past ten years and seem likely to continue to rise in the next

[6] I define assets as a stock of wealth; they include all resources and capabilities, both tangible and intangible, that a country has available to it at a given point in time.

[7] Notably between countries within the European Community and between countries in Asia.

[8] Estimated from the sales or net-assets data on TNCs or their foreign affiliates.

[9] In other words, GNP minus Government expenditures.

decade, particularly in countries where they currently are 20 per cent or less, for example, Japan and the Republic of Korea.

The first of the features of the global economy I then wish to highlight is the following:

- *An increasing proportion of economic activity is potentially footloose in its location; hence the owners of that activity are likely to be locationally more responsive than in the past to changes in the factors that influence their costs and revenues.*

Two questions now arise. First, how mobile is TNC activity really? Second, what influence do national Governments have in affecting the choice of TNCs in the siting of their value-added activities?

In answering both these questions, it is useful to consider two kinds of income-generating assets and capabilities and two kinds of costs. The two kinds of assets and capabilities are *natural* and *created*; the two kinds of costs are *production* and *transaction* costs.

Natural and created assets

I define natural assets as the fruits of the earth and the stock of untrained labour. All other assets are created from natural assets. They may be *tangible* (for example, the stock of physical and financial assets) or *intangible* (for example, technological know-how, trade marks, goodwill, the learning and inter-personal relationships forged by individuals, and the cultures and organizational structures of institutions).

In the early stages of a country's development, the ratio of its created-to-natural assets is likely to be small. This is especially so in the case of countries rich in raw materials, minerals or agricultural resources. However, even in these countries, the ability of firms to convert these resources into marketable products depends on their access to created assets, including a satisfactory legal and commercial system and an adequate infrastructure of transport and communication facilities. By contrast, the overwhelming proportion of the wealth of today's advanced economies consists of their stock of inherited human and physical assets and their capabilities to create new wealth from these assets. In a very real sense, economic growth consists of *creating* new income-generating assets, including the competence to organize these and existing assets productively.

There are, of course, some countries that still gain their wealth mainly from their natural resources. But a feature of the present generation of innovations is that materials that were previously (directly or indirectly) based on natural resources may themselves be created.[10] Thus, by controlling the behaviour of atoms and electrons in materials, scientists can tailor their basic structures and properties to suit their needs (Kodama, 1992). A further feature of these innovations is that they are tending to downsize or miniaturize both intermediate and final products, hence make value-added activities less locationally bound than once they were (McKenzie and Lee, 1991).

It is a characteristic of created assets that they tend to be more mobile across national boundaries than natural assets. This is partly because many of the former are intangible, and partly because, since they are the proprietary rights of firms, they are frequently more easily traded within firms between countries than between firms within countries.[11] Information, brainpower and organizational capacity are excellent examples of created intangible assets; but as human beings become better qualified and more affluent, and as real travel costs fall, the cross-border movement of people is also likely to increase. Once again, TNCs are one of the main vehicles making this asset more mobile, particularly within their own organizations and between advanced industrial countries.

The rising costs of upgrading natural and created assets — almost exclusively by way of technological innovation, but also fostered by economic growth, market-oriented government policies and regional integration — have, themselves, been a driving force towards globalization. The growing real costs of research and development, and the increasing need for the fusion of technologies to produce new products, processes or materials, have compelled firms to diversify their international portfolios. This they have done both by seeking new markets to generate the revenues to help finance their innovatory activities[12] and by striking up alliances with foreign firms to share the costs of these activities and/or to reap the benefits of technological synergy. The demands of modern technology are also changing the organizational channels among firms and the locational patterns of inno-

[10] Not quite human beings — but note, for example, sperm banks, replacement surgery, robots etc.

[11] Obvious examples include tourism and business travel; but in the past decade, there has also been a sharp rise in inter-country immigration, be this temporary or permanent. For an examination of the reasons for, and implications of the progressive trans-border mobility of the critical assets of firms, see an interesting study by McKenzie and Lee (1991).

[12] Which, themselves, are necessary as competition among firms is increasingly based on their ability to produce new or improved products, or to do so at lower cost.

vatory activities. More particularly, competitors, suppliers and industrial customers are forging much closer ongoing value-added relationships than they did in the past. Sometimes, these related activities need to be physically adjacent to each other in order to gain agglomerative supply or marketing economies.[13]

The second implication of the global economy is then:

- *The competitiveness of countries is becoming increasingly dependent upon their ability to create new assets; but in order to do so, firms domiciled in one country may need to extend their markets and their supply capabilities into other countries that offer the greatest commercial opportunities.*

This means, for example, that firms will wish to establish a presence in those countries that not only offer the largest or fastest growing markets (or better access to these markets — for example, an individual European Community country from which to service the Community as a whole), but that also offer the best assets and organizational structures from which they can generate new wealth.

Production and transaction costs

The second distinction I wish to make is between production and transaction costs.[14]

I define production costs as those costs that have to be incurred to supply a given quantity of goods or services *in the absence of any failure in intermediate product and factor markets*, that is, under perfect competition. The costs include those incurred by producing enterprises at all stages of the value chain, that is, they include those of research and development and marketing as well as the processing and fabrication of products. Essentially, they represent the opportunity costs of the resources used, that is, the price paid for the inputs multiplied by the number or units of each used to produce a given output. In a perfectly competitive market, firms are assumed to optimize both the combination of inputs needed to produce a given output, and the value-added generated from any given combination of inputs. In this situation, too, *private* transaction costs are assumed to be zero, that is, the market, as an organizational mechanism, is costless. In practice, however,

[13] As shown particularly by the spectacular growth of science parks — usually in a major university city — in recent years.

[14] As the argument proceeds, the reader will observe that I am defining transaction costs rather more broadly than is typically the case; see, for example, Williamson (1986).

even to create and sustain perfect markets, there are always some set-up and running costs that have to be borne by society. These include a legal framework designed to ensure that the rights and responsibilities of buyers and sellers are identified and protected, and an insurance industry, the function of which is to spread the risks of individual market transactions over a larger number of transactions.

Consider, now, a situation in which markets fail. I distinguish between two types of market failure, *viz.*, structural and endemic (or intrinsic) market failures. *Structural* market failure is brought about by the anti-competitive strategies of one or more of the participants in the market, or by Governments intervening in the market to pursue objectives (for example, political, social or cultural) which the market is unable or is not set up to achieve. *Endemic* market failure arises because the exogenous demand or supply conditions underlying a particular transaction are such that the market cannot perform with optimal efficiency — at least not in the Pareto sense. Both kinds of market failures raise the prices of the goods or services exchanged above the opportunity costs of the resources used, that is, *they result in positive transaction costs.*

Let me give one or two illustrations of both kinds of market failure. From the time of J. S. Bain's classic treatise (Bain, 1956), the literature has identified a large number of *structural market distortions.* However, the common feature of each and every distortion is that it confers some degree of non-competitive power on one (or one group) of participants in the market and results in a sub-optimal distribution of the economic rents between the participants. The *origin* of this power might be a reduced number of competitors, a privileged access to critical raw materials or the ability of firms to differentiate their goods or services from those of their rivals. The *outcome* of the power may take various forms, including charging buyers above-competitive prices, a reduction or greater variability in the quality of goods and services provided, a range of restrictive business practices, irregularities in the supply of, or demand for, inputs or increased negotiating costs over prices. Sometimes, these market deficiencies are revealed *directly* to the supplying firms in the form of higher input costs, and sometimes *indirectly* through increases in transaction costs associated with the acquisition or use of factor services and intermediate products.

