

Fioretos, Karl-Orfeo

Working Paper

How and why institutional advantages are preserved in a global economy: a comparison of British and Swedish multilateral preferences

WZB Discussion Paper, No. FS I 96-320

Provided in Cooperation with:

WZB Berlin Social Science Center

Suggested Citation: Fioretos, Karl-Orfeo (1996) : How and why institutional advantages are preserved in a global economy: a comparison of British and Swedish multilateral preferences, WZB Discussion Paper, No. FS I 96-320, Wissenschaftszentrum Berlin für Sozialforschung (WZB), Berlin

This Version is available at:

<https://hdl.handle.net/10419/44108>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

discussion paper

WZB

WISSENSCHAFTSZENTRUM BERLIN
FÜR SOZIALFORSCHUNG

SOCIAL SCIENCE RESEARCH
CENTER BERLIN

FS I 96 - 320

**How and Why Institutional Advantages are
Preserved in a Global Economy: A Comparison
of British and Swedish Multilateral Preferences**

Karl-Orfeo Fioretos

October 1996
ISSN Nr. 1011-9523

**Research Area:
Labour Market and
Employment**

**Forschungsschwerpunkt:
Arbeitsmarkt und
Beschäftigung**

**Research Unit:
Economic Change and
Employment**

**Abteilung:
Wirtschaftswandel und
Beschäftigung**

ZITIERWEISE / CITATION

Karl-Orfeo Fioretos

How and Why Institutional Advantages are Preserved in a Global Economy: A Comparison of British and Swedish Multilateral Preferences

Discussion Paper FS I 96 - 320
Wissenschaftszentrum Berlin für Sozialforschung 1996

Forschungsschwerpunkt:
Arbeitsmarkt und
Beschäftigung

Research Area:
Labour Market and
Employment

Abteilung:
Wirtschaftswandel und
Beschäftigung

Research Unit:
Economic Change and
Employment

**Wissenschaftszentrum Berlin für Sozialforschung
Reichpietschufer 50**

D-10785 Berlin

Karl-Orfeo Fioretos

* Department of Political Science
Columbia University
New York, NY 10027

Email: KF14@columbia.edu

An earlier draft of this paper was presented at the 1996 Annual Meeting of the American Political Science Association, San Francisco, August 29-September 1, 1996. I would like to express my immense gratitude to the Department of Political Science, Lund University, the Wissenschaftszentrum Berlin für Sozialforschung, and the European Institute, London School of Economics for lengthy and generous institutional support in connection with my research. Additionally, I gratefully acknowledge the input of Steve Casper, Helen Milner, Jonathon Moses, David Soskice, and Hendrik Spruyt.

Abstract

This paper contributes to research at the intersection of international and comparative political economy, with particular emphasis on domestic explanations of multilateral cooperation. It explains why members of the European Union often have strongly diverging institutional preferences with regard to the manner in which multilateral cooperation should be structured. Moreover, the paper develops an understanding of states' international institutional preferences based on the structure of domestic capitalist relations and demonstrates how there are distinct logics behind states' preferences for domestic and international institutions based on how these institutions can be combined to produce a situation in accord with the national regime of production. Specifically, the paper shows how the organization of domestic interest groups along with the market profile of industries condition the aggregation of domestic interests. Furthermore, the paper specifies how and when governments that operate in a global world economy with high levels of trade and capital mobility will adopt new policies to promote industrial competitiveness in the domestic and multilateral spheres. The paper compares British and Swedish responses to declining industrial competitiveness, and compares their institutional preferences in areas of industrial and social policy: the role of industrial subsidies and labor market regulation is assessed, as well as how the economic institutions that regulate these areas have changed in the wake of an increasingly globalized and competitive world economy.

Contrary to claims that globalization will force a convergence of domestic economic policies and multilateral institutional preferences, this paper demonstrates the importance of how differences in domestic capitalisms condition the choice of divergent domestic policies and multilateral institutional preferences. I conclude that while members of the European Union have common interests in institutionalized forms of economic integration, they prefer divergent institutional solutions depending on their domestic production regimes. The attention to the organization of capitalism at the domestic level, it is argued, will not only help the scholars of international relations understand divergences in state preferences across issue-areas, but also aid in understanding outcomes of negotiations between states in the past and the future.

