Part I

Environment for Government-Business Relations

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CHAPTER 1

Origins of Government and Business

GOVERNMENT HAS BEEN an influential factor in the American economy in every period of the nation's history. From the beginning the United States has had natural resources that other major nations lacked, a deep-rooted entrepreneurial tradition, and a large domestic market. These have given it an advantage over other industrializing nations. What has distinguished the United States from other nations, however, has been the ability of the American government to enact public policies that assisted economic growth and promoted industrial development.

The history of public policy in the United States is sometimes described as a chronicle of government responses to economic change.[1] Advocates of new manufacturing technologies, improvements in transportation, and innovations in communications all struggled against established interests defending the status quo. The results of contests between the old and the new not only altered the nation's economic practices but also transformed the country's social and political life.

A review of the nation's economic history sheds important light on the relationship between government and business today. An assessment of the activities of government in past eras helps us judge contemporary proposals for government action. An awareness of the changes that have occurred in business organization helps us appraise the corporate innovations taking place around the world today. An understanding of the evolution of American legal doctrine clarifies the legal choices now being made in the United States and other countries.

When we investigate historical occurrences, we must scrutinize past controversies carefully. Many terms and concepts used today have been around for centuries, but their meanings have changed substantially. Institutions as central to the economy as *government, business,* and *law* have been reformed from generation to generation, and an awareness of past changes in these institutions is needed to appreciate the significance of present-day events.

In this chapter, I examine the role of government, the nature of industrial organization, and developments in legal doctrine in three historical periods:

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colonial times to 1860, the Civil War to the Great Depression of the 1930s, and the depression to the year 2010.[2] Because each country industrializes in its own way, I also explore the process of industrialization in Great Britain, Germany, and Japan. By surveying critical features of past eras and other nations, we are better able to address the challenge of designing a constructive relationship between government and business for the years ahead.

Colonial Times to 1860: Legal Foundations of Business

After the American Revolution, the former colonies were faced with the task of creating an economy that could survive outside the British Empire. In establishing their political and economic institutions, the founders of the new nation drew upon two distinct intellectual traditions: the market-oriented tradition associated with Adam Smith, and the active government tradition advocated by Alexander Hamilton.

The Role of Government

It is one of history's great coincidences that the Declaration of Independence and Adam Smith's *Wealth of Nations* appeared in the same year, 1776. Smith believed that a government could never be knowledgeable enough or impartial enough to manage a country's economy successfully. Because the state lacked these qualities, Smith argued that nonintervention by the state in economic matters was generally the wisest policy. This analytic tradition emphasized the advantages of freely operating markets and praised the decentralized decisions that markets permitted. Smith's viewpoint, however, was not the dominant opinion of his age. He opposed the prevailing sentiment that government should direct a nation's economic life. When the colonial leaders debated the structure of government and the economy, they accepted Smith's advice, but they also drew guidance from the activist tradition of government associated with mercantilism.

Mercantilism was the economic theory that guided British policy toward colonial America.[3] According to mercantilism, wealth was conceived as a stockpile of treasure gathered from neighbors or colonies. Government, under this policy, should control all aspects of economic activity in order to increase the wealth, unity, and power of the state.

During the colonial era, British trade regulations were designed to benefit the home country. Britain limited manufacturing in the colonies, restricted the colonies to the role of producers of raw materials, and confined colonial trade to the vessels and ports of the British Empire. Until the 1750s, the colonies derived more benefits than burdens from the British mercantile system. They found British markets for their goods, received protection from the British navy for their shipping, and obtained British capital to develop their economies. The

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growth of the colonial economies and the increased rigor with which Britain enforced trade restrictions in the 1760s were factors that contributed to the outbreak of the American Revolution.

Two plans from the early decades of U.S. history underline the influence of mercantilist assumptions by advocating an expansive role for government in economic development. Alexander Hamilton's *Report on the Encouragement and Protection of Manufactures* in 1791 urged the national government to aid fledgling industries by providing economic assistance and tariff protection. A quarter-century later, Henry Clay and John Calhoun devised a plan, christened the "American System," that would boost economic development through a combination of tariff protection and federally funded public works projects. Although the national government did not fully embrace either plan, Congress enacted numerous tariffs to promote new industries, and most of the other proposals were implemented by state governments.[4]

It was common in these years for states and municipalities to own stock in private companies that operated turnpikes, bridges, and canals.[5] The city of Baltimore supplied the money to found the Baltimore & Ohio Railroad, and it then retained stock in the company. The state of Pennsylvania owned one-third of the capital of the Bank of Pennsylvania, and the Pennsylvania Railroad was literally the railroad of the state of Pennsylvania. Government ownership of private companies aroused opposition when firms lost money, and the practice was curtailed after the Panic of 1837, when states had to appropriate funds to pay off company debts.

States and localities in these years subsidized specific industries and regulated exports, product quality, weights and measures, and agricultural harvests.[6] These programs demonstrate that both the activist and the limited government traditions were common in the early decades of the American experience.

Business Organization

Most Americans in these years were in business for themselves—they were entrepreneurs rather than employees. The United States was still a rural society, and as late as 1850, 20 million of the 23 million Americans lived in rural areas. The great majority were farmers, and most owned the farms they worked. Those who manufactured goods did so by hand at home or in small shops.[7]

Although the economy grew substantially in preindustrial America, little change occurred in the nature of the firm. Most enterprises were single-unit businesses managed by their owners and employing fewer than fifty people.[8] Before 1840, much of the stimulus for development came from Atlantic trade and favored East Coast cities. After 1840, the growth of the American market and lower per-unit production costs encouraged capitalists to turn from international

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trade to the domestic market. The American West benefited from this trend, and population in the new states soared.[9]

Legal Doctrine

Legal developments in this era probably had a more enduring impact on relations between government and industry than developments in the political or economic sphere. American law emphasized individual liberties and limited government action, and it provided more support for business expansion than legal systems in other countries. Befitting a new nation, the American legal system possessed an innovative spirit and a vitality that was unmatched in other lands.[10]

Three specific legal developments made essential contributions to economic development: the definition of property rights, the emergence of corporations as business entities, and government enforcement of the terms of contracts.

Economic growth requires stable commercial relationships, but the American Revolution, like most wars, had loosened the bonds of society. During the 1780s, political disorder, fears of social disintegration, and growing concern over the security of property were common in American states.[11]

Such concerns led states to adopt new constitutions that safeguarded the value of the currency, guaranteed payment of the public debt, and protected private property. These actions also contributed ideas to the drafting of the U.S. Constitution and the Bill of Rights. The Fifth Amendment to the Constitution stated, "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation." These guarantees reduced the risks of enterprise and encouraged entrepreneurs to undertake projects that furthered economic development.

Today, discussions of property rights might be construed as defenses of privilege and attacks on democracy. In the eighteenth century, property was viewed differently. Whereas property rights today are often seen to limit political and social rights, property rights in the eighteenth century were the foundation of political rights. In that era, the notion of property was associated with the workplace. Property provided sustenance, and people's livelihood would be threatened if government seized their property. When the possession of property became a right that government could not revoke, people were able to enjoy political freedom and promote the country's development.[12]

The second legal innovation in this era was the emergence of the corporation as a form of business organization. A corporation is a legal entity that can own property, transact business, sue others, and be sued itself. During the colonial and early national periods, corporations operated under special charters granted by state legislatures. Corporate charters were granted to organizations providing public benefits in such areas as charity, religion, or education.[13]

As the economy evolved, private firms began to sell goods and services that improved people's lives. Even though the owners sought to make a profit, their

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firms received corporate charters because their products offered "public benefits," such as banking services, textiles, or glass. Until the Civil War, corporate charters listed a firm's activities and identified the benefits it was supposed to provide to the public.[14]

In this period, the corporation was a more popular form of economic organization in the United States than in other countries.[15] Some historians argue that the popularity of the corporate form resulted from its "democratic" rather than its economic character. Indeed, corporate status extended economic and legal stability to all citizens, not just the few who received special favors from government. The democratic nature of the corporate form was confirmed by the enactment of general incorporation laws in the middle of the nineteenth century that normalized the incorporation process.[16]

The third major legal innovation was government enforcement of contractual obligations. Stability in economic relationships was the goal of several clauses in the U.S. Constitution. Article I, section 10, stipulated, "No state shall . . . pass any . . . law impairing the obligation of contracts."

Chief Justice John Marshall became a vigorous champion of the obligations of contracts.[17] He insisted that state governments as well as private individuals must comply with contractual provisions. *Dartmouth College v. Woodward* nominally involved control of the records and seal of the college.[18] Dartmouth was founded under a colonial charter from King George III in 1769. In 1816, a dissident group seeking to take over the assets of the college persuaded the New Hampshire legislature to enlarge the board of trustees and give it control. The New Hampshire Supreme Court approved the acts of the legislature, but John Marshall wrote for the U.S. Supreme Court that a charter was a contract and the provisions of a contract could not be altered by a state legislature. This decision reinforced the sanctity of a contract and protected corporations from legislative interference.

Whereas this ruling stressed the obligations to fulfill a contract, the decision in *Charles River Bridge v. Warren Bridge* in 1837 held that community welfare could not be ignored in assessing the meaning of a contract.[19] A corporation chartered to build and operate a toll bridge sought to invalidate a subsequent Massachusetts law that authorized the construction of a rival bridge. Even though the new legislation was said to violate the older contract, the U.S. Supreme Court upheld the law and ruled that no legislative charter could confer powers that harmed the public welfare. In this decision, the Supreme Court insisted that contracts must be interpreted and private economic activity conducted within the standards of community interest.

Legal doctrines from this era provided the foundation for the country's development. Some commentators emphasize the political dimensions of these principles, and others stress their economic motivations. In fact, such sharp distinctions were less visible in the eighteenth century than they are today.

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Property rights found special favor in the Constitution, but the nature of property in the eighteenth century made this almost a populist action. Corporations were permitted to become significant business entities, but corporations originally had public service obligations. Courts defended the integrity of contractual relationships, but such decisions also compelled government to honor the terms of its own agreements. In each of these instances, democratic values shaped the legal doctrines that became the foundation of relations between government and business.

As an economic document, the Constitution provided the basic framework for commercial activity. In addition to protecting property and providing a basis for enforcing contracts, it authorized the national government to impose taxes, establish a currency, borrow money, regulate commerce, and protect intellectual property, all provisions that contributed to the nation's economic success. At the same time, however, the Constitution left unresolved issues of slavery, race, gender, and the status of Indians, all topics that would do substantial harm in the decades ahead.