Endemic transaction costs stem from (at least) six main kinds of market failure:

- First, wherever there is uncertainty (for example, uninsurable risks) associated with the supply of, or demand for, goods and services, a simple or single optimum solution for resource allocation can no longer exist. To reduce uncertainty, the participants in a market have to incur transaction costs which, in the case of firms, may affect both their revenues and costs. Such transaction costs include uncertainty over future prices or the quality of inputs, future demand conditions and the behaviour of competitors (or potential competitors), as well as Governments.
- Second, the proponents of a free market assume that the costs and benefits of particular transactions are incurred and received solely by the participants to the transaction. Yet, by itself, the market mechanism cannot easily embrace the consequences of a particular transaction for other economic entities, or for society at large, that is, market externalities. Where such costs or benefits do arise, it follows that non-market (for example, societal) costs and benefits of transactions may be different from those incurred or gained by participants to the exchange.
- Third, in perfect markets, it is presumed that each firm can supply its optimum (or least cost) level of output, while the elasticity of demand for the products it produces is still infinite. Such a situation makes implicit assumptions about the relationship between the firm's production capabilities and the size of the market for the output it is supplying. In practice, however, it is often the case (for example, in the auto, semiconductors and reinsurance industries) that the optimum size of output cannot be reached without a firm becoming sufficiently large to influence market prices.
- Fourth, and related to the third condition, in the case of some goods, the marginal cost of production is very low, or even zero, once the good is actually produced; but the start-up or fixed costs are extremely high. This suggests that, de facto, the good takes on the characteristics of a public good, such as an interstate highway or a national grid for electricity transmission.
- Fifth, perfect markets are assumed to adjust easily, and without cost, to changes in the conditions of demand or supply for the good or ser-

vice being produced. Again, in practice, there are many markets — notably the markets for the most sophisticated created assets or their output — in which rigidities or distortions of one kind or another prevent the unfettered operation of market forces and sometimes (where there are externalities) that of social efficiency as well.

- Sixth — and this is frequently neglected by the literature — the classical and neoclassical ideal of perfect competition assumes that both consumers and producers always behave rationally and consistently, and with their own self-interests in mind. But, as several scholars, notably Oliver Williamson (1992) have pointed out, the presence of bounded rationality and opportunistic behaviour suggests that the concept of the omniscient *homo-economicus* of rational choice theory needs to be treated with some caution. I agree; indeed I would go further to suggest that it is precisely in the global markets for created assets and/or their products, where behavioural assumptions of the *laissez-faire* economists are most questionable.

Trends in the significance of created assets and transaction costs

The relative significance of production and transaction costs to the total costs of value-added activity is likely to vary according both to the nature and geographical spread of that activity. Similarly, the balance between *structural* and *endemic* market failures is likely to be both activity- and location-specific. One might, for example, hypothesize that those products that require a high ratio of created to natural assets are most likely to exhibit a higher-than-average ratio of transaction-to-production costs and to be undertaken in conditions of endemic market failure. Thus, at the one extreme, (natural) resource-intensive products for which a (reasonably) competitive market exists (for example, eggs, paper tissues, woollen textiles, haircuts[15]) have low transaction-to-production-cost ratios; while at the other extreme, a microchip, optoelectronics technology, industrial robots, a new pharmaceutical product, higher educational services etc. are likely to have much higher transaction-to-production-cost ratios.

To some extent, too, the relative significance of the two kinds of costs is likely to be country-specific. The least developed countries, for example, are likely to incur relatively high transaction costs. This is because of their lack

[15] Even in the case of some of these products (especially agricultural products), instability of supply due to bad harvests or natural disasters may contain a substantial element of supply uncertainty.

of complementary or supportive assets to commercial value-added activity, for example, a good communications and transport infrastructure, an acceptable legal framework, an entrepreneurial business culture and a positive work ethic. Later, with these assets in place, but with the structure of production continuing to be one largely based on natural resources, and apart from an increase in the role of physical (but fairly standardized) capital equipment, the transaction-to-production-cost ratio of economic activity is likely to fall. It then rises again as an economy moves from a resource-based to an innovatory-based, to an information and high-value service-based economy;[16] there are suggestions that, in the most advanced economies (for example, Germany, Japan, the United States), the ratio is higher than it has ever been. However, these scenarios should be treated with some caution as, independently of a country's stage of development, there are many transaction costs that vary between countries. Compare, for example, the costs of doing business in Tunisia, with that in Jamaica, Thailand and Turkey, or in Singapore with that in Spain, Israel or Ireland — two groups of countries with broadly comparable GNPs per capita.

There is some suggestion that, as the global involvement of an industrialized economy increases, so will the ratio of its created-to-natural-resource assets and that of its transaction-to-production costs. This is best demonstrated by examining the composition of trade, FDI and cross-border cooperative arrangements — not just of a particular country, but of all countries. The increase in these ratios is most marked in the manufacturing and services industries already characterized by created asset and transaction-cost intensity.[17] These are also the industries that are generating the fastest growth of intra-industry and intra-firm trade, particularly between the advanced industrial countries. The third implication of the global economy is, then:

- *Globalization is leading to an increase in the relative significance of transaction to production costs of doing business; outside the primary product sector, this is likely to be associated with a rise in the significance of created to natural assets in the value-added process.*

At this point, it should, perhaps, be emphasized that I am not seeking to identify a particular *causal* relationship between the variables identified and globalization, but simply to establish that such an interaction does exist.

[16] Some examples of possible development paths or trajectories of countries are set out in Porter (1990) and Ozawa (1992).

[17] Notably the most advanced technology-intensive manufacturing industries and the information-intensive services industries.

However, if the association is as I have hypothesized, it may be reasonable to infer that countries that pay special attention to enhancing their created assets and lowering the costs of doing business are likely to be those in the vanguard of the globalization process, or in a favoured position to take advantage of it.

Governments and business: the changing interaction

Where and how do Governments enter the picture? Up to this point, I have argued that the growth of inherited assets and technological progress — the main ingredients of economic growth— are raising the created-to-natural-asset ratio of economic activity. Simultaneously, because of the endemic imperfections in the markets for created assets, the relative significance of transaction costs to production costs is increasing. I have further suggested that, because of the rising costs of creating new assets and the increasing competition for global markets (often the result of new entrants, for example, TNCs from Japan and the Republic of Korea), firms are being compelled to globalize their value-added chains, including the sourcing of their inputs and the sale of their final products. Moreover, they are doing so by a plurality — and an increasing plurality at that — of organizational modes.