Zusammenfassung

Mit diesem Papier soll ein Beitrag geleistet werden zu der Forschung an der Schnittstelle internationaler und vergleichender politischer Ökonomie. Besonderes Augenmerk wird dabei auf die in den jeweiligen Staaten spezifischen Erklärungsansätze multilateraler Kooperation gelegt. Erklärt wird, warum Mitgliedsstaaten der Europäischen Union oft sehr unterschiedliche institutionelle Präferenzen zur Strukturierung multilateraler Kooperation haben. Darüberhinaus geht es darum zu verstehen, daß Staaten unterschiedliche Präferenzen im Hinblick auf internationale institutionelle Regelungen haben, da sie auf den innerstaatlichen Institutionengefügen der jeweiligen kapitalistischen Volkswirtschaft basieren. Weiter

wird gezeigt, daß deutlich unterschiedliche Logiken in Bezug auf die jeweilige Präferenz für das innerstaatliche bzw. internationale Institutionengefüge im Blickwinkel auf die Passung dieser Institutionen zu dem nationalen Produktionsregime bestehen.

Ein besonderes Augenmerk gilt der Frage, wie die Organisierung der nationalstaatlichen Interessengruppen in Abhängigkeit von den Marktprofilen der einheimischen Industrien die Bündelung nationalstaatlicher Interessen bedingt. In dem Papier wird analysiert, wie und wann Regierungen solcher Staaten, die in der Weltwirtschaft mit ihrem intensiven Handelsaustausch und hoher Kapitalmobilität agieren, neue politische Ansätze entwickeln, um ihre industrielle Wettbewerbsfähigkeit im Inland wie auf den internationalen Märkten zu fördern. Dazu werden die Maßnahmen Großbritanniens und Schwedens als Antwort auf den Rückgang ihrer industriellen Wettbewerbsfähigkeit und darüberhinaus ihre institutionellen Präferenzen in der Industrie- und Sozialpolitik verglichen: Die Rolle von Subventionen für Unternehmen und die Regulierung des Arbeitsmarkts werden eingeschätzt, ebenso, wie sich die ökonomischen Institutionen, die diese Bereiche regulieren, sich angesichts einer zunehmend globalisierten Wirtschaft mit ihrem immer stärkeren Wettbewerb geändert haben. Im Gegensatz zu Behauptungen, daß die Globalisierung eine Konvergenz nationalstaatlicher Wirtschaftspolitiken und multilateraler institutioneller Präferenzen erzwingt, wird in dem Papier gezeigt, daß Unterschiede in nationalstaatlichen Regulierungen in kapitalistischen Volkswirtschaften die Wahl nationalstaatlicher Politiken und die Präferenzen für bestimmte multilaterale institutionelle Regulierungen bedingen.

Abschließend wird festgestellt, daß die Mitgliedsstaaten der Europäischen Union zwar gemeinsame Interessen an institutionalisierten Formen für eine ökonomische Integration haben, daß sie aber bezüglich der institutionellen Lösungen je nach ihrem Produktionsregime unterschiedliche Vorstellungen haben. Wenn man die Art der nationalstaatlichen Organisiertheit einer kapitalistischen Volkswirtschaft als Ausgangspunkt der Analyse nimmt, so hilft dies nicht nur, die unterschiedlichen Präferenzen von Staaten bei unterschiedlichen Themen zu verstehen, sondern es hilft auch, die Auswirkungen vergangener wie zukünftiger Aushandlungsprozesse zwischen Regierungen zu verstehen.

Table of Contents

| | page |
|--|------|
| 1. Introduction | 1 |
| 2. Competing Theories of Multilateral Institution-Building | 4 |
| 3. Globalization, Variations of Capitalism, and the Domestic Sources of International Cooperation | 9 |
| 3.1. Variations in National Production Regimes and Two Competitiveness Strategies..... | 13 |
| 3.2. Central Propositions: Sources of Institutional Preferences, Influence, and Policy Outcomes | 15 |
| 4. Comparing Domestic Capitalisms and International Commitments: The Cases of Britain and Sweden | 22 |
| 4.1. Britain..... | 22 |
| 4.2. Sweden | 28 |
| 4.3. Brief Comparative Notes on Britain and Sweden..... | 34 |
| 5. Conclusion: Domestic Production Regimes and Support for International Institutions | 36 |

List of Tables and Figures (at end)

| | |
|----------|---|
| Table 1 | International Competitiveness Rankings |
| Table 2 | R & D Expenditure as a Share of GDP |
| Figure 1 | Comparative Hourly Manufacturing Costs 1994 |
| Figure 2 | The Balance Sheet of Swedish Investments, 1982-93 |
| Figure 3 | Reinvested Earnings on Direct Investments in Sweden and Abroad |
| Figure 4 | Swedish FDI to EU as a Share of Total FDI |

The most successful firms and governments will ultimately be those which adapt quickly to their shifting industry and political environments as well as those which seek to change the rules by overcoming historical inertia and even altering the global structures of industries in which they compete.