The Rise of Modern Industry: 1860–1929

Between the Civil War and the stock market crash of 1929, the United States experienced an industrial revolution. The country was transformed from a sparsely populated agricultural society into the leading industrial and manufacturing power in the world. The Jeffersonian image of an agrarian, individualistic America receded, and an America characterized by the factory system, the closing of the frontier, robber barons, big cities, and labor conflict emerged to take its place.

Business Organization

Industrialization occurred in the United States fifty years later than in Great Britain but about fifty years before it took place in Japan.[20] The pace of economic growth had accelerated in the Civil War years because of improvements in transportation, the availability of energy sources, and increased productivity in agriculture. More important than simple growth, however, were changes that occurred in the structure of the economy.

These decades witnessed a revolution in production technologies and the development of the factory system.[21] Power-driven machinery, continuous processing, and the interchangeability of parts became the order of the day, and the American economy became noted for its high-volume and low-cost production.[22] U.S. firms at this time benefited from the large American domestic market whereas trade barriers made it difficult for firms from other nations to sell their goods internationally.[23] The new techniques of mass production reduced the role of the solitary craftsman. By 1900, 60 percent of the country's workers

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were employed in industry, and the typical worker now faced the dependency and regimentation characteristic of a "labor force."[24]

The size of individual businesses also increased dramatically during this era. The Civil War had given the country a model of large-scale military organization, and the country's economic institutions soon adopted comparable organizational forms.[25] Instead of a few dozen employees, companies would employ first hundreds, then thousands, and then tens of thousands of workers. The United States, in fact, was the first nation to have its economy dominated by large firms, and their size allowed U.S. manufacturers to become more efficient than their international competitors. Close relations between large firms and major universities also provided business rapid access to new and emerging technologies.

American railroads became the nation's first big businesses.[26] They were, for a time, the largest economic organizations in the world. In the late 1880s, when no manufacturer had more than 2,000 employees, the Pennsylvania Railroad employed 50,000 workers. By the time the federal government came to employ 50,000 civilian workers, some individual railroad companies already had more than 100,000 employees. Railroads also faced the era's most demanding management problems: unprecedented size, enormous capital requirements, and the technical and political problems of route planning and land acquisition.[27]

The factory system and the industrial revolution permitted sharp increases in productivity and extraordinary declines in wholesale prices. Between the end of the Civil War and 1890, one index of wholesale prices declined by more than 50 percent.[28] To reduce operating costs, many American firms assembled inside their own organization various stages of production, from gathering and transporting raw materials, through product design and mass production, to mass marketing. "Vertical integration," as it was called, increased efficiency by increasing predictability in production, reducing profits of other firms, and permitting economies of scale—the reduction in per-unit production costs that usually accompanies increases in the number of units manufactured.

Technological innovations in this era soon resulted in more production capacity than was needed. Agreements among firms to limit production, set prices, and divide markets appeared immediately after the Civil War, but these agreements were soon outlawed by Congress. About 1880, restrictive arrangements began to be replaced by "trusts," in which companies surrendered the stock of their firms to trustees, who operated them for their mutual benefit. The Standard Oil Company was the nation's first important trust. It was broken up by the Ohio Supreme Court in 1892 but then reorganized under New Jersey law. When consolidated companies proved to be even more profitable than trusts, a wave of horizontal mergers—mergers among firms making the same product—followed in such industries as steel, copper, rubber, and tobacco. As a consequence of these horizontal mergers, individual companies at the end of the

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nineteenth century controlled a larger share of the market in a wider range of industries than at any other time in the nation's history.[29]

The spectacular growth in the size of American companies led to the emergence of professional managers who succeeded the entrepreneurial "captains of industry" who had founded major firms.[30] Corporations developed central managements with departments for finance, transportation, marketing, personnel, research and development, accounting, planning, and, later, advertising. The United States, in fact, pioneered university-based management education, with the first program endowed in 1883, and this too helped American firms pull ahead of competitors from other nations.[31]

In this period, fundamental changes occurred in the structure and performance of the American economy. The turbulence of the era also challenged the traditional role of government in American society.

The Role of Government

Government in the post–Civil War decades played a focused version of the promotional role it had adopted previously. In addition to imposing tariffs to protect domestic industries, Congress encouraged the development of railroads by providing massive land grants to support new construction. By the end of the century, it had given 131 million acres of land to assist private rail promoters, and the state governments had granted an additional 49 million acres.[32] The national government also appropriated public lands to promote scientific agriculture by supporting the establishment of land-grant colleges and agricultural experiment stations in each state.

In this era, government began to devise public policy responses to the new corporate economy. The replacement of the series of regional economies by a continent-wide economy sparked fierce resentment of corporate behemoths. The transformation of workers from independent entrepreneurs into salaried employees led to rancorous and sometimes violent labor-management disputes over wages, working conditions, and job security. Building a national market also resulted in the destruction of numerous local markets and the collapse of small businesses that had served these markets. The bitterness of the owners and employees of these businesses and the hostility of farmers combined to ignite a prairie revolt against corporations. The growth of national companies also alienated local elites, who lost status in their communities to the giant firms and who later provided leadership for campaigns against business. Opinion leaders came to fear not only the power of government but also the enormous economic power of private groups, and an extraordinary range of interests in virtually every sector of the economy turned to government for protection from the new corporate giants.

Meat packaging, in the years before the Civil War, had been a regional industry with local producers and local butchers serving local markets.[33] After

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the Civil War, Swift, Armour, and other firms established national distribution and marketing systems that threatened the positions of local producers. The National Butchers' Protective Association, dominated by local producers, advocated regional boycotts to keep meat from distant suppliers out of local markets. The association persuaded states such as Minnesota and Colorado to enact laws prohibiting the sale of meat unless the animals had been inspected by the state's officials, a requirement that effectively prevented national firms from selling products across state boundaries. Antitrust laws and statutes prohibiting price-fixing and restraint of trade were passed to address the general threat posed by giant corporations. Later, both state and national governments adopted legal standards for corporate conduct in sensitive areas such as working conditions, transportation services, and banking transactions.

Most government efforts to respond to the industrial revolution in this era were more significant as symbols than as accomplishments. Despite popular rhetoric, it was often difficult to know where the public interest in specific situations, such as the meatpacking one, stopped and where private efforts to use government authority to limit competition and secure commercial advantage began.[34] As a result of the lack of consensus, landmark pieces of legislation, such as the Interstate Commerce Act of 1887 and the Sherman Antitrust Act of 1890, resembled declarations of traditional values rather than clear statements of legislative goals. The full significance of the legislative initiatives in the era would not be realized until the nation faced the challenges of the New Deal.

Legal Doctrine

The economic transformation of the United States raised numerous legal questions.[35] Legal doctrines developed for an agrarian society were ill suited to the problems caused by huge concentrations of industrial wealth. The issues that generated the most controversy were the role of government in regulating economic activity and the level of government responsible for regulation.

Until the end of the nineteenth century, states were the centers of regulatory activity. As one source notes, "Quite literally, state legislation was the only regulatory game in town."[36] The emergence of a national economy, however, undermined the effectiveness of state regulation. When the Fourteenth Amendment was adopted, its clauses prohibiting states from restricting the "privileges or immunities" of U.S. citizens and denying them due process of law seemed to limit state authority to regulate economic activity. When courts ruled on the Fourteenth Amendment, however, judges first upheld state regulation of economic activity and only later sustained the validity of national action.

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The first major test of the Fourteenth Amendment came in the *Slaughterhouse Cases* in 1873.[37] The Republican-controlled legislature of Louisiana required as a health measure that all meat be slaughtered by a firm operated by its political friends. Other butchers sued, arguing that the legislature had abridged their "privileges and immunities" and reduced the value of their property without due process of law. The U.S. Supreme Court, however, upheld the Louisiana law and ruled that the Fourteenth Amendment clauses still allowed states to regulate economic activity.

By the end of the century, the federal judiciary began to acknowledge the dynamics of a national economy and to emphasize the significance of national rights. In 1886 the justices struck down an Illinois law that regulated railroads inside Illinois borders on the grounds that intrastate regulation could affect interstate commerce, and interstate commerce could be regulated only by Congress.[38] In 1890 the U.S. Supreme Court overturned a Minnesota law and ruled that a federal court rather than a state commission should be the final judge of the reasonableness of railroad rates.[39]

Basic changes in the structure of commerce and industry had reduced the ability of the states to regulate the country's economy, but the popularity of the laissez-faire philosophy among judges delayed the emergence of a national alternative to state regulation. Eventually the federal and state judiciaries bowed to popular preferences and accepted the social legislation designed to square legal precedent with the new economic conditions. During the period between the Civil War and 1929, the legal foundations were laid for the expansive role that the national government would assume during the New Deal.

The Emergence of Positive Government: 1929–2010

The stock market crash of 1929 symbolized the beginning of the Great Depression of the 1930s. Once under way, the decline rippled out into the economy in ever-widening circles until the country's market system had collapsed and national income had fallen by almost 60 percent.

Economic historians do not agree on the reasons for the depression. They mention excessive borrowing and speculation, the decline of international trade, a drop in the profitability of agriculture, inadequate investment, and damaging public policies. Regardless of the original causes, however, the economic crisis deepened, and its scope became nationwide. Care of the hungry and the unemployed exhausted the resources of states and localities and forced them to turn to Washington for assistance. By the time the depression abated, the federal government had assumed broad new responsibilities, and the political system had been altered permanently. Before the emergence of positive government was possible, however, the changes in legal doctrine that had begun in previous decades had to be completed.

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Legal Doctrine

The economic emergency brought into stark focus the historic issue of the role of government in regulating the economy. Old legal doctrines had been giving way to new realities, but massive economic deprivation tested the country's patience with the slow pace of constitutional change. New Deal initiatives provoked legal confrontation.

The National Industrial Recovery Act of 1933 (NIRA) was the centerpiece of early New Deal policies.[40] It authorized the drafting of "codes" for each industry that would control the supply of goods, fix prices and wages, and regulate working conditions. The Agricultural Adjustment Act of the same year was even bolder. It sought to establish parity between industry and agriculture by raising prices for farm goods and reducing the burden of agricultural debt. It also gave government power to restrict production by limiting the acreage available for cultivation. After the slashing of wages by employers and the growth in joblessness during the 1930s aroused labor militancy, the National Labor Relations Act of 1935 threw the weight of the federal government behind union-organizing battles and outlawed antiunion practices.