I need to add one final piece to my conceptual jigsaw puzzle. It concerns the economic relations between the major actors in the global economy. Until the late nineteenth century, most international trade was between countries that had markedly *different* structures of resources and capabilities. Such trade conformed well to the classical and neoclassical principles of the comparative advantage of country-specific and location-bound natural assets. Though there was some competition between firms from different countries for the same markets, in the main, the products traded between countries were complementary with, rather than *substitutable* for, each other.

As income levels and the asset structures of the leading industrial nations converged (first the United States and much of Western Europe caught up with the United Kingdom, and then, since the Second World War, Japan has largely caught up with the United States, and overtaken much of Western Europe), and as the composition of economic activity has switched from one based on natural assets to one based on created assets,[18] two

[18] This is not to say that some natural assets (for example, oil and some metals) are not absolutely essential to the workings of a modern industrial economy; the activities of OPEC in the 1970s demonstrated how high the transaction costs associated with enhanced supplier bargaining power can be.

things have happened. The first is that the comparative trading advantage of many firms and countries has shifted from one based on the possession of natural assets to one based on created assets,[19] *including* such intangible assets as business culture, goodwill, attitudes to wealth creation and so on.[20] The second is that the main focus of competition in many kinds of trade — and especially that of created-asset-intensive trade — has changed from one between firms producing similar products in the same country to one between firms producing the same products in different countries. Thus, while General Motors and Ford fiercely compete with each other for global markets, their main rivals (certainly outside the United States market) are Toyota, Honda, Nissan, Volkswagen, Fiat, Renault and, increasingly, auto producers from developing countries. Similar examples could be given from such other internationally oriented industries as pharmaceuticals, rubber tires, oil, aircraft, investment banking and computer services.

The extent of global competition again varies between countries, industries and firms; furthermore, it is played out in the various organizational forms described earlier. Few enterprises are immune from it. While the large TNCs are at the centre of global economic competition, the ripple effects of their activities encompass even the smallest firms. Moreover, even corporations catering to local markets are under increasing competition from foreign producers, either in the form of imports or of FDI.

The fourth attribute of the global economy of the 1990s is then:

- *Globalization is leading to increasing competition between firms and industries — and hence between countries — in which these firms and industries are located, producing similar products.*

With this attribute in mind, and because the economic welfare of countries is ultimately the responsibility of the Governments of those countries, it may be argued that, in a very real sense, national administrations compete with each other to ensure that their macroeconomic and organizational strategies and policies are such as to provide their wealth creators with the maximum possible incentives to sustain and advance their competitiveness, *vis-à-vis* their foreign rivals.

However, before turning to consider some of the ways in which the global economy requires national Governments to re-evaluate their domestic

[19] As discussed by Lipsey (1991).

[20] I am not one of those scholars, such as Porter (1990), who believe that the principle of comparative advantage is less relevant today than in the nineteenth century. Rather, it is simply that the components of the location-bound assets of countries have changed.

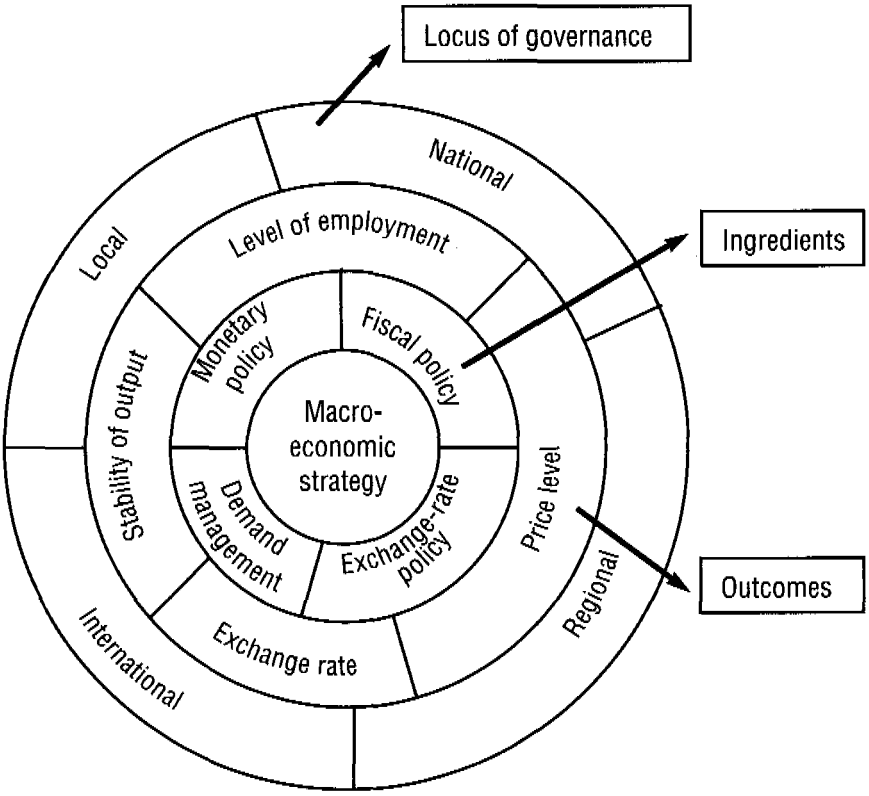
organizational policies, let me identify some of the instruments available to central or local administrations to affect the allocation and competitiveness of the assets within their jurisdictions and how, in spite of the contemporary trends towards the deregulation and liberalization of markets and towards regional economic integration, the role of national Governments is becoming more, rather than less, critical.

Figures 1 and 2 depict the two main arenas of governmental economic responsibility. The first — and one that is a generally acknowledged function of Government, even though there may be some disagreement about the content of the responsibility — is of macroeconomic governance. Ever since the era of Franklin D. Roosevelt, William Beveridge and John Maynard Keynes, Western Governments have assumed overall responsibility for maintaining (as nearly as possible) full employment with stable prices and balance-of-payments equilibrium. To these goals, another — a steady and sustainable rate of growth — was added in the 1950s. Governments have an array of measures by which they can influence the macroeconomic variables that will determine the success of their macroeconomic strategies. Some of these are set out in the figures.

Since the late 1960s, and increasingly so as the linkages between national economies have become more pronounced, some attempt has been made to coordinate national macroeconomic policies, and particularly those of the seven leading industrial nations,[21] which, between them, accounted for 61 per cent of the world's GNP (excluding the former USSR) in 1990 (World Bank, 1991). Though, in the last resort, Governments still look first after their national interests, while coordinated action has not always been successful, the recognition that the macroeconomic strategies of any one of the leading nations (and particularly those of Japan and the United States) may affect the welfare of the others—together with an acknowledgement that, in some instances, cooperation may be more welfare promoting than competition — is a noticeable step forward. It is an example of international or supranational action designed both to facilitate orderly monetary and exchange markets and to compensate or circumvent some endemic failures in those markets. Sometimes this is accomplished by reducing uncertainties (for example, over future exchange rates); sometimes by an exchange of information; sometimes by the avoidance of destructive beggar-thy-neighbour policies; and sometimes by a sharing of the burden of the adjustment costs caused by changes in regional or global markets.