David B. Yoffie¹

Plus ça change, plus c'est la même chose.

French proverb

1. Introduction: Domestic Production and Multilateralism

Two seemingly contradictory trends characterize the contemporary political economy of Western Europe: on the one hand is the construction of international institutions within the European Union (EU) to promote market liberalization between states, and on the other is a trend toward the decentralization and deregulation of important economic decisions within states. Both developments, it has been said, take place in order to improve the competitiveness of European industries. A large literature in international relations has addressed the sources of international cooperation, but why there is variation between international institutions and why states prefer different institutional alternatives are two issues that are rarely addressed.² Similarly, a voluminous literature in comparative politics speaks to the sources of market reforms domestically but seldom considers the relationship between domestic institutional choice and international economic integration. More importantly,

¹David B. Yoffie, "Conclusions and Implications," in David B. Yoffie, ed., Beyond Free Trade: Firms, Governments, and Global Competition (Boston: Harvard Business School Press), p. 449.

²This is largely true both with regard to why international institutions within similar issue-areas have divergent characteristics in different organizations, as well as why there are variations in the composition of various issue-areas within in the same organization. There are some obvious exceptions, and if we are to believe the current trend in IR theory, the future will make the first point less penetrating. For recent exceptions, see Lisa Martin, "Economic and Political Integration: Institutional Challenge and Response," paper presented at The Political Economy of European Integration: The Challenges Ahead (Berkeley, April 20-22, 1995); Beth V. Yarbrough and Robert M. Yarbrough, Cooperation and Governance in International Trade: The Strategic Organizational Approach (Princeton: Princeton University Press, 1992) .

however, no sustained argument has been presented that connects the contemporary development of domestic reforms with international economic cooperation in Western Europe. This study links these two developments and argues that they are complementary and emanate from the same source, which is an increasingly globalized world economy that has altered domestic balances of power, as well as the institutional preferences of key societal interest groups.

This project posits that the way international economic changes associated with factor price convergence and capital mobility (the independent variables) are accommodated at the national level to produce identifiable sets of policies and multilateral institutional choices (the dependent variable) is a function of the organization of capitalism within states. More specifically, I argue that countries will adopt particular domestic policies and multilateral institutional preferences depending upon how the exchange of goods, services, labor and capital is organized at the national level—formally referred to as a national production regimes—and how this system is integrated into the global division of production. I suggest that national production regimes constitute crucial intervening variables in translating international economic changes, and that these regimes shape the structures of domestic coalitions, as well as determine which institutional preferences will be adopted as policy. The paper brings particular attention to two crucial elements of national production regimes—the degree of business coordination (high versus low) and the product market strategy of industry (cost- versus quality-competitive)—and how these elements are affected by international economic changes to shape the responses and interaction of economic groups and governments. I distinguish between two types of production regimes: liberal market economies (LMEs) and coordinated market economies (CMEs).³ The former is characterized by low degrees of business coordination and industries that primarily compete on cost, while the latter has a highly coordinated business community and an industry that mainly competes on quality. In this paper, LMEs are exemplified by Britain and CMEs by Sweden, and I show that the organization of production regimes in these two countries produces different institutional choices, although both economies face the same external economic challenges.

Extensive economic interdependence in the last two decades has prompted some scholars to suggest that countries in Western Europe will converge on a set of similar domestic economic policies that signal the end to demand-management and the affirmation of orthodox policies and monetarism.⁴ Not coincidentally, another set

³I borrow the typology from David Soskice, "Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s," in Herbert Kitschelt, et al., eds., Continuity and Change in Contemporary Capitalism (forthcoming); see also David Soskice, "Reinterpreting Corporatism and Explaining Unemployment: Co-ordinated and Non-co-ordinated Market Economies," in Renato Brunetta and Carlo Dell'Aringa, eds., Labour Relations and Economic Performance (London: Macmillan, 1990), pp. 170-211; Herbert Kitschelt, Gary Marks and John D. Stephens, "Conclusion: Convergence and Divergence in Advanced Capitalist Democracies," in Herbert Kitschelt, et al., eds., Continuity and Change in Contemporary Capitalism (forthcoming).