The early New Deal initiatives came under surprisingly bitter attack. The constitutionality of the NIRA was challenged in *Schechter Poultry Corp. v. United States.*[41] The Schechter brothers were poultry wholesalers who openly violated the NIRA's Live Poultry Code to boost their profits. When prosecuted for selling "unfit" chickens at cut-rate prices, they argued that the NIRA statute was itself unconstitutional. The Supreme Court agreed. The justices ruled that Congress had exceeded its powers by regulating matters that were the responsibility of the states. The next year, the Supreme Court invalidated the Agricultural Adjustment Act as well. In *United States v. Butler,* the justices wrote that the act constituted "a statutory plan to regulate and control agricultural production" and held that such efforts were beyond the scope of federal authority.[42]

In other cases, state and federal judges provided more mixed reactions to New Deal initiatives.[43] Some measures were sustained, and others were found wanting. Conservative judges objected to New Deal restrictions and sometimes convinced moderate colleagues that the statutes were vague and without proper constitutional foundation. The conservatives failed, however, to identify legal principles that would permit government to act to alleviate the economic crisis.

The election landslide of 1936 confirmed the popularity of the New Deal and placed traditional judges in conflict with majority sentiment in both Congress and the executive branch. Threatened with plans to alter the composition and jurisdiction of the Supreme Court, conservative justices retreated from their earlier opposition to New Deal measures and gave their blessing to new initiatives. A 1937 decision illustrates the shift.

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In *National Labor Relations Board v. Jones and Laughlin Steel Corporation,* business groups had argued that the federal government had no power to regulate factory working conditions.[44] The Supreme Court majority, however, abandoned its earlier view and ruled that the Commerce Clause did grant Congress the authority to regulate industrial relations. "When industries organize themselves on a national scale," the court wrote, " . . . how can it be maintained that their industrial relations constitute a forbidden field into which Congress may not enter?"[45] By the time prosperity returned, almost all constitutional restraints on the federal government's power to regulate the nation's economy had been discarded.

The Role of Government

Big government in the United States is mostly a product of the twentieth century.[46] At the beginning of that century, citizens could go about their lives unaware of national government decisions; today, almost every problem is a reason for government action. The ideal of limited government has been swept aside, and positive government engulfs us, despite occasional proposals to cut back some areas of government authority.

The federal government now affects every facet of corporate operations. The ways firms assemble capital are defined by federal statute, and production decisions are made with regard to public environmental and energy policies. Marketing practices, accounting rules, employee relations policies, equal opportunity procedures, and occupational health and safety standards are all within the realm of government policy.

The emergence of positive government in the twentieth century is a widely appreciated development, but the reasons for the growth of government remain controversial. An examination of federal employment and spending since 1929 reveals some reasons for the growth of government.

In 1929, the total civilian workforce of the federal government was 580,000.[47] More than half that number, more than 300,000 people, worked for the post office, and another 100,000 were civilian employees of the Defense Department. This means that in 1929 only 180,000 workers provided all the other national services a country of 120 million people required. During the 1930s, the count of federal civilian workers grew from 580,000 to more than 950,000, and by the end of the 1940s it had reached 2.1 million. In the next two decades, the pace of growth slowed, but by the 1970s the number of employees had climbed to 3 million. In the 1990s direct federal employment registered small declines.

In 1929 total federal, state, and local government spending equaled $10 billion, or 10 percent of the gross domestic product (GDP, the value of all goods and services produced by the nation in a specified period, usually a year), as Table 1-1 indicates. During the next decade, government spending as a share of

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Table 1-1 Government Expenditures and Employment, 1929–2008

Calendar year	*Total government expenditures*[a]	*Federal government expenditures*[a]	*Federal civilian employment*
1929	10	3	580,000
1939	19	10	950,000
1949	23	16	2,100,000
1959	27	18	2,400,000
1969	30	19	3,100,000
1979	31	21	2,900,000
1989	32	22	3,100,000
1999	34	19	2,800,000
2008	39	25	2, 800,000

Sources: U.S. Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism,* December 1987; and U.S. Department of Commerce, *Statistical Abstract of the United States: 2011* (Washington, D.C.: U.S. Government Printing Office, 2010).

[a] As a percentage of gross domestic product.

GDP almost doubled, reaching 19 percent in 1939. Federal government expenditures increased substantially during the 1940s, and total government spending has continued to grow at a moderate pace in the decades since 1949, reaching 39 percent of GDP in 2008.

The great growth in federal employment and spending that occurred in the 1930s and 1940s coincided with the two major government crises of the twentieth century, the depression of the 1930s and World War II. The severity of the economic crisis of the 1930s led to the national programs to restructure industry, agriculture, and labor-management relations mentioned above and to emergency measures to support the unemployed and the destitute. Subsequently, permanent measures were enacted to provide Social Security pensions, unemployment compensation, and assistance for the needy and the disabled, and these programs became the foundation of the national government's expansive welfare policies.

During the depression years, the British economist John Maynard Keynes argued in *The General Theory of Employment, Interest, and Money*[48] that declines in a nation's economy could result from insufficient demand for goods and services. To achieve higher levels of economic growth, Keynes advocated public action to stimulate economic demand by increasing government spending beyond revenues, thus incurring government deficits. New Deal policies are widely associated with Keynesian economics, even though some scholars point out that the administration of Franklin D. Roosevelt tolerated extraordinary levels of unemployment and resisted budget deficits until the eve of World War II. Regardless of the historical accuracy of the association of Keynesian

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economics with New Deal policies, the New Deal era did mark popular acceptance of the view that fluctuations in the economic cycle could be managed by government policy. This view represented another expansion of the role of the national government in society.

The huge military expenditures required to fight World War II finally ended the economic depression of the 1930s. The fiscal stimulus from military spending secured the economic recovery that had eluded President Roosevelt during the 1930s, and it practically wiped out unemployment. The concentration of federal employment and expenditure growth during the 1930s and 1940s demonstrates that national emergencies can lead to an expansion of government that persists after the crises have passed, but the record also indicates that other factors have contributed to the expansion in the role of government as well.

The emergence of a modern, urban-industrial economy generates problems that only positive government can address.[49] The growth of private firms has led government to become more active in regulating business practices, supervising competition, and protecting society from corporate action. The importance of this role is seen in the founding even before the New Deal of the Interstate Commerce Commission, the Federal Trade Commission, the Federal Reserve System, and the Justice Department's Antitrust Division. An urban, industrial society also implies pollution and congestion. The Environmental Protection Agency, natural resource programs, and public transportation agencies are bureaucratic responses to these factors.

Government has also grown in recent decades because it provides citizens an array of popular social services. Education, health care, Social Security, and housing have all become major public responsibilities. Some programs distribute social benefits to all citizens, and others redistribute income and benefits from one group to another.

Finally, the growth of government has been stimulated by pressures from politicians and bureaucrats. Government is composed of officials and institutions that have their own interests and ideologies. Government responses to national crises, to modernization, or to social service demands are usually bureaucratic responses. The programs enacted to address such needs sometimes take on a life of their own. They may survive because they serve the interests of officeholders rather than the goals of the broader society. In any case, once enacted, the programs of one era influence both the subsequent development of a nation's institutions and the policy choices that are available to succeeding generations.

The national government grew dramatically in the twentieth century, but its authority over private activities and institutions may have grown more rapidly than its payrolls or expenditures. As government responded to events, it shaped a new public philosophy that supports positive government. It is no longer conceivable that government could return to its pre–New Deal or even

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its pre–World War II scale. Positive government embodies the values and aspirations of a large majority of the American people. It is the distinctive accomplishment of the post-depression years, and it will be a critical factor in relations between government and business in the future.

Business Organization

Multinational operations, product diversification, and professional management characterized large American corporations at the dawn of the twenty-first century, and the service sector has now replaced manufacturing as the principal engine of economic growth. New technologies have revolutionized the way companies operate and made flexibility the country's greatest economic asset. Large firms, however, are only part of the U.S. economy.[50] Companies with fewer than 500 employees provided jobs for slightly more than half of all workers, and companies with more than 500 workers provided jobs for the rest. Small firms are less profitable than larger firms, but they provide 75 percent of new jobs and about half of all industrial innovations. Small businesses employ the greatest number of workers in the retail sector, whereas major companies employ the largest share of workers in manufacturing.

In the 1980s, the U.S. economy faced heightened competition in the global marketplace, and it responded with a structural renewal based on innovations in information technology, communications, synthetic materials, biotechnology, and computer systems. Production techniques were modernized, research and development practices reformed, and new skills were demanded from managers and other employees. After the economy emerged from recession in 1991, the chairman of the Federal Reserve Board, Alan Greenspan, told Congress that the U.S. economy had become a "different animal."[51] In the mid- and late 1990s, the economy offered the most encouraging inflation outlook in a generation, recorded the greatest surge in productivity in twenty years, and experienced the fastest growth in GDP since the boom during the administration of Ronald Reagan. In the first years of the new century, the economy experienced a mild recession as job creation weakened, business investment stagnated, government finances deteriorated, tax cuts were enacted, and spending increased for national defense and homeland security.[52] At the same time, however, historic crises were already taking shape on Wall Street and in housing finance, government spending, employment, and international trade.

Paths to Industrial Development

Each country has its own history of industrial development. Industrialization in the United States embodied its values and ideology, rested on its political framework, and reflected the specific features of its raw materials, capital, labor, and markets, and the same is true for other major countries. Industrial nations,

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however, also have much in common. A comparison of industrial development in the United States with the process of development in Great Britain, Germany, and Japan identifies events in other nations that were critical in shaping their institutions and policies, and it also highlights important aspects of U.S. history that might otherwise go unrecognized.