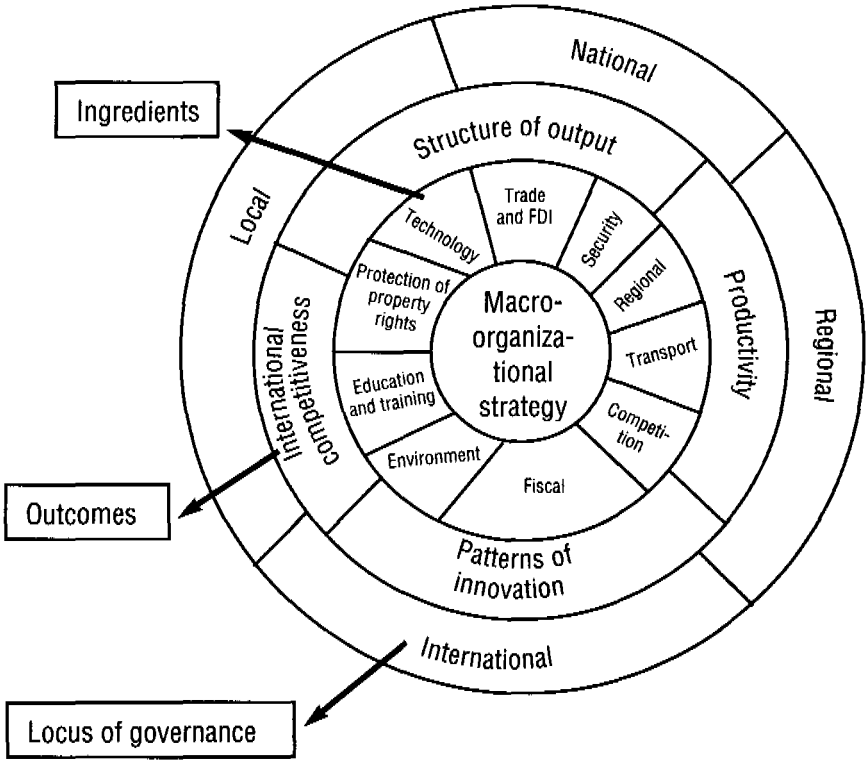
[21] Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

Figure 1. Realms of economic governance: macro-economic strategy



The second kind of governmental managerial responsibility is concerned with ensuring that the *structure* of economic activity (that is, the allocation of a country's scarce resources) is consistent with that of the wider objectives of economic policy. Some of the areas that are embraced by macro-organizational strategy, and some of the "outputs" of such a strategy, are set out in figure 2. Here, there is an often profound disagreement among economists and policy makers about the appropriate role for Governments. This disagreement has recently been articulated (or rearticulated) in both the United Kingdom and the United States national election campaigns, and ranges from a preference for a zero, or near-zero, government role by the right wing of the political spectrum to a fairly substantial degree of government intervention advocated by representatives of the left wing of the political spectrum.

Figure 2. Realms of economic governance: macro-organizational strategy



Yet, very rarely is this debate directed to the appropriate macro-organizational strategy a Government needs to adopt in the light of the globalization of economic activity. Rarely is the fact that Governments compete with each other to retain or attract mobile assets and to advance the competitiveness of these assets fully appreciated or recognized in domestic policy formation. Only exceptionally is it acknowledged that Governments can, in a host of ways, quite dramatically affect the costs of doing business. Seldom does the argument for government intervention focus either on the positive market-facilitating role of Governments, or on their participation in international forums to ensure that, as far as possible, their competitors abide by the same rules of international commerce, that is, play on a level playing-field. All too frequently — notwithstanding the frequent use of such terms as "partnership between Government and firms" — discussions on the role

of Government still centre on regulating the conduct of businesses, instead of ensuring that they are stimulated to upgrade their core competences, and are provided with the complementary assets necessary for these competences to be effectively utilized. Rarely do Governments adopt, or even recognize the need to adopt, *systemic* or *holistic* macro-organizational strategies.

In consequence, debates about the way in which Governments may advance industrial competitiveness tend to be both fragmentary and myopic. Instead of cooperating with each other to promote a number of common goals (for example, those identified in figure 2), ministers responsible for trade, technology, taxation, the environment, regional matters, energy, transport and communications and so on tend to compete for the scarce assets available to pursue their narrow departmental interests. While these claims for resources may be subject to intensive cost-benefit scrutiny — for example the building of a new road or increased expenditure on universities — they are seldom evaluated in terms of how they may affect the competitiveness of a country's created assets, *or* how any decision taken may impinge on similar programmes of the country's major competitors. *To this extent, Governments often fail to optimize the economies of common governance of their own macro-organizational strategies.* This is particularly likely to be so where there is no identifiable coordinating council or department for such strategies. Can one imagine any commercial enterprise organizing its value activities in this way, let alone a large firm with extensive international interests?

Even in a closed economy, the motivation and capability of firms to be competitive is influenced by the taxes Governments impose and the fiscal incentives Governments offer. The extent to which Governments allow firms to merge or to conclude alliances with each other may affect their ability to capture economies of scale or scope. The structure and quality of a firm's skilled labour force are critically dependent upon a Government's education and vocational training policies. The quantity and quality of a wide range of public goods, the production of which is either wholly or partly financed by Government, will affect the costs of doing business. Through their standards of procurement, Governments may also raise or lower the quality of goods produced, while their regional and urban policies might either aid or inhibit the agglomeration of related business activities. These examples could be multiplied a hundredfold.

Government influences on location-bound costs

If the market, by itself, could create the tangible and intangible assets necessary for the competitiveness of firms and countries, and if it could ensure that the commercial transactions related to these (or to complementary assets) were free of structural or endemic imperfections, then there would be no need for Governments to intervene. But our knowledge about the cost structure of firms and the factors influencing the locational decisions of firms strongly suggests that Governments, for better or worse, can and do play a decisive role in affecting asset creation and deployment.

They may, for example, affect the *revenues* of firms by tariffs, quotas, sales taxes, price or production controls, as well as their own procurement policies. They may affect the *costs* of firms by cash or in-kind payments for research and development, training grants, wage subsidies and the environmental regulations they enact. They may affect the level of corporate *profits* by a variety of fiscal measures and by their policies towards transfer-price administration. They may affect the *cost of engaging in capital investment* by the tariff concessions or tax exemptions they offer on imported or domestically produced equipment. They may affect the cost of obtaining capital by raising or lowering interest rates, loan guarantees, controls on remitted dividends, investment guarantee schemes and exemptions from capital-gains taxes. They may better motivate firms to innovate by upgrading cooperative research programmes and the funding of university research. They may stimulate *entrepreneurship* by helping to reduce start-up costs and by offering various support programmes to small businesses. By the work, savings and wealth-creating culture they encourage, they can and often do dramatically affect the desired ambience for raising productivity and competitiveness.

These are just a few of the factors identified by studies such as the *World Competitiveness Report*[22] as being among the critical variables affecting the competitiveness of firms in different countries and the determinants of industrial location. With the reduced significance of natural resources costs as a component of production costs and the rising significance of created assets — especially information, technological capability and skilled labour — the role of Governments is becoming more, rather than less, decisive.