⁴While not explicitly stating it with reference to the convergence theme, Vivien A. Schmidt, From State to Market? The Transformation of French Business and Government (New York: Cambridge University Press, 1996) and Jonathon W. Moses, "Abdication from National Policy Autonomy:

of scholarship surfaced along with the renaissance of the European Community (EC) in the early 1980s and stressed that a process of preference convergence was taking place across Europe and was the cause for deeper economic integration and market liberalization.⁵ The convergence of policy preferences, it was argued, was a fundamental element in the Community's rebirth and in member-states' commitment to the Single European Act (SEA) and the Single European Market (SEM).⁶ But, given that a decade later important discrepancies persist domestically within members-states of the EU and that these states favor divergent institutional solutions within the Union attests to the fact that despite shared commitments to stronger and closer economic ties, there are fundamental differences with regard to states' multilateral institutional preferences. This paper examines the institutional solutions that Britain and Sweden have promoted in the areas of industrial and social policy—specifically concerning industrial subsidies and labor-market flexibility—at the national and European levels. Despite the fact that these two issues have been identified as the two core areas for institutional reform in order to recapture industrial competitiveness, they have diametrically opposed institutional configurations: industrial policy is highly centralized within the EU, while social policy is decentralized and remains largely the domain of the member-states. How do we explain this variance, and how do we account for the fact that member-states have conflicting views on their organization? The picture that emerges from comparing Britain and Sweden is that although both countries have very similar views, and both support a centralization of EU policy in issues pertaining to industrial policy, they diverge in their preferences over the role of the EU in social policy. Both countries are adamant in their support for an end to discriminatory forms of government subsidies and a centralization of regulation in this area at the EU-level. However, Britain has opted out of most social policy legislation in the EU and strongly opposes any limitations in national labor-market legislation set at the EU-level, while Sweden supports most social policy legislation as long as it remains relatively decentralized and primarily within the domain of the member-states. Explaining the variance in these countries' multilateral institutional preferences is the central objective of this paper.

Thus, in contrast to theories stressing the convergence of domestic policies and multilateral preferences, this project draws attention to the source of dissimilarities in the organization of domestic capitalisms and interrogates why these

What's Left to Leave?," Politics and Society 22 (2, 1994), pp. 125-148, do in their own ways suggest the limits of statist and corporatist solutions respectively.

⁵In referring to the organization variously known as the European Community (EC) and the European Union (EU), I will use the former when referring to events before the Treaty on European Union (also known as the Maastricht Treaty) was signed in December 1991, while I reserve the latter term for events after that date.

⁶Robert O. Keohane and Stanley Hoffmann, "Institutional Change in Europe in the 1980s," in Robert O. Keohane and Stanley Hoffmann, eds., The New European Community: Decisionmaking and Institutional Change (Boulder, CO: Westview Press, 1991), pp. 1-39; Andrew Moravcsik, "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community," International Organization 45 (1, 1991), pp. 19-56.

differences are likely to persist. I argue that to better understand why states' interests in multilateral cooperation differ across issue-areas requires a theory of how specific national production regimes are integrated into the global economy. National production regimes emerge over long periods of time and tend to cement the organization of interest groups, their interaction with each other and governments, as well as solidify the market profile of a country's industry. As such, national production regimes have always existed in a global context, and I demonstrate—contrary to the convergence thesis—that economic globalization will cause states to promote their distinct comparative institutional advantages rather than adopt a common institutional profile. In other words, as the nature of external economic challenges changes, the institutional requirements to protect a national production regime changes as well and thus prompts different countries to embrace divergent multilateral institutions for the same purpose; namely, to protect and promote the distinct comparative institutional advantage of their production regime. Thus, I argue that while economic globalization has led most Western European countries to support deeper economic integration, they have espoused different institutional solutions in order to anchor their respective domestic objectives and to protect their production regimes through membership in the EU. Indeed, inter-state negotiations are designed to find a solution to divergent institutional goals, and only with a clear theory that accounts for the emergence of diverse multilateral institutional preferences and how they become government policy will we arrive at an understanding of why the EU has its particular shape, as well as what possible scenarios we may expect in the future.