Great Britain was the world's first industrial nation.[53] Its industrialization was advanced by the country's political unity, a unified currency, and the absence of internal tariffs. At the end of the eighteenth century, agricultural productivity was increasing sharply in Great Britain, new types of machinery had emerged in the textile industry, water power and steam had replaced animals and humans as the dominant sources of energy, and government had begun to intervene less in the economy than during the heyday of mercantilism. Industrial development was financed largely by individual capitalists, their families and friends, and country banks rather than by government subsidies. In 1859, a prominent author wrote that Great Britain's economic progress depended less on national industrial policy than on the personal qualities of individual entrepreneurs.[54]

Great Britain industrialized before the nation's internal transportation system was completed, so firms served regional and foreign markets instead of a single homogeneous national market. Foreign trade accounted for 30 percent of British national income between 1860 and 1913, compared with only 5 percent in the United States.[55] "Invisible exports" such as capital, insurance, and shipping, however, were more important than manufactured goods. London was the world's financial center in the nineteenth century, but World War I destroyed its commanding position in international commerce. Small and medium-size firms dominated the British economy until World War I, but such firms lacked the resources to dominate steel, chemicals, and other heavy industries. Family control has remained such a significant feature of corporate leadership in Great Britain that one prominent historian describes the British economic system as an example of "personal capitalism."[56]

Industrialization in Germany roughly coincided with industrialization in the United States.[57] Until 1871, German identity rested on a common language rather than on the existence of a unified German state. Before Napoleon conquered central Europe at the beginning of the nineteenth century, hundreds of separate fiefdoms and principalities existed in what would become Germany. One of these states was Prussia, which modernized its administrative, economic, educational, and military systems to improve its prospects in the struggle against Napoleonic rule.[58] With Napoleon's defeat, Prussia emerged as a great European power at the Congress of Vienna in 1815. After Prussian armies defeated Austria in 1866 and France in 1870, Prussia persuaded the other German states to join it in a new German empire.

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Germany's prominence in world markets resulted from its political unification in 1871, but its industrialization had roots in events that had occurred earlier in the century. Railroad development was more important in German industrialization than it had been in Great Britain or the United States. Local rail networks were built early in the nineteenth century, and these networks were then linked together to provide a national rail system that could serve national markets. The need to pool capital to finance large rail projects stimulated the development of the German banking industry, and vast demand for railway equipment provided enormous assistance to the emerging coal, iron, and machinery industries.

At the beginning of the twentieth century, Germany established itself as a world leader in such classic industries as coal mining, steel production, chemicals, electrical products, and machine tools. The German economy was distinguished by its strong export orientation and its unusual commitment to employee skills. Although founding families remained influential in German companies, managers with technical skills occupied key posts in corporate hierarchies. German companies pioneered the development of corporate research laboratories and emphasized the technical training of production workers.

Germany's system of "cooperative capitalism" involved labor union representation in corporate management and public policy formation, and it also encouraged collaboration among corporations within an industry. Cartels—business organizations that can divide markets, regulate production, and set prices for member firms—were a major feature of German industry from unification in 1871 until World War II because they could prevent member firms from sacrificing the long-term interests of the industry and the economy for short-term profits. Whereas the British and American economies became more service oriented, manufacturing industries have remained the core of the German economy. Industrialization has been a critical stage in the development of most economies, but India has leapfrogged the industrial era by moving from agriculture to high technology (see Box 1-1).

Industrial development occurred later in Japan than in Great Britain, Germany, or the United States, but once under way it took place quite rapidly.[59] In 1868, the existing Japanese government was overthrown by a coalition of regional nobles who believed that the nation had become too technologically and militarily weak to resist Western demands. A reform government was established under a member of the imperial family in an event known as the Meiji Restoration, and, after securing its position, the new government launched a modernization program with the slogan, "Rich nation, strong army."[60] The national government restructured the military, legal, and educational systems; ended feudal restrictions on domestic travel and the choice of occupations; and sought to learn as much as possible from Western administrative and technological practices.

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Cases in Development

BOX 1-1 A Snapshot of the Indian Economy

A recent snapshot of the Indian economy presents an unusual puzzle. India is among the world's leaders in such modern industries as information technology, pharmaceutical production, and space research, yet it is also among the world's poorer nations. Almost two-thirds of India's workers are employed in agriculture, but agriculture accounts for less than 25 percent of the country's GDP. Almost 20 percent of workers are engaged in industries that produce textiles, chemicals, cement, and similar goods, but industrial products also contribute only about 25 percent of GDP. Accompanying the dismal state of Indian agriculture and the country's mediocre manufacturing record, however, is a service sector that has recently emerged as a dynamic participant in the global economy. With only 20 percent of the nation's workforce, the service sector produces more than half of India's GDP. How has an agricultural economy leapfrogged the industrial era to become a leader in twenty-first century industries?

India was part of the British Empire from 1858 until it achieved independence in 1947. British colonial rulers allowed British groups to manage the country's development and restricted the activities of Indian entrepreneurs. When India became independent, its new government favored policies that allowed the state to ration capital among firms, subsidize specific products, and protect favored industries. The lack of competition among firms led to inefficient operations, poor product quality, and much government ownership of industry. At the start of the 1990s, a new Indian government abandoned the interventionist philosophy of its predecessors and allowed corporations to guide more of their own affairs. Some industries were opened to foreign investment, the production of consumer goods increased, and the country's well-educated workers were able to take jobs in rapidly growing international industries, such as telecommunications, banking, and information technology. The government faces the challenge of accommodating the country's traditional economy with its more recent successes.

Sources: Edward Luce, "Cure for India's Rural Woes Lies in Ability to Escape the Farm," Financial Times, December 7, 2004, 5; "Stichwort: Indien—die grösste Demokratie der Welt," Financial Times Deutschland, www.ftd.de, December 14, 2004; "Country Briefings: India Economic Structure," Economist, July 10, 2002, www.economist.com/countries/India, ID•1223675; U.S. Central Intelligence Agency, The World Factbook: India, www.cia.gov/cia/publications/factbook, updated December 16, 2004; and Ananya Mukherjee Reed, Perspectives on the Indian Corporate Economy: Exploring the Paradox of Profits (New York: Palgrave, 2001).

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Modern Japanese business began to emerge in the 1880s.[61] *Zaibatsu*—groups of companies owned by families that had been a part of Japan's traditional economy—evolved from trading companies of earlier centuries that were active in such areas as shipping, banking, and mining. With the encouragement of the Japanese government, the *zaibatsu* enlarged the scope of their activities and diversified into heavy industry. The government also promoted the textile industry by building model factories and selling equipment to new firms at low prices. Relationships among companies remain such an important feature of the Japanese economy that the country's business system is sometimes designated "alliance capitalism."

Japanese industry was strengthened by military spending for wars against China in 1894 and Russia in 1905, and it benefited substantially from the nation's position as a British ally during World War I. During that war, Japan seized German colonies in China and the North Pacific; its international trade doubled; the significance of industrial goods such as chemicals, dyestuffs, and machinery surged; and the *zaibatsu* continued to gain importance. With the growth of large firms, the Japanese economy acquired a dual structure: although large firms achieved high productivity and offered better working conditions, 58 percent of industrial workers in 1930 were employed by firms with four or fewer employees.[62] The government role in the economy increased in the 1930s, and there was great growth in the steel, shipbuilding, machine-tool, and automotive industries as military spending increased in anticipation of World War II.

The nations examined here did not follow a single path to industrial development, and their governments did not embrace a single form of capitalism. The legal foundation for the U.S. democratic and commercial systems was established in the first era of the nation's history, large business organizations were created in the second era, and positive government appeared in the third era. The processes of industrialization in Great Britain, Germany, and Japan followed quite different paths of development. In Japan and Germany, in fact, the sequence of development was essentially reversed: large government bureaucracies became important before industrialization, and democratic institutions were not secured until after major business organizations were already in place.

The different sequences of national development have had enduring effects on the characteristics of the institutions and practices in the four countries. Business organizations were created in Germany and Japan after government agencies were already major societal institutions, and the new business firms depended on government for financial support and public acceptance. Corporations were created in the United States when the national government had only limited impact on the economy. Thus, it is not surprising that commentators in Germany and Japan stress the cooperation between business organizations and government whereas U.S. specialists find that relationships between businesses and public officials are characterized by suspicion and mistrust. As seen in the

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chapters ahead, the consequences of the alternative paths of institutional development are still evident in countless commercial practices and policy arrangements in the countries we have examined.

Summary

The features of government, business, and law have changed dramatically during the successive eras of American history. Table 1-2 presents an overview of these changes. Legal doctrines developed in the country's first decades provided the foundation for its democratic and business systems. The period from the Civil War to the New Deal witnessed the emergence of a modern, industrial economy and also the turmoil associated with the disruption of traditional markets and institutions. In the years since the stock market crash of 1929, the national government has grown from a minimal institution into a major force affecting all facets of American life.

From the beginning, American history has been testimony to the continuing importance of two economic traditions, the market-oriented tradition associated with the analyses of Adam Smith and the tradition of government activism embodied in the policy proposals of Alexander Hamilton. Both intellectual traditions have persisted throughout the nation's history, although they have had different levels of importance in different eras. In the first decades of the Republic, government guided the general economy, promoted the welfare of critical industries, and involved itself in private economic decision making. The activist tradition was more restrained during the era of industrialization in the second

Table 1-2 Overview of Developments in Law, Business, and Government

Period	*Legal doctrine*	*Business organization*	*Role of government*
Colonial Times to Civil War	Property rights, contracts, and corporations	Agrarian economy, trading, and small firms	Creation of political framework, promotion of economy
Civil War to Great Depression	Transition from rural to industrial society	Emergence of industrial economy with large corporations	Promotion of selected industries, expansion of government regulation
Great Depression to 2010	Acceptance of regulation and activist government	Multinational firms, diversification, and information technologies	Growth of government role in sustaining welfare and economy

Source: Author.

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half of the nineteenth century and the beginning of the twentieth century, when market-oriented policies dominated center stage. In the New Deal years and during World War II, the role of government expanded dramatically, to be followed in the 1980s and 1990s by renewed debate about the appropriate responsibilities of government, private institutions, and individual citizens. Throughout the nation's history, policymakers have drawn upon both the activist and the market-oriented traditions to create the mix of policies that have guided the country's economy to significant prosperity.

The place of business in a system of popular government and the role of government in the management of a successful economy are complex topics. The challenge of fashioning a constructive accord between government and business for the future requires us to supplement the historical investigation summarized here with contemporary perspectives on associations between democracy and markets.