[22] This is an annual report that presents a detailed examination of the factors influencing national competitiveness and compares the performance of 22 OECD countries and 14 other countries in the world; see World Economic Forum (1992).

In each of the above examples, it is not so much the *price* of the assets or intermediate products that is important, but the costs of market *failure* associated with their provision and usage — or what may be termed the "hassle costs of doing business". These include such unwelcome features as traffic delays, dock strikes, computer breakdowns, inadequate or unreliable cross-border telephone or facsimile services, the difficulty of conducting negotiations with clients or suppliers from different business or institutional cultures, the costs of governmental regulations and information-collecting exercises, protracted negotiations over wage settlements or changes in work routines and so on. Transaction costs such as these, directly or indirectly, are strongly influenced by the actions of national Governments, and may determine the locational choice of TNCs just as much as the more traditional variables, like the size and character of markets, the price of labour and raw materials, transport costs and net tax burdens. They also affect the competitiveness of domestic companies — in their ability both to export and to stave off the challenge from foreign imports.

Thus, the fifth implication of the kind of globalization now occurring is:

- *Governments, by their direct or indirect actions, are becoming a more, rather than less, important force in affecting the locational decisions of TNCs and the competitiveness of firms that produce only within national boundaries.*

The global economy and macro-organizational strategy

It is a fundamental tenet of this article that, while the reluctance of Governments to adopt a systemic macro-organizational policy in a *closed* or a *partially open* economy is regrettable, it may not be critical. However, in a global economy in which their foreign counterparts are adopting such strategies, be they market-facilitating or market-distorting, the unwillingness of any one national Government to adopt — and to be seen to adopt — decisive and vigorous competition-enhancing strategies is likely to prove much more serious. Indeed, it could be extremely damaging to the long-term productivity of its location-bound assets and the economic welfare of its constituents.

What, then, are the implications of the five features of a global marketplace previously identified, for the macro-organizational governance of domestic economic activities? Some of these, as they affect the particular areas of governance illustrated in figure 1, are set out in table 1. But over

Table 1. Some illustrations of differences in domestic economic policy according to whether or not a global economy exists

Policy	*Non-strategic/domestic*	*Strategic/global*
Trade	Primarily to support regional or international efforts to establish a level playing-field for trade in goods and services.	Seek to establish market-oriented common rules of the trading game for all participants. Seek, in consultation with wealth creators, to identify industries in which a country's dynamic revealed comparative advantage is increasing, and work to facilitate the creation of competitive and effective markets in those industries. Assist market to adjust to change whenever social net benefits are perceived to be in excess of private net benefits. Provide at least as good training and information services to small firms as are available to major competitors.
Technology	Depending on the broader economic goals of the country, to assist in the financing of competitive and basic research and development by, for example, cooperative research and development. Some recognition that social net benefits of innovatory activity may exceed private net benefits. Emphasis placed on cooperative research and development.	Consider measures other countries are using to boost or affect the direction of their innovatory capacity, and direct strategy to reducing or compensating for market failure in creating and sustaining technological capacity. Stress the need to maintain level playing-field with respect to technology exports and imports, and to minimize restrictions on membership of Government-supported research consortia to foreign companies. More emphasis given to diffusion of technology.

Fiscal and procurement policies	Entirely directed to meeting economic and social needs of the domestic economy. Depending on the goals of Government. Important emphasis may be given to social goals. De facto procurement policy is sometimes discriminatory against foreign-owned firms. Often directed to protecting weak national champions from international and domestic rivalry. Sometimes helps to provide secure home demand for domestic firms, and encourages economies of learning and scale.	Take account of fiscal policies of other countries and also of tax-incentive changes of the location of domestic and foreign-based activities. Consider long-term implications of the way tax policy might affect long-term competitiveness of domestic-domiciled business and future tax revenues. Fiscal policies of Governments may also affect structure, level and quality of demand by domestic consumers, thereby influencing the size and character of markets facing domestic producers and foreign-owned affiliates. Government procurement strategies might greatly influence international competitiveness of firms in key industries, for example, telecommunications, as well as that of their customers, and also the extent to which foreign affiliates are allowed to tender for government contracts. Here, it is important to establish level playing-fields with foreign Governments.

(Table 1. continued)

Policy	*Non-strategic/domestic*	*Strategic/global*
Competition	Anti-trust legislation is mainly geared towards protecting domestic consumers against unfair competition and unacceptable restrictive practices by enterprises.	Consider effect of cross-border acquisitions and mergers and alliances on long-term competitiveness of the companies involved, and also the likely spillover consequences on the rest of the industry. Recognize need to strike a balance between encouraging healthy rivalry and enterprise creation and accepting the need for collaboration between suppliers and buyers, which may help promote successful innovation. Take account of the strategies of other countries to such mergers and alliances. Evaluate the significance of concentration ratios, entry barriers and restrictive business practices from a global, rather than a national, perspective.
Environment	Very much related to domestic needs and priorities. Usually environmental policy has little to do with rest of macro-organizational strategy. Often the cost and quality implications for the competitiveness of firms are ignored or downplayed.	Explicitly evaluate effects of any environmentally related measures on international competitiveness of the firms affected. Attempt to make environment measures competitively enhancing. Consider policies of competitors. Encourage performance and safety standards that help improve quality, upgrade technology and provide superior product features. Strive for a minimum level of environmental standards and business standards; do not restrict firms if they wish to produce above minimum standards.

Education and training	*Education policy* Generally geared to culture and life-style rather than vocational needs of population. Usually policy independent of rest of macro-organizational policies. *Training policy* More related to needs of commerce and industry, but mainly directed to more areas where social net benefits or training are likely to exceed private net benefits.	Closely tie education policy with trade, technology and competition policies. Give utmost priority to upgrading human capital and supporting training programmes whenever anticipated net social benefits warrant it. Give more recognition to the fact that skilled and professional labour is becoming increasingly mobile across national boundaries. Seek to integrate better (global) commercial needs of education and training with those of helping to prepare citizens to live a richer and more fulfilling life. Strategic education policy also considers its outcome in terms of its effects on other countries in influencing the supply of human capital which, itself, is a key component of a country's future wealth-generating capacity.
Transport and communication	Some consideration is given to commercial needs and the standards provided by other nations, but rarely are such assets considered as critical in affecting the cross-border locational decisions of firms (as, for example, with intra-national locational decisions).	The quality and cost of the transport of goods, people, finance and information over space is one of the key transaction-related determinants of both the competitiveness of firms, and where they established their value facilities. Yet, the market for transport and communication facilities is highly imperfect. Many transport- and communication-related products are either public goods or involve very large externalities. Hence, Governments usually play a critical role in affecting their supply. The emphasis of strategic transport and communication policy is to ensure that domestic-domiciled firms are provided with as good a transport and communication infrastructure and network as their foreign competitors and that transport and communication investment policy is an integral part of a holistic strategy for competitiveness.