Including this introductory section, the paper has five parts. In the next section, I briefly review some existing explanations of states' multilateral institutional preferences and the design of international institutions. The third section elaborates upon an alternative approach to answering these questions based on the role of differences in national production regimes, and develops a set of specific propositions relating to this theme. In the fourth section, I test the main propositions in two brief case-studies of Britain and Sweden. The final section summarizes the conclusions and lists a number of implications for research in international political economy.

2. Competing Theories of Multilateral Institution-Building

It would not be an overstatement to say that cooperation in Europe is overdetermined if judged by competing theories of international relations. Explanations of why the member-states of the European Union have overcome the dilemmas of cooperation abound and claim causes such as high levels of trade dependence; the convergence of policy preferences; and shared beliefs among

political elites.⁷ In fact, there seems to be a consensus that contemporary developments in the EU are not characterized by collaboration but rather by coordination between states.⁸ As such, the central question is not why states cooperate, but how they decide to structure their partnership. Yet, why states favor particular multilateral institutional alternatives over others—in other words what the very subject of inter-state negotiation is—remains under-theorized in the existing literature. The questions that this paper raises—why do states have divergent multilateral institutional preferences, and why do these preferences vary across issue-areas—are poorly addressed in the central analytical approaches in international political economy. The following section reviews three types of explanations to these questions, and identifies their weaknesses.

Systemic theories addressing what kind (if any) of international institutions will be adopted designate the relative power resources of states as the crucial mechanism in determining outcomes. If states have a joint interest in policy coordination, the question becomes—to use Stephen Krasner's language—where on the Pareto frontier partners settle.⁹ Given the emphasis on relative power resources, however, systemic theories cannot explain why similarly powerful states have divergent multilateral institutional preferences. Moreover, since institutional preferences are not derivative of a country's relative power, we cannot explain why the powerful "winner(s)" in negotiations favored a particular outcome. Some scholars have attempted to move beyond this approach's traditional treatment of the state as a black box with rather static preferences, and have tried to document the background to states' preferences at the domestic level.¹⁰ But even in the most sophisticated of such attempts, no explanation is provided for the specific institutional preferences that a government adopts in international negotiations.¹¹

⁷As in all academic debates, there are of course those who would disagree with statements that make European cooperation seem inevitable. See, most prominently, John J. Mearsheimer, "Back to the Future: Instability in Europe After the Cold War," International Security 15 (1, 1990).

⁸For an theoretical explication of the differences between cooperation (or collaboration) and coordination, see Arthur A. Stein, Why Nations Cooperate: Circumstance and Choice in International Relations (Ithaca: Cornell University Press, 1990) , chapter 2. For an empirical study that engages the theme, see Michael C. Webb, The Political Economy of Policy Coordination: International Adjustment since 1945 (Ithaca: Cornell University Press, 1995) .

⁹Stephen D. Krasner, "Global Communication and National Power: Life on the Pareto Frontier," World Politics 43 (1991), pp. 336-366.

¹⁰In the European context, see specifically Andrew Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach," Journal of Common Market Studies 31 (4, 1993), pp. 473-524; Andrew Moravcsik, "Why the European Community Strengthens the State: Domestic Politics and International Cooperation," Working Paper Series #52, Center for European Studies, Harvard University (1994) . See also, David Lake, "Beneath the Commerce of Nations: A Theory of International Economic Structures," International Studies Quarterly 28 (June, 1984), pp. 143-70.

¹¹For instance, Moravcsik, "Preferences and Power in the European Community," asserts that "Groups articulate preferences; governments aggregate them" (p. 483). However, he does not specify the source of group preferences, why they may differ across countries, nor why governments adopt some group preferences and not others.

The reason for this shortcoming is associated with a one-sided concern over outcomes and uni-dimensional treatments of domestic interest groups (e.g. who are the net beneficiaries of reforms), neither of which articulate the institutional preferences of domestic constituencies. Barring an understanding of the institutional preferences of domestic groups, a theory of institutional preferences on the aggregate governmental level cannot be furnished. Despite Robert Keohane's observation that comparative analysis must begin at a systemic level, to date no theory that places systemic-level variables at the center of analysis has systematically explained why states have divergent multilateral institutional preferences.¹² Since the institutional preferences of winners and losers of negotiations alike remain unaccounted for, and the fundamental source for inter-state bargaining remains unexplained, relatively impoverished theories of international institution-building emerge.