Further Readings

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Questions

1. How does the market-oriented tradition associated with Adam Smith differ from the active government tradition advocated by Alexander Hamilton?
2. What three legal doctrines had an important impact on economic activity during the first period of U.S. national development? Explain their impact.
3. What factors explain the growth of positive government in the United States in the third period of development?
4. What were the distinctive features of the industrialization process in Great Britain?
5. Compare the process of industrialization in Germany with the process of industrialization in the United States.
6. What is the significance of the different sequences of political and economic development in the four countries examined here?

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Notes

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8. Alfred D. Chandler Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass.: Harvard University Press, Belknap Press, 1977), 14.
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31. Blackford, *Rise of Modern Business,* 57; Cochran, *200 Years of American Business,* 56, 158; Galambos and Pratt, *Rise of the Corporate Commonwealth,* 80–91; and Robertson, *America's Business,* 126.
32. Blackford, *Rise of Modern Business,* 191.
33. Bruchey, *Wealth of the Nation,* 122–23.
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CHAPTER 5

Globalization of Business Activity

THE WORLD BANK reported that global economic growth made 2004 the most prosperous year in human history.[1] Although the United States did rather well, it was the developing nations that led the economic parade with a growth rate of better than 6 percent. All the world's developing regions expanded their economies in the half-decade ending in 2004, but "spectacular" reductions in poverty appeared in East and South Asia. Even setting aside the dynamic economies of China, India, and Russia, the rest of the developing world still recorded a growth rate in 2004 of almost 5 percent. The reason for this good fortune, some commentators insist, was the increased globalization of the world's economy.[2] The developing nations that embraced international trade, foreign investment, and an increased presence of multinational firms recorded greater declines in poverty than did countries that vetoed pro-globalization policies.

At the time the World Bank report was released, however, a top American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) official delivered a strikingly different assessment of the impact of globalization.[3] From the AFL-CIO perspective, globalization was spreading joblessness throughout the world and increasing disparities in income. Globalization had created a world in which the rich became richer and working families everywhere suffered reduced living standards. Increased transnational economic activity restricted health insurance, lowered wage levels, cut pension benefits, and limited investments in good jobs. Globalization has fashioned "a new world order in which employers roam the world in search of cheaper and cheaper labor, pitting workers against workers in a relentless race to the bottom."

These contradictory interpretations of globalization result in part from the basket of diverse images associated with the term *globalization.* When the members of the World Trade Organization gathered in Seattle in 1999 to set the group's agenda, they were met by 40,000 protesters who linked the emerging global economy to just about every concern then unpopular. For groups unhappy with immigration policies, genetically modified food, American movies, the defects of democracy, lax environmental standards, or human rights abuses in

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China, the global economy was the culprit. Even though the internationalization of business has brought considerable prosperity to numerous nations, influential groups in many countries regard globalization as a "trap" and consider it to be the source of their own domestic problems.[4] In this chapter, I investigate what globalization actually is and consider why it has become a prominent symbol in contemporary politics.

Today's global economy is driven by the actions of multinational corporations (MNCs).[5] Explored here are the emergence of multinational enterprises, their strategies in the industrialized world, and their impact on the countries where they are headquartered and where they are active. The United States was a significant player in the world economy throughout the twentieth century, and it remains an influential force in the early years of the new century. Although U.S. producers have long been active in global markets, international firms now affect economic conditions within the United States as well. A British company has bought Holiday Inns, Japanese firms acquired Firestone and CBS Records, and German corporations took over the A&P, Chrysler, and a major cell phone operator. Each country's economic institutions define its style of capitalism and determine how its firms fit into the emerging global framework. The chapter concludes with an assessment of national styles of capitalism and their relationship to globalization.

The Emergence of the Global Marketplace

In his best-selling book *The Lexus and the Olive Tree*, Thomas Friedman, a columnist for the *New York Times*, contends that globalization now "shapes virtually everyone's domestic politics and international relations."[6] Friedman associates globalization with an impressive array of important world events, but he fails to define what globalization actually is. Friedman and other analysts find little value in forcing the multiple facets of globalization into a single framework, but without clarity the concept becomes difficult to apply.[7] Globalization originated as an economic concept involving the behavior of firms, and I use it in that sense here.[8] Globalization is an increase in cross-border commercial activity. Globalization, therefore, involves the establishment of cross-border production systems, distribution networks, financial markets, and product development centers. Globalization was made possible by both technological advances and international agreements. Enhanced technology has increased the mobility of people, goods, and capital across national borders, and it has created communications networks that permit people everywhere to share messages instantaneously.[9] As individual corporations rationalize their use of resources globally, they increase their productivity and improve their position in the marketplace. When some firms benefit from new conditions, competitive pressures prompt other corporations to follow suit.

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The post–World War II regime of economic renewal was framed in a series of treaties negotiated in Bretton Woods, New Hampshire, in July 1944, and these agreements championed increased international economic activity as the best means to promote economic welfare.[10] Since many nations lacked the resources to revive their economies after wartime destruction, the Bretton Woods treaties created the World Bank to provide long-term loans for reconstruction and development. Fluctuating rates of exchange among currencies were a common barrier to international trade because firms could not be certain how much they would receive from the sale of their products. To limit this risk, the Bretton Woods treaties created the International Monetary Fund to stabilize exchange rates among currencies. The Bretton Woods negotiations also led to an executive agreement establishing the General Agreement on Tariffs and Trade (GATT), whose signatories pledged to reduce international tariffs and comply with a code of fair trade practices.

The current global era is characterized by an increased volume of cross-border economic activity, but this is not the first time the world has experienced a surge in international activity.[11] In the period from 1870 to 1913, the volume of trade, the amount of capital, and the number of workers crossing national borders rivaled, relative to the size of the world economy, what we see today. The devastation of World War I and the turmoil of the Great Depression of the 1930s brought this era of globalization to an end.

The current era of globalization, however, does not simply reprise past levels of cross-border activity. The new globalization differs from the older version in that it reflects a deeper level of economic integration. This is seen in the changing nature of international trade. International commerce traditionally involved the sale of commodities and the exchange of finished goods that were manufactured in one country and sold in another. An increasing share of international trade today involves the exchange of intermediate goods, often between divisions within the same company. IBM, for example, may ship disk drives from Taiwan to France, where they are combined with components from other locations to yield finished products. This change in the nature of trade reflects the emergence of multinational production systems and more interdependent operations.

The modern financial landscape also differs from the earlier era.[12] During the previous era of globalization, only a limited number of countries, led by Great Britain, invested in foreign countries, and these funds were concentrated in long-term investments in public infrastructure projects in developing countries. Today numerous countries make international loans, and these loans are concentrated in industrial rather than emerging nations. Contemporary investment activity normally occurs in knowledge-intensive industries through joint ventures, alliances, and franchise arrangements. In addition, international

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finance has witnessed a tremendous increase in the flow of capital into short-term bonds, commercial paper, equities, and derivatives and an extraordinary surge in currency transactions.

The older era of globalization rested largely on improvements in transportation, whereas the current era is based on enhanced communication services.[13] Advances in information technologies permit the transmission of vast amounts of data, text, pictures, and speech faster, farther, and more cheaply than most people could have imagined. From this perspective, the new globalization encompasses both an increased volume of cross-border economic activity and a qualitative change in the nature of that activity. National economies today are more profoundly affected by international economic activity than they were during the older era of globalization, and international economic decisions now affect countries' internal practices more directly than in the past.

Contemporary discussions of globalization also involve issues that reach beyond corporate operations, but the relationship between globalization and these issues is more problematic. The United States has certainly lost manufacturing jobs in recent years as globalization has become more pronounced, but it is a mistake to presume that all events in a global age are the product of globalization. In recent decades, the world, not just the United States, has experienced a formidable increase in manufacturing productivity.[14] The world's production of manufactured goods increased by 30 percent between 1995 and 2002, but world employment in manufacturing fell by 11 percent. As the United States developed a postindustrial economy, fewer workers were needed to produce far more goods. One source reports, for example, that U.S. steel production increased in one decade from 75 to 102 million tons (in 2004), but the number of workers employed in the steel industry actually fell from 289,000 to 74,000 during that time.[15] Even if a ten-foot wall had been built around the United States after World War II, the proportion of workers employed in manufacturing would still have declined in past decades and would still be declining today. This does not mean that outsourcing and international fabrication of products for the U.S. market does not occur. Of course they do. But it does mean that globalization is only one of the developments now occurring in the world economy.

Globalization is understood in some quarters to be a political rather than an economic project.[16] Some observers who believe that limited government will promote economic growth and individual freedom champion globalization as a technique for advancing these goals.[17] For them, globalization implies the self-regulation of markets and the deregulation of national economies. The activities of governments in the global marketplace, however, contradict the image of free and neutral exchanges among autonomous economic actors.

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Global markets are the product of political decisions intended to promote national advantage, and they have become forums that witness national subsidies for aircraft firms such as Airbus Industries, the manipulation of trade laws to benefit steel manufacturers, the invocation of antitrust laws to protect software enterprises, adjustments in the value of currencies to advance nationalistic policies, and so much more. Although globalization may have limited the utility of some tools governments use to implement their policies, there is little evidence that the withering away of the state will be the result of global trends. As Paul N. Doremus and his colleagues point out, "states charter MNCs and shape the operating environment in which they flourish. States retain the political authority to steer their activities."[18]

Globalization is thought by still other analysts to increase the leverage of major corporations in the political arena. This view is difficult to assess, as Graham K. Wilson indicates, because major corporations are usually perceived as politically influential actors in every arena and we lack an accepted metric for differentiating their power in specific circumstances.[19] Companies are said to gain political power because globalization has made it easier for them to shift facilities and employment to another country if a government enacts policies that increase their costs.[20] We do know that employment costs are only one factor in a firm's location decisions, and it is likely to be decisive only when the gap between high and low wage levels remains substantial over a considerable period of time. Sizable variations in income levels among American states have persisted for more than a century, and large numbers of employers still maintain their facilities in high-cost regions where governments are often unfriendly.[21]

Diverse factors shape globalization, but neither the extent nor the nature of globalization is inevitable. The period from 1870 to 1913 indicates that seemingly irreversible global trends can be halted and even rolled back.[22] Furthermore, globalization is not entirely global. Some industries and some countries are more "global" than others. The pharmaceutical, computer, and semiconductor industries are truly international, but resource- and labor-intensive sectors are still largely national. The dominant share of international economic activity is also concentrated in the three dozen countries of the Organisation for Economic Co-operation and Development (OECD), and many nations stand at the border of the global economy looking in. Even countries deeply involved in the global economy, however, maintain their distinct national identities. In most years, the United States is the world's largest exporting nation, but exports still account for only about 11 percent of the U.S. gross domestic product. As Paul R. Krugman insists, a nation's prosperity depends more on its performance in the domestic marketplace than in the global economy.[23] South Korea's efforts to deal with the challenges of globalization are examined in Box 5-1.