(Table 1. continued)

Policy	*Non-strategic/domestic*	*Strategic/global*
Foreign direct investment	Policy may vary from *laissez-faire* to considerable controls on inward and/or outward investment. Policy may be linked to overall economic goals, but rarely to other aspects of macro-organizational strategy — which, broadly speaking, are not thought either to affect or be affected by FDI.	Must be linked to broader macro-organizational policies. In particular, measures designed to affect the behaviour of foreign or domestic TNCs should be implemented only where that behaviour is different from that of non-TNCs. In general, entry restrictions or incentives and performance requirements of foreign firms should be kept to a minimum, although a strategic case for such measures may be made on non-economic grounds, or where other countries are pursuing unacceptable strategies which international negotiations cannot resolve. More generally, it is more important to acknowledge the role and significance of FDI as a commercial fact of life in the formulation of other macro-organizational strategies than to introduce specific FDI measures to promote macro-organizational goals.

Regional	For the most part, designed to affect locational decisions of domestic firms, and geared to the social and economic needs of the regions. In economies in which the participation of foreign affiliates is important, some attention might be paid to the specific reaction of these firms to regional policy. For the most part, however, the impact of such policies on the international competitiveness of firms is not a major strategic consideration.	Relatively few modifications to domestic policies, except that regional subsidies, grants and promotion schemes need to be either harmonized to or competitive with those practiced by competitor countries. Also research suggests that foreign-owned firms are more susceptible to regional taxes and incentives than are domestic firms. Regions, too, need to promote aggressively their locations in foreign countries. Central Governments may also wish to monitor and/or limit "beggar-thy-neighbour" intraregional incentive schemes. At the same time, they may wish to supplement actions of regional authorities to promote the locational clustering of certain kinds of economic activity.
Defence and security	Usually considered completely separately from the rest of the resource-allocative strategy, though it may be accepted that defence goals may directly compete with economic goals and that there may be some "spin-off" from defence related activity to innovation and productivity in the private sector. Very rarely, however, will there be any systematic cost-benefit analysis of these issues.	Involves role of foreign-owned firms and transfer of technology by domestic TNCs in strategically sensitive industries. But whatever policy is decided on non-economic grounds, economic consequences cannot be ignored as long-term economic strength may, itself, aid and abet a country's security. Again, it is vital to integrate defence and security policy with the rest of the macro-organizational policies and to monitor carefully the behaviour of competitors (or potential competitors) in this arena.

and above these micro-organizational strategies is the *need for Governments to evolve and sustain a well-articulated systemic organizational strategy, the specific intention of which is to promote consciously the long-term competitiveness of firms and resources within their jurisdictions by a series of interrelated market-supportive policies.*

To repeat: the question of whether or not, in a global economy, Governments should play a role in affecting the organization of the resources and capabilities within their jurisdictions is no longer an appropriate one to ask. The relevant questions are how much and what kind of government involvement there should be. Second, the kind of government action I am suggesting is very different from that which economists and policy makers have debated in the past, when the issues at stake were primarily domestic and social in character. Though the globalization of markets and production may increase rather than reduce competition, and uphold rather than weaken traditional market values, its primary consequence is to enhance the role of the organization of created assets as a key success factor and that of transaction costs in the value-added process. Since such hassle costs are frequently government-influenced, it follows that any measures taken by Governments to reduce them is likely to facilitate the functioning of markets, and be symbiotic with the goals of firms. In short, the kind of macro-organizational policies that Governments need to pursue in the 1990s are essentially complementary to, rather than substitutable with, the interests of firms and markets. Far from obliging producers of wealth to act against their own interests, Governments should help them to upgrade their economic performance and to behave as they would in the absence of market failure.

Third, I cannot emphasize too strongly that Governments should take a more strategic posture in their macro-organizational policies. Just as TNCs are developing new organizational structures to exploit the advantages of global markets and production to counter the measures of their foreign competitors, so, too, Governments need to re-examine their own cultures of governance to take account of the same phenomena.[23]

[23] In a recent book, Osborne and Gaebler (1992) point to the need to reform the way in which the (United States) Government machine is oriented and managed. This plea for Governments — at both a central and a local level — to be more entrepreneurial, catalytic, mission-driven, result-oriented, competitive, customer-driven and market-oriented is entirely consistent with my own views. Indeed, I would argue that the globalization of the world economy is one of the forces bringing about such change. I also recognize that, for Governments to implement any radical shift in their organizational strategies, there must be a strong pressure from the constituents that they represent. My own opinion is that this is, currently, an uphill task.

At the same time, a Government's strategy must also be extended to the regional and international arenas. In particular, administrations in favour of a global market economy must do their best to encourage other Governments to abide by the rules of the free market and, where market-distorting policies (for example, dumping, non-tariff barriers) are being pursued, to try to negotiate the elimination of these. This is where a mechanism similar to the efforts of the Group of 7 to coordinate macroeconomic policy so as to best meet the needs of global markets and minimize structural adjustment difficulties is needed.

Government responses to different kinds of market imperfections

One of the reasons for much of the controversy surrounding the role of Governments in a market economy is the inability of many policy makers to distinguish between two very different reasons why markets do not always work in the way in which textbooks say they should. Earlier, I identified the unique features of *structural* and *endemic* market failures. I believe that an understanding of these differences is critical, as the actions that Governments need to take to reduce, or counteract, the two kinds of failure are very different.

Table 2 sets out some of these reactions. The important point is that, to minimize structural market distortions, Governments (except when they, themselves, are the cause of the market failure) usually behave in a *reactive* way to the behaviour of participants in the market, and often against the (perceived) interests of at least some of these participants. By contrast, in cases of endemic market failure, Governments need to play a more *pro-active* role and form a partnership with the participants in the market to help make it work better for all concerned.

At the same time, and in both cases, it must be emphasized that there is a cost of government involvement, even when Governments are attempting to simulate market conditions. It is important to try to estimate these costs — which are described at some length in the literature[24] — as it is quite possible to construct a scenario when the costs of market failure are lower than the costs of eliminating or reducing that failure. The proposition of this article, however, is that the globalization of markets and production is more likely to increase the costs of endemic market dysfunction than those of

[24] See especially Wolf (1990).

Table 2. Types of market failure and some possible government responses to them

A. *Structural market distortions*

(Brought about by participants in the market or by inappropriate government intervention)

Types of distortion	*Possible government responses*
• Barriers to entry[a] legally restricted access to inputs or final goods markets, possession of proprietary rights (for example, patents, trade marks) by incumbent firms, restrictive entry requirements (for example, for some kinds of labour), scale economies, non-contestability of markets.	• Disallow exclusive ownership of essential inputs and/or exclusive dealings with customers; deregulate and/or encourage the contestability of markets, assist new (and small) firms to enter markets; revise patent laws to encourage more innovation.
• Oligopoly/monopoly control of output[a] leading, for example, to price hiking, "X" inefficiency, restrictive business practices, cartelization, higher transaction costs (through unreliability of delivery schedules), lack of pressure to innovate etc.	• Break up monopolies and outlaw restrictive business practices and cartels; in case of "natural" monopolies, enforce accountability and monitoring procedures over performance and/or introduce price controls.
• Excessive product differentiation or market fragmentation (leading to higher unit costs and/or cut-throat competition and lower product standards), excessive marketing (including advertising) expenditure.	• Sometimes legally imposed entry barriers may be desirable (for example, to protect quality standards and/or reduce *excessive* competition), but mainly government action should be directed to encouraging more *effective* competition, for example, by removing import barriers that may lead to a proliferation of foreign-owned production units (as in Canada).