Another set of theories emphasizes the importance of the domestic level of analysis and adopts a pluralist approach in explaining how domestic interest groups influence governments to adopt economic policies.¹³ Jeffrey Frieden, for instance, has argued that the more specific the assets of a firm, the higher its incentives are to lobby governments for or against particular policy changes.¹⁴ Based on this observation, Frieden suggests that firms with highly specific assets will be the most influential actors in determining a state's policy choice. While Frieden's assertion that levels of asset-specificity determine the shape and intensity of firms' preferences may be accurate in the context he discusses, the implications drawn from this with regard to firms' power over executives are erroneous in the context of advanced industrial states.¹⁵ In highly open economies like those of advanced

¹²Robert O. Keohane, "The World Political Economy and the Crisis of Embedded Liberalism," in John H. Goldthorpe, eds., Order and Conflict in Contemporary Capitalism (Oxford: Clarendon Press, 1984), p. 16.

¹³For a short review of different domestic theories of international cooperation, see Helen Milner, "International Theories of Cooperation Among Nations," World Politics (April, 1992), pp. 466-496.

¹⁴Jeffrey A. Frieden, Debt, Development, and Democracy: Modern Political Economy and Latin America, 1965-1985 (Princeton: Princeton University Press, 1991), pp. 19-22. It is interesting to note that in another piece, Frieden seems to contradict this observation and suggests that those with mobile capital may be more influential. I owe this observation to Paul Pierson. See, Jeffrey A. Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," International Organization 45 (4, 1991), pp. 425-451.

¹⁵The source of policy preferences are not synonymous with actors' power resources. To infer political influence from incentives to lobby and the extent of lobbying activity has no basis without sustained empirical analysis that documents the impact of this activity on government policy. Svein S. Andersen and Kjell A. Eliassen, Making Policy in Europe: The Europeification of National Policy-making (London: Sage, 1993), follow in Frieden's footsteps, and argue that groups with specific assets are more widely represented in Brussels, and thus have more influence in EU policy-making. A competing hypothesis—and a plausible one in my mind—is that the less influence a group perceives that it has and the more affected it may be by sudden changes in policy, the more likely it is to attempt to influence policy by lobbying. Conversely, groups that have structural power have less need to set up big and large numbers of offices. This is evident in the very small number of staff in organizations like UNICE, ERT, and national industry and employers associations, which are widely regarded seen as the most influential lobbying groups in Brussels. See, for instance, Maria

industrial countries, firms that possess mobile capital tend to have more influence because they can move their capital. Thus—in contrast to Frieden's thesis—other theorists have claimed that with high levels of international capital mobility, owners of mobile capital will set the policy parameters of a government. That argument rests on the observation that with increased capital mobility, there are few barriers against firms to move production (that is, they can use the so-called "exit" option), and that this will induce governments to give them more "voice" at home.¹⁶ This perspective neglects, however, to consider that the preferences of firms with mobile capital often diverge across countries: for instance, why countries with similar shares of mobile capital support different multilateral institutional solutions cannot be accounted for. Moreover, similar levels of international capital mobility do not translate across countries in identical ways, but, as I elaborate below, the degree to which the exit option is used is fundamentally determined by differences in national production regimes.

Despite its imprecision with regard to multilateral institutional preferences, however, this approach provides important insights to the logic behind micro-agents' policy goals. While it remains underdeveloped with regard to why governments would give into a particular groups' policy preferences, this tradition tends to provide strong theories of the source of societal groups' policy demands. Indeed, in the alternative theory that I develop below, I draw on some parts of this research tradition to formulate the institutional preferences of domestic interest groups. However, by providing a larger institutional framework, which emphasizes the product market profile of industries and the meso-level institutions that aggregate economic interests and mediate their interaction with governments, I also incorporate a theory of when and what type of societal preferences governments will support.

A version of a domestic-level explanation is offered by John Goodman, who adds the nature of the issue-area itself as an important variable in explaining which areas countries decide to centralize multilaterally and which are maintained for domestic control. Goodman argues that "[i]n policy areas that have a clear impact across a specific and identifiable constituency, coalitions typically emerge to resist the transfer of national authority."¹⁷ Yet, in matters relating to industrial policy—an area which arguably has the most significant "impact [on] a specific and identifiable constituency," namely European companies—the majority of European industry has

Green Cowles, "Setting the Agenda for a New Europe: The ERT