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Cases in Development

BOX 5-1 SOUTH KOREAN RESPONSES TO GLOBALIZATION

By the mid-1990s, South Korea had created a strong economy. Its state-led development policy had reduced unemployment to 2 percent, increased per-capita income from $200 per year in 1960 to $10,000 per year, created the world's most efficient steel industry, and made the country the world's largest producer of DRAM microchips. The South Korean government believed that globalization was shifting manufacturing away from the mass production of standardized goods based on energy- and labor-intensive processes toward more flexible manufacturing based on capital- and knowledge-intensive procedures, and the country needed to adapt. The administration sought to bring the country's labor practices up to international standards so as to confirm South Korea's emergence as an advanced nation and prepare for its entry into the World Trade Organization and the Organisation for Economic Co-operation and Development. The Korean president proposed to reduce government intervention in the economy and reorganize the agencies that administered economic policy.

Little progress had been made on these proposals when South Korea was hit by the Asian financial crisis of 1997–1998. When it reached Korea, the economic panic highlighted problems that had previously been acknowledged but remained unaddressed. The decades of economic growth had increased income inequality and concentrated economic power in the hands of a few large Korean conglomerates. The conglomerates were unable to repay their loans, companies of all sizes went bankrupt, banks were unable to deal with the pile of bad loans, and fearful international lenders demanded that South Korea pay them what was owed. The country's currency lost its value, and the government turned for assistance to the International Monetary Fund (IMF). South Korea marked its recovery in 1999-2000 with a 9 percent increase in GDP and an annual increase in GDP of 4-5 percent between 2003 and 2007. Reflecting the global economic downturn that began in South Korea in 2008, the country's GDP fell to 0.2 percent in 2009 but then rose 6 percent in 2010. South Korea's reform agenda would address an aging population, an inflexible labor market, and excessive reliance on manufacturing for exporting. South Korean scholars debate whether globalization constituted a threat to South Korea's economy or whether it was an opportunity to carry out necessary policies.

Sources: Based on Young Whan Kihl, *Transforming Korean Politics: Democracy, Reform, and Culture* (Armonk, N.Y.: M. E. Sharpe, 2005), chap. 5; Charles Harvie and Hyun-Hoon Lee, *Korea's Economic Miracle: Fading or Reviving?* (New York: Palgrave Macmillan, 2005), chap. 4, and *CIA Factbook*, www.cia.gov/publications/factbook.

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Multinational Corporations in the Global Economy

Of the 100 largest economic organizations in the world, half are national governments and half are multinational corporations. For decades, MNCs have been entering new markets through mergers, takeovers, partnerships, joint ventures, and direct investments, and they are now the world's dominant vehicle for conducting global business.

Literally, a multinational corporation is simply a company that operates in more than one nation.[24] By some definitions, a firm must have manufacturing facilities or service locations in more than one country or conduct a specific proportion of its business outside the country in which it is headquartered in order to qualify as an MNC. In fact, being a multinational firm is as much an evolutionary process as a specific condition. Typically, corporations begin to export products from their home country and then create overseas marketing organizations to boost sales. Later the firms license foreign companies to make certain products and eventually build their own manufacturing plants in other countries. Gradually, companies internationalize their workforce, management structure, and ownership; eventually they organize their total operations on an international basis. Even though major companies now stand at different points in this evolution, most are increasingly internationalized.

When MNCs became prominent in the 1950s and 1960s, they were perceived as a new form of colonialism.[25] MNCs typically came from the United States and focused their operations in so-called third world nations. MNCs were regarded as instruments—or, at least, symbols—of Western domination, and the United Nations established an agency to monitor their operations. Although multinationals provided nonindustrial nations access to capital, technology, management skills, and export markets, they were also criticized for deepening the economic dependence of these countries, importing inappropriate technologies, interfering with domestic politics, and destroying traditional cultures.[26]

Whatever the validity of these views, the world of multinational operations has changed. The lion's share of transnational business activity today occurs in industrial countries that have sophisticated governments. Industrial nations, and especially the United States, are now the targets of MNCs as well as their homes. Today, developing nations protest being ignored by MNCs as frequently as they complain that they are exploited by them.[27] Other changes in MNCs are revealed by an examination of Table 5-1.

Multinational firms are no longer an exclusively American phenomenon. In 2003, ten of the world's largest firms were at home in the United States, whereas by 2010 four had dropped out and only six of the twenty largest were headquartered in the United States. Of the 500 largest firms, based on revenues in 2003, 189, or 38 percent, were based in the United States, and 35 were headquartered in Great Britain.[28] By 2010, only 139, or 28 percent, of the largest companies

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Table 5-1 The World's Largest Corporations, 2010

Corporation	*Home country*	*Sales in millions of $*
Wal-Mart Stores	United States	408,214
Royal Dutch Shell	Netherlands	285,129
Exxon Mobil	United States	284, 650
BP	Britain	246,138
Toyota	Japan	204,106
Japan Post Holdings	Japan	202,196
Sinopec	China	187,516
State Grid	China	184,496
AXA	France	175,257
China National Petroleum	China	165,496
Chevron	United States	163,527
ING Group	Netherlands	163, 204
General Electric	United States	156,779
Total	France	155,887
Bank of America	United States	150,450
Volkswagen	Germany	146,205
ConocoPhillips	United States	139,515
BNP Paribas	France	130,708
Assicurazioni Generali	Italy	126,012
Allianz	Germany	125,999

Source: CNNMoney, "Global 500," retrieved from money.cnn.com/magazines/fortune/global500/2010/.

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located their headquarters in the United States and only 29 called Great Britain home. The number of the largest companies located in Japan fell from 149 in 1994, to 82 in 2003, and to 71 in 2010; and the number at home in Germany declined from 44 to 37 in the same period. Between 2003 and 2010, moreover, the number of the 500 largest corporations based in China grew from 15 to 46, whereas 11 came from South Korea, and 4 resided in India.

Multinational Strategies and Tactics

General Electric, number thirteen on the *Fortune-CNN largest companies* list in 2004, confirmed its status as a global enterprise by obtaining almost half of its $156 billion in revenues outside the United States. Its international activities include manufacturing for local and export markets, import and sale of goods produced in other regions, leasing of aircraft, and provision of financial services for various regional economies.[29] In 2005, Sony Corporation, the Japanese entertainment

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conglomerate, displayed its multinational credentials by naming Sir Howard Stringer, the British-born chief of its U.S. unit, to be its first non-Japanese CEO.[30] Deutsche Bank, whose name testifies to its prominent status in Germany, was accused in 2005 of being "un-German" for announcing plans to lay off German workers at the same time that it reported that profits had risen 87 percent.[31]

Multinational companies differ. Their international activities are intended to benefit from the following forms of competitive advantage:

1. Location-specific production advantages based on differences in costs
2. Extranational production efficiencies based on large volume
3. Access to important national markets
4. Production locations in countries with advantages in skills and technology
5. Global distribution policies with cost and cross-product advantages[32]

Firms pursuing a *domestic* market strategy concentrate on defending their home market against foreign competition. They turn to the international arena to find production locations where the costs of production are cheaper than at home. They hope to gain a marketplace advantage by manufacturing their products in these "export platforms" and then shipping them home for sale at a better price than competitors can offer. Companies following a *national* strategy establish semi-autonomous subsidiaries in large countries to gain access to national markets that might otherwise be closed to them, thus capturing advantages from economies of scale. They may also believe that partially independent corporate structures inspire more creativity and dedication from their employees than divisions tightly controlled by a foreign headquarters. Finally, a company's international activities may be part of a plan to build a *global* production and distribution strategy and establish a multiproduct identity in various geographic markets. Firms pursuing a truly global strategy will decide where to buy raw materials and components, where to obtain capital, whom to hire, what to sell, and where to manufacture products on the basis of worldwide operating considerations.

Government Relations

The distinctive features of multinational firms are that they are active in multiple countries and maintain relations with numerous governments. As they pursue their strategies, MNCs must comply with the laws of the home country where they are headquartered as well as the requirements of the host countries where they are active. The dual identity of MNCs makes both home-country and host-country governments suspicious and renders conflict between governments and multinationals almost inevitable.

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Most home-country governments regard multinationals as vehicles to promote their political and economic interests. Firms are their modern-day gladiators. Home-country governments usually seek to expand the international role of firms headquartered in their countries, help them win access to lucrative foreign markets, and defend them against hostile action by other governments.

The U.S. government has been less diligent than other major governments in promoting the interests of its MNCs. Although U.S. foreign policy sometimes operates on behalf of American business interests, U.S. economic concerns typically have been subordinated to foreign-policy objectives.[33] For decades, for example, the pattern of U.S. policy toward Germany and Japan was to secure political objectives by surrendering economic advantages, and today U.S. policy toward China is guided by a desire to shape that country's place in the international community.[34] In addition, U.S. administrations may seek to achieve their political objectives by restricting the actions of the foreign subsidiaries of American MNCs, and they often attempt to change other countries' human rights, political, labor, environmental, and emigration policies by penalizing American companies whose foreign subsidiaries are active in those countries.[35]

Host-country governments welcome MNCs because of their potential to enhance their nations' economies, but they also resent MNCs because of the subordination of their countries' welfare to the interests of the MNCs and the policies of home-country governments. They fear MNCs' ability to shift factories, products, and employment from country to country, and they worry that MNCs will gather up economic rewards in their countries and leave without helping to solve their social and political problems.[36]

Conflicts between MNCs and host countries proceeded in the 1970s under the threat of nationalization of MNC assets by the host country. In recent decades, however, industrial nations have avoided extreme actions and managed relations with MNCs within a framework of bargaining and negotiation.[37]

Most major countries walk a fine line between welcoming MNCs and demanding that their national interests be respected.[38] Foreign multinationals have traditionally found that certain sectors of a host country's economy—such as defense, telecommunications, and broadcasting—are closed to them.[39] Host-country governments often review the plans of MNCs when they enter the country and establish performance requirements for incoming firms in such areas as investment, product development, employment, and ownership by host-country nationals.