• Interference with market mechanism by Governments [a] (for example, price controls, import quotas, output limitations, performance requirements, employment subsidies, inefficient imposition of health, safety and environmental regulations, immigration laws, discriminatory taxation etc.).	• Reduced government intervention to allow firms to perform more effectively and to encourage domestic competition.

B. *Endemic or intrinsic market failure*

(Brought about by the inability of unaided markets to minimize transaction costs)

Types of failure	***Possible government responses***
• Failure of markets to take account of costs and benefits of transactions that accrue to non-market participants. Results in social consequences of markets being different than "private" consequences. Especially noticeable in markets for knowledge and human capital, and often leads to under-investment in creation of new assets (Brooks, 1982).	• A variety of actions that may increase (or reduce) demand and/or supply as the need arises. As concerns research and development and the upgrading of human capital, action may vary from generic policies to improve educational standards and encourage basic research in universities (often in cooperation with local firms) and treatment of intellectual property rights to more specific fiscal, labour-market and innovation policies designed to promote more (or less) investment in asset creation. These may include the undertaking, or commissioning, of research and development and the dissemination of its results by the Government itself, especially in industries that tend to be made up of small producers that cannot economically perform these functions.

(Table 2. continued)

B. *Endemic or intrinsic market failure*

(Brought about by the inability of unaided markets to minimize transaction costs)

Types of failure	*Possible government responses*
• Failure of markets to deal adequately with risk and uncertainty. To a varying degree, uncertainty is inherent in most markets. Again, however, the social costs of risk may be greater than the private costs; Governments have a responsibility to reduce the private costs or increase the (expected) private benefits of risk-taking to equate the social and private net returns of uncertainty-bearing.	• Encourage private institutions to "socialize" uncertainty, for example, by facilitating insurance and futures markets and to protect buyers and sellers from some of the consequences of uninsurable risks (the breaking of commercial contracts). In cases of Government-related risks, to foster or help finance investment guarantees and/or insurance schemes, for example, as set up by several Governments to protect their overseas investors from adverse political actions of foreign Governments. To encourage capital markets to be entrepreneurial in the financing of risk-intensive projects, particularly by small firms; where necessary (preferably jointly with the private sector) to help provide a fund of risk capital. To lessen politically related uncertainty by injecting more stability in economic policies. Governments should also encourage a positive ethos to (judicious) risk-taking and not penalize rewards for successful risk-taking by excessive taxation. Finally, Governments may help reduce uncertainty by providing more information — again, especially to smaller firms, for example with respect to export markets, foreign investment regulations etc.

- Failure of markets to cope with the public-goods characteristics of some products; that is, those which involve very high "front-end" or "set-up" costs and low or zero marginal costs. Again, many public goods have characteristics of social intermediate or final goods. This uncertainty sometimes reflects a lack of knowledge or information and, in the case of public good, the difficulty of risk evaluation. Willingness to undertake risks also reflects the structure of rewards and the transaction costs of risk-taking. Often, too, the pay-back period of such production is very long (for example, for highways and airports).

- Allow consortia of companies; sometimes jointly financed by Governments, even though these result in a monopolistic or oligopolistic market structure. The greater the socially generic use of goods the more they should be funded by Government. Note, however, that the presence or absence and the quality of some public goods facilitates or hinders production by firms. Hence, governments have a responsibility to increase the supply of these goods, whereas the social rate of return justifies it.

- Failure of markets to ensure that all firms are price takers and, at the same time, to ensure that they produce at the optimum level or output. Technological imperatives may require a concentrated market structure and/or alliances between firms, either along or across value-added chains. In some cases, such alliances may be required to be cross-border.

- Some positive response in respect to competition and anti-trust policies. This kind of market failure requires Governments to encourage a delicate balance between too little and too much industrial concentration. A constant monitoring and redefining of the concept of workable competition, that is, that which promotes the market structure, which best combines static efficiency and the dynamic upgrading of resource usage and product quality.

- Insufficiency or inadequacy of institutional framework within which markets can operate efficiently. (A good example is the current situation in many Eastern European countries.) Lack of impetus or initiative of producers to innovate or to upgrade resources, and of consumers to demand sophisticated and fault-free products.

- Responsibility of Governments to set up an institutional and legal framework so that markets can efficiently perform their function. Such a framework is more complicated with technologically sophisticated and "generic" intermediate goods and services than with simple consumer products. Governments can also do much by legislation, persuasion and example to help set the appropriate entrepreneurial and work ethos and to upgrade consumption standards.

(Table 2. continued)

B. *Endemic or intrinsic market failure*

(Brought about by the inability of unaided markets to minimize transaction costs)

Types of failure	*Possible government responses*
• Failure of markets to adjust to changes demanded of them speedily and efficiently, due to extra-market structural rigidities.	• To promote, encourage and financially assist in retraining and relocation schemes. Encourage, by tax credits etc., firms to absorb redundant labour elsewhere in their organization by appropriately restructuring their portfolios of products and/or markets. Foster a positive attitude towards changes, while helping those who are adversely affected by change to help themselves.

[a] These practices are only structurally distorting if they result in a less than static or dynamic optimal market structure and/or allow the supplying firms to exploit their privileged position by earning economic rent or engaging in anti-competitive practices for their own gain.

domestic government action to eliminate or reduce it and that, because of this, the case for government involvement is strengthened as an economy becomes more global in its orientation.

Implementing strategic policies

The implementation of a systemic macro-organizational strategy by national Governments requires major changes in the way Governments are currently organized. Indeed, it could be that the difficulties of reorganizing the machinery of governance is one of the reasons why most administrations are so cautious and half-hearted to the idea of a holistic or top-down approach to resource allocation. Certainly, there are serious doubts (some of which are probably valid) that the leading Western nations could introduce a Japanese or Korean management style into their existing governance structures.

But, again, like firms, Governments should be prepared to restructure their internal administrative systems wherever it is in their best interests to do so. It is my opinion that the global economy is challenging even the most conservative of Governments to rethink the way they organize their own decision-making processes.

The ways in which this may, or should, be done cannot be explored fully in this article. Here I would simply make two points. The first is that I am *not* suggesting that the main response of Governments to the global economy should be to tax and spend more. It is certainly possible — indeed likely — that more of the resources and capabilities of national economies may need to be allocated to reducing the hassle costs of doing business. The question of *how* these resources and capabilities should be paid for is another question, although, whenever the resulting output takes the form of "public" goods, it is appropriate that the public should bear some of the cost.[25] But the impact of globalization on national governance systems is not *primarily* a financial one. Neither is it a question of the extent to which they should be directly responsible for spending more or less of their GDP.

What, then, is the issue? It is simply that the kind of systemic and strategic approach to the management of a country's assets advocated in this article requires a different culture and structure of internal governance than one that is oriented to achieving a variety of objectives, each of which is

[25] Here, there is a tremendous educational-cum-publicity job to be done by Governments in respect of the rationale for taxation in a modern competitive global economy. It is my perception that a completely new "culture" of taxation needs to be created by Governments.

assumed to be largely independent of the other. It also needs a different approach towards the management of the individual department or ministries, responsible for one or another of the ingredients of macro-organizational strategy identified in figure 2. The current practice of Western Governments is to treat each ministry as a competitor for the resources available to (or acquirable by) Governments, with the final decision of "who gets what" usually being taken at the Cabinet or equivalent level. In this respect, the locus of decision-making resembles the hierarchical structure of a firm in which the heads of different products or functional areas bid for resources to pursue their own objectives, the outcome of which is decided by the board of directors. Figure 3*a* illustrates this "hub-and-spoke" approach.

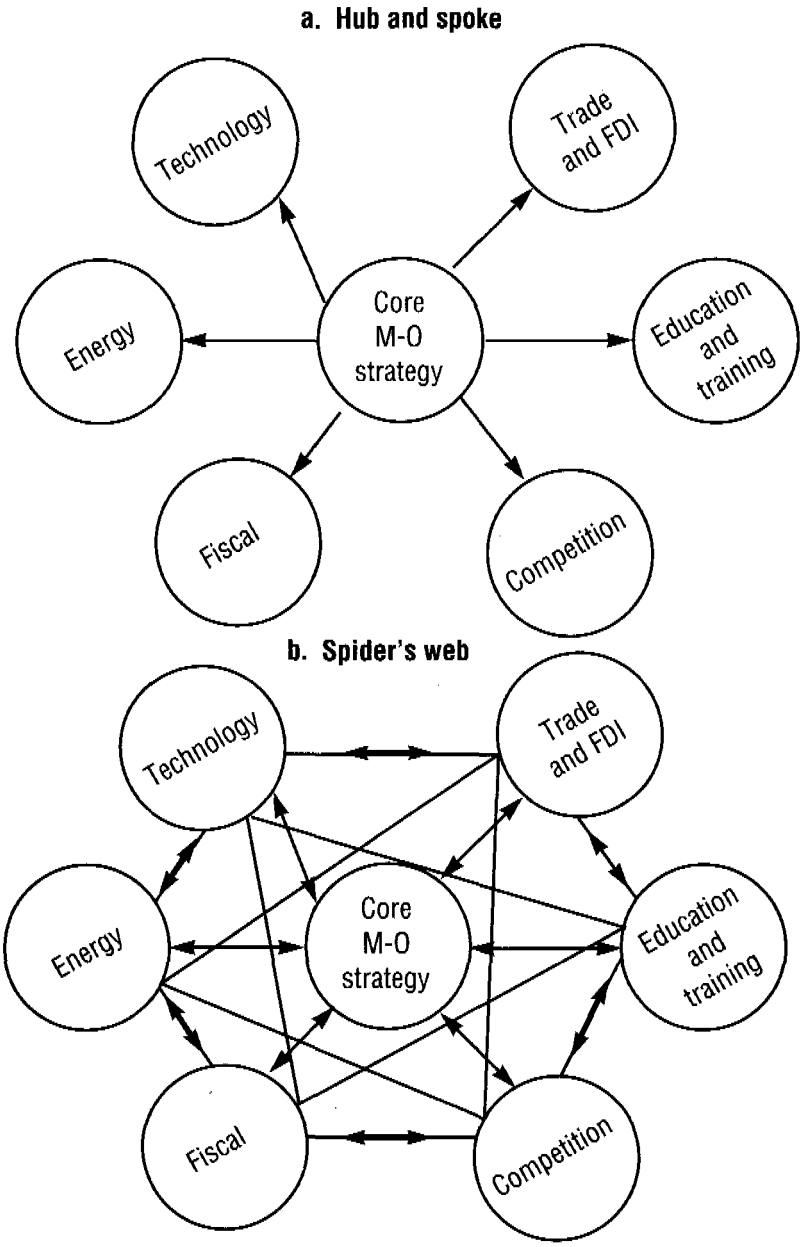
The "strategic systemic" approach suggests a network of relationships both between a central coordinating body responsible for the formation and outcome of macro-organizational strategy and individual areas responsible for advising on and implementing that strategy, and between these areas[26]. Figure 3*b* sets out this "spider's-web" approach to governance. This resembles much more a heterarchical system of decision-making, in which there is a complex web of lateral, as well as vertical, decision-making relationships. While each department continues to press for resources to meet its own particular objectives, the final allocation of resources is decided — in part at least — on the basis of the perceived effects on a Government's core macro-organizational strategy.[27]

The other aspect of macro-organizational policy that requires reappraisal is that of the relationships among Governments. If, as this article has suggested, Governments are increasingly being compelled to behave as strategic oligopolists —in the sense that the actions of any one Government may affect the welfare of corporations or citizens in other countries, and this will trigger off a reaction by their Governments — it follows that this may require a modification to their earlier strategies. These are of two kinds. The

[26] It is to be hoped that in the new administration in the United States this will be one of the tasks of the Council of Economic Advisers. In the United Kingdom, a recent report by the Economists Advisory Group (1993) recommends the establishment, at Cabinet level, of a *Council on Competitive Strategy*, the aim of which would be to initiate and coordinate a coherent strategy to sharpen Britain's competitive edge in world markets.

[27] To illustrate, the decision on whether to allocate resources to building a major new highway would not be taken solely on the basis of the direct costs and benefits involved, but also on how the competitiveness of the country's firms and location-bound resources would be affected. Similarly, any proposal to change the corporation tax should take account of the possible consequences of such tax changes on the locational decisions of its own and foreign TNCs.

Figure 3. Two kinds of intra-government administration[a]



[a] These diagrams are for illustrative purposes only and do not embrace all areas of government macro-organizational strategy.

first is a genuine strategy to promote competitiveness and reduce endemic market failure. The second is to try to reach an international accord for a level playing-field, and to penalize structural distortive policies taken by any one national Government (Bergsten and Graham, 1992). Both of these strategies may necessitate organizational changes in the way intra-governmental decisions are taken.

Conclusions

The emerging global economy of the 1990s is placing a variety of pressures on national Governments to reappraise both their domestic economic policies and the strategies they bring to the international negotiating table. This article has described some of the features of the contemporary global economy and has argued that, because it is essentially driven by market forces (which involve substantial transaction costs) and because there is a great deal of competition between countries for resources and markets, Governments are being required to adopt a more systemic and strategic approach to the way in which they organize their economies.

The conclusion of this article is that the competitiveness of a country rests both on the ability of its firms to organize and utilize its own assets efficiently and also on the ability of Governments to ensure that the markets in which firms compete are the least distorted. In order to achieve these objectives, Governments need to restructure their own internal systems of management so as to gain the maximum benefits from an integrated system of governance. ■

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