MNCs, in turn, are not defenseless in their negotiations with host governments. They control the capital, technology, and access to export markets that host governments want. MNCs also play one country against others while seeking investment subsidies, research and development funding, job training,

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infrastructure projects, favorable pricing rules for their products, and favored treatment under national procurement programs.

Multinational Investment and the United States

Multinational firms are accused both of damaging their home country's economy by exporting jobs and factories and hurting the host country by exploiting its markets and weakening its production capacity. Any assessment of the impact of MNCs should be done cautiously because multinational strategies differ dramatically and negotiations between MNCs and host governments vary from case to case. The effects of the outward investment by MNCs on a home country and of the inward investment by MNCs on a host country are discussed in this section, using the United States as an example.

The AFL-CIO official mentioned earlier believed that transnational economic activity and, especially, investment by U.S. firms in other countries make it tougher for U.S. workers to defend the salaries and benefits they now receive. Others, who maintain that investments by U.S. firms in foreign countries help the American economy, argue that outward investment by MNCs occurs because U.S. firms can earn higher profits abroad than at home. The subsequent spending of these increased profits in the United States then stimulates the growth of the U.S. economy more than if the MNC had invested only at home. The failure of U.S. firms to invest outside the United States would close off profitable investment opportunities, raise overall production costs, increase prices to American consumers, lower aggregate sales, slow the growth of the U.S. economy, and thus reduce the number of jobs available to American workers.[40]

Even though outward investment may have a net positive effect on the U.S. economy, there is no doubt that some workers and communities are "dislocated" by outward investment. Plants are closed, workers are fired, and communities are devastated as MNCs move investments from the home country into the global economy. Organized labor is one of the groups most harmed by the outward investment practices of MNCs.[41] Outward investment typically occurs in manufacturing industries, where unions are strong, and it places national labor groups in competition with one another. Although multinational union bargaining is a logical response to this situation, it has been slow to emerge because of the nationalistic structure of the labor movement, the diversity of national labor laws, and ideological divisions among unions.

The American government "encourages" foreign investment in the United States.[42] An interagency Committee on Foreign Investment in the United States can screen foreign investments that threaten the nation's security, but the committee seldom meets. Japan, in comparison, requires every foreign investor to submit a detailed investment proposal and secure approval before proceeding. Foreign investments in Japan can be prohibited on national security grounds or

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because they might have adverse effects on Japanese companies. Among the most ardent defenders of foreign direct investment in the United States are state and local governments.[43] Forty states have established offices to woo international investors. Governors and mayors travel widely and look to foreign investment as a means of stimulating employment, increasing tax revenues, gaining new technology, and obtaining development capital.

Foreign investment in the United States totals $3 trillion. More than 80 percent of these investments are *portfolio* investments in government securities, corporate stocks and bonds, and bank deposits. The portfolio investor is a passive investor who plays no role in managing assets. The balance of the investments are *direct* investments in companies, banks, and real estate in which the investor can make decisions about how those assets will be used. Recent increases in foreign investment in the United States have been large, but the total value of direct foreign holdings in the United States remains at a modest level by international standards.[44] Total foreign holdings in most other countries are a larger share of GDP than in the United States.

Transnational investments in the United States or other host countries affect the host-country economies in either of two ways.[45] First, international investors can enter a region and *stimulate* the local economy. MNCs can introduce new techniques, increase demand for local goods and services, generate new employment, and be tough competitors that prod indigenous companies to improve their operations. Alternatively, transnational investors can come into a region and *displace* local economic activity. They can aggravate the weaknesses of the region by shifting high-value-added functions to their home country and reducing the skill level of the remaining workers. They can steer business away from innovative local firms in favor of suppliers from their own country.

Werner Meyer-Larsen argues that major German companies have adopted a strategy of challenging corporate America by investing in U.S. firms.[46] This strategy builds on earlier actions by German firms to locate production facilities in the United States, as represented by Daimler-Benz's decision to manufacture Mercedes automobiles in Tuscaloosa, Alabama, and BMW's choice of Spartanburg, South Carolina, as its manufacturing site. Will such investments by German firms attract new suppliers to Tuscaloosa and Spartanburg, improve the skills of local workers, and generate additional business for Charleston and other ports, or will the German firms ultimately transfer the highest-value-added functions to Munich or Stuttgart, ship the most sophisticated parts from Germany to the United States, and leave only low-paid jobs for American workers? Only in retrospect is it possible to determine whether specific investments have actually stimulated or displaced local economies.

The critics of foreign direct investment in the United States argue that MNCs are more likely to displace local economic activity than to stimulate it.[47]

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They point out that most foreign outlays are used to acquire existing businesses rather than to establish new ones.[48] Whereas 3 million Americans work for foreign firms, by one estimate, these enterprises created only 90,000 new jobs in a recent seven-year period.[49] The critics maintain that MNCs have reduced the skill level of American jobs and transformed successful firms into hollow shells for assembling products that were conceived and designed elsewhere, and they insist that the United States must restrict multinational investors whose actions displace U.S. economic activity, destroy local firms, and diminish American jobs.[50]

The best policy response both to the outward investment by U.S. firms and foreign investment in the United States is to make the U.S. economy as productive as possible. Foreign MNCs generally assign sophisticated tasks to countries with highly trained workers, exceptional suppliers, and a well-developed infrastructure, and U.S. firms invest outside the United States when they obtain better returns than are available in the U.S. economy.[51] When challenges such as the "offshoring" of service jobs emerge, it is important to rest the debate on reliable data and acknowledge that some workers and firms will be dislocated regardless of the eventual benefits to the total economy.[52] Critical job skills, an attractive location for high-value services, and a fair playing field remain a sound strategy.

In the era of globalism, nations seek to aid home-based MNCs in their competition with firms from other nations, but the national identity of the MNC is eroding. It is increasingly difficult to determine exactly what it means to say a firm is an American or a German multinational.[53] The author of a prominent article on MNCs posed the question, in fact, in his article "Who Is Us?"[54] All of a company's directors and most of its owners and managers may be American citizens, and yet the company may still place most of its facilities, employ most of its workers, and conduct most of its research outside U.S. borders. In the future, it may be no more meaningful to say a firm is an American company than it is today to view an enterprise as a Delaware or a New Jersey corporation. Even though we live in a globalizing world, the politics that define a nation's economy are still predominantly national politics. National governments strive to devise policies and institutional arrangements that will give their firms a competitive advantage both at home and in the global arena.

Carving Up the Global Pie: Varieties of Capitalism

The principal question facing national models of capitalism in a globalizing age is whether their traditional institutions and practices can still deliver the prosperity their citizens have come to expect. From the mid-1960s to the mid-1980s, the managed market economies in Germany and Japan flourished while the performance of the liberal market economies lagged behind. In the 1980s, the

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Anglo-American competitors began to restore their position, and by the early 1990s, Germany and Japan recognized that their version of capitalism no longer delivered the level of economic performance found elsewhere.

National economies are embedded in international markets and production processes, but scholars disagree about the extent to which globalization may supplant national sovereignty and restrict political diversity. Andrew Shonfield leads one group of researchers, who argue that the institutional features of a nation's capitalist system determine the success of the country's economy and its quality of life.[55] These analysts emphasize the significance of the organizational arrangements of capitalist systems and the societal context of the institutions. Other scholars maintain that the ability of governments to define national practices and policies has already been largely eroded by globalization and all that is left for national governments in a global age, as Colin Crouch and Wolfgang Streeck write, is to hide from "their voters the dirty secret that it is no longer they who determine their country's economic policies."[56] Whether events finally prove the globalists or the nationalists correct, capitalist systems will continue for some time to reflect divergent national circumstances.

The United States

In 2004, the World Competitiveness Yearbook, compiled by the Institute for Management Development in Switzerland, ranked the United States the world's most competitive economy.[57] The organization's ranking of fifty nations was based on more than 300 criteria grouped into four factors: economic performance, government efficiency, business efficiency, and infrastructure. Focusing on the ability of nations to create and maintain an environment in which firms can compete, the organization ranked Singapore second, followed by Canada and Australia. Germany was ranked twenty-first, Great Britain twenty-second, and Japan, which had been ranked first until 1994, was twenty-third.

Two decades earlier, the picture had looked very different. Americans were then told that the United States had entered a period of irreversible economic decline: the dollar was finished as the world's currency of choice, the country's technological lead had disappeared forever, and future generations of Americans would never again experience an increased standard of living. The Yale historian Paul Kennedy, author of the best-selling *The Rise and Fall of the Great Powers,* then appraised the nation's geopolitical future in these terms: "The only answer to the question increasingly debated by the public of whether the United States can preserve its existing [international] position is 'no.'"[58] Kennedy's analysis coincided with the prominence of non-American goods in the global marketplace and the view that the glory days of the U.S. economy were over. Long before the 1990s ended, these experts insisted, the United States would be relegated to third place among world economic powers, behind Germany and Japan.[59]

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Why were these dire predictions wrong? First, they exaggerated the severity of the U.S. decline. Most theorists predicting decline compared the position of the United States in 1990 with its position in the late 1940s.[60] These comparisons had ignored the fact that the devastation of the world's other economies in World War II made the United States appear more dominant than it actually was. The largest part of the decline in the U.S. share of world production since the late 1940s reflected the ebbing away of temporary postwar conditions.

The forecasts of decline were also off the mark because they ignored the historic strengths of the American economy. In the years before World War II, the United States had consolidated its nineteenth-century lead in mass production industries, and its educational advances and large consumer market had spurred invention and innovation. The country emerged from World War II with a massive corporate research and development sector, a strong university research base, and unprecedented investment in science and technology, and the country combined these advantages to dominate the "high-tech" industries of the postwar era.[61] As a result of its cultural traditions and institutional arrangements, U.S. capitalism has displayed an unusual degree of organizational flexibility, financial efficiency, entrepreneurship, and innovation.

In the 1980s, the value of some of these historic advantages had eroded. The increased volume of international trade had reduced the benefits American firms derived from being located in the world's largest consumer market. Although U.S. companies had pioneered techniques of mass production to serve this market, mass production principles had been largely superseded by Japanese-style flexible manufacturing. A cross-national investigation of key manufacturing industries in the 1980s reported that the United States had lost its monopoly of efficient production techniques and best industry practices.[62] The global diffusion of commercial technology meant that companies everywhere could now compete with U.S. firms as technological equals.[63]

U.S. companies eventually woke up to the reality of foreign competition and domestic decline, and the historic benefits of the American system of capitalism gradually reappeared. As a liberal market economy, U.S. firms faced the competitive discipline of the marketplace. Demonstrating flexibility and responsiveness, U.S. firms in the 1990s reviewed their strategies, restructured their operations, and redesigned their procedures. The overvaluation of the U.S. dollar moderated, and the availability of capital slowly improved. During the second half of the 1990s, American workers learned to use the computers that had been sitting on their desks, the Internet penetrated the corporate world, and extraordinary innovations in information technologies appeared at every turn. As a result, the United States enjoyed surprising economic growth, and the economy reported improvements in manufacturing and service-sector productivity that had not been seen in decades.[64] To much surprise, the federal government in 1999 reported its first budget surplus in thirty years.

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There is no reason for complacency about the U.S. economy, however, with many grounds to recall Paul Kennedy's admonition that it "simply has not been given to any one society to remain permanently ahead of all the others."[65] During the George W. Bush administration, the budget deficit reached historic heights, the merchandise trade deficits grew to amounts not previously imagined, corporate spending for basic research declined, and the nation still recorded low, occasionally even negative, savings and investment rates. Although corporate America has repaired and revitalized its production systems, it has not recaptured the comparative advantage it once had in such industries as motor vehicles and consumer electronics. Even more alarming is the evidence of deterioration in the political and social arena. Substance abuse, medical costs, litigation, incarceration rates, and functional illiteracy are costly problems that place substantial burdens on a competitive society. In international comparison, American high school drop-out rates are high, and levels of achievement are low. The T-shirt slogan "Underachiever—and Proud of It" is curiously emblematic of the problems the United States continues to inflict on itself.

Germany and Japan

In the 1970s and 1980s, the advantages of the coordinated market economies found in Germany and Japan were widely celebrated by journalists and academics. For most of these years, Japan was the world's model for economic success as its management methods and capitalist arrangements produced results that surpassed its American and European rivals. Japanese firms conducted business in corporate networks that emphasized the value of long-term relationships over short-term performance. Dubbed "alliance capitalism," these networks shared technical information, production assistance, and strategic advice.[66] Because network members such as lenders, suppliers, affiliates, and strategic customers hold large blocks of stock in Japanese firms, there is little need for the firms to respond to ordinary shareholders. Personal relations among Japanese managers are a central feature in a system that prioritizes commitments to executives, employees, lead banks, regulators, affiliated corporations, suppliers, and important customers and deemphasizes the importance of high profits and capital markets.

A frequent explanation for Japan's economic success was its peculiar combination of institutional stability and operational flexibility.[67] The alliance of the Liberal Democratic Party (LDP), business figures, and bureaucratic elites facilitated the flow of information and unified the state and the civil society. Strong state institutions nurtured the system's adaptability by stressing the benefits of technocratic competence, emphasizing national unity on economic goals, and insulating economic policy from political pressures.[68]

In the 1990s, however, changes in the country's socioeconomic structure forced the LDP to transform its electoral base, the gap between successful global

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firms and domestic companies dependent on protectionist barriers widened, and the prestige of the bureaucracy declined. The Japanese system had emphasized production and market share as corporate goals and had accepted high levels of corporate debt. When the economy flourished in the 1980s, large debts were little problem, but when the government was unable to maintain economic growth in the 1990s, the costs of borrowing for many companies became unsustainable, and financial institutions were then forced to acknowledge vast uncollectible loans. As a result of these developments, the ability of Japan's developmental state to fashion effective responses to national crises vanished. In 1998, only 2 of the world's top 100 companies by market capitalization were Japanese, whereas in 1989 fully 43 of the top 100 firms were owned by Japanese interests.[69] Japan's economic plight is confirmed by the wave of corporate restructuring announcements, the first acquisitions of Japanese companies by international buyers, and the continuing absence of a consensus on the policies needed to restore growth.[70]

The German capitalist system presents an institutional framework within which governments, corporate representatives, and labor unions negotiate responses to changing market conditions.[71] Not known for radical innovations, industries organized under this model excel at balancing the interests of traditional groups and implementing improved production technologies. As Doremus and associates note, banks are the key providers of capital in the German system, core members of the supervisory boards, and sources of guidance and support in times of crisis. Its champions argue that West Germany's coordinated market system gave it the world's most successful economy at the end of the 1980s.[72] The country accounted for a larger share of world exports than Japan, even though it had half the population, and for about the same share as the United States, whose population was four times the German total. German wages were higher than Japanese or American wages, wage inequality was lower, and the system protected the position of established groups such as unions, farmers, civil servants, and small business.

By the mid-1990s, however, the weaknesses of the German model had become more apparent.[73] Commentators insist that the German economy is unusually rigid, permits little competition among German firms, and is characterized by significant weakness outside its core industries. As a result of protecting established groups, the nation incurred enormous public-sector deficits in financing the reunification with its eastern states with disappointing results. The country's high wage rates cut into its international trade surplus, and its persistently high social expenditures, living costs, and unemployment rates eroded the social cohesion its institutional arrangements were designed to ensure.[74] Germany has traditionally relied on political intervention to alter market behavior, but in recent years, it lacked a strategy to accommodate its high-cost production

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system with its leadership aspirations in the European Union and the global economy.[75]

Great Britain and the European Union

Most EU members have styles of capitalism that stress institutional coordination, whereas the Anglo-American model of capitalism gives market-oriented activities greater prominence. The conservative era of Prime Minister Thatcher mirrored this disposition by minimizing taxes, restraining government, relying on private companies to make production decisions, and accepting social inequality as an inevitable by-product of economic development.[76] The Thatcher government succeeded in reducing inflation, increasing manufacturing productivity, revitalizing British management, and expanding both home and stock ownership, but its accomplishments came at the price of increased social tensions. Great Britain has continued to support its liberal market economy by favoring deregulated labor and financial markets, supporting low levels of business coordination, and seeking to make Britain the "Enterprise Centre of Europe."

The European Union is an inchoate system of government resting atop twenty-seven member nations. The Union's governing institutions administer a single market for most products, services, employees, and flows of capital. It has fashioned an agricultural sector that is dominated by public subsidies and government programs, and it has become the single voice in trade negotiations. A European Central Bank has been established in Frankfurt, and a common European currency, the euro, replaced national currencies in most of its countries.

The European Union is now creating its own model of capitalism.[77] British traditions reflect a liberal market philosophy, Germany has created coordinated market mechanisms, France has proposed policies urging more aggressive government intervention, and newer member states from Eastern Europe are still struggling to fashion their own economic identity after decades of Soviet domination. A single market, a common currency, and a unified position in trade negotiations will make it difficult for national styles of capitalism to endure unchanged, but it is reasonable to assume that the member states will strive to fashion a European model of capitalism that lets them maintain as far as possible the economic advantages they derive from their existing arrangements.[78] Many European companies have long been shielded from takeovers, guaranteed high prices for their goods, spared domestic competition, and given priority in public procurement, but they are now beginning to face a more challenging environment. A rash of mergers and takeovers suggests that the stronger, larger European companies with skilled employees and advanced technologies will emerge as eventual winners in the new system.

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Multinational firms are a new way of structuring competition and increasing economic efficiency, but tensions between multinational enterprises and a political order composed of nation-states are inevitable. As Raymond Vernon points out, however, neither national governments nor multinational corporations are likely to become obsolete.[79] The world is now experiencing a lag in institutional development.[80] The internationalization of business has outpaced the development of the political institutions needed to regulate the new global economy. Similar to the American experience at the end of the nineteenth century, economic events have undermined the capacity of one set of political institutions to regulate economic activity, but the emergence of new institutions to take their place has not yet occurred.

A logical response to the globalization of business is to create an international regime to regulate MNCs on a global basis, but most governments are not yet prepared to cede sovereignty over important national activities.[81] The successes in international regulation have appeared in functional areas where all parties gain from collective action, such as in the international regulation of telecommunications and air transport.[82] A structure for the regulation of MNCs will probably emerge, but it will be preceded by a long period of frustration and experimentation.

Summary

Globalization, the increase in cross-border commercial activity, has resulted from developments in technology and the policy decisions of national governments. There have been earlier eras of globalization, such as the period from 1870 to 1913, but the current era is distinguished by a deeper level of economic integration than has appeared in the past. Globalization has far-reaching implications for national economies and political systems, but only some scholars fully embrace the assertions that globalization has led to the disappearance of U.S. manufacturing jobs, the withering away of the state, and the political hegemony of multinational corporations. Many factors will contribute to the future of the global economy, but past events demonstrate that apparently unstoppable global trends can sometimes be halted and even reversed.

The global economy is driven today by multinational corporations, and most of their activity in concentrated in major industrial states. Companies are profit-seeking entities, and they have entered the international arena to win production efficiencies, gain marketing advantages, and obtain access to scarce skills and technologies. The countries where multinational firms are headquartered usually support their endeavors, but the host governments, although believing the MNCs can enhance their economies, also fear that they will displace existing economic activity and aggravate the problems the nations hoped they would solve.

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National economies are embedded in global markets and production processes, but the evolving relationship between the global economy and diverse national economic systems is unclear. Some scholars argue that global economic systems will aid liberal market economies at the expense of coordinated market economies, whereas others investigate whether national diversity itself can survive the emergence of global capitalism.

Further Readings

Fortune magazine assembles an informative listing of domestic and global firms, and these are available at www.pathfinder.com/fortune. Corporate Watch is an organization that investigates the consequences of corporate power in a global age: www.corpwatch.org/trac/globalization/corp/index.html. The Novartis Foundation for Sustainable Development discusses the responsibilities of multinational corporations in the global economy: www.foundation.novartis.com.

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Questions

1. According to the text, what is the simplest way to describe globalization? Refer to the section titled "The Emergence of the Global Marketplace."
2. What events stifled the previous global period of increased cross-border activity?
3. Briefly describe the differences between MNC domestic strategies, national strategies, and global strategies.
4. How are the U.S., British, German, and Japanese economies groups, and what do these groupings signify?
5. What are the strengths and weaknesses of Japan's alliance capitalism?
6. What did Prime Minister Thatcher's economic policies accomplish?

Notes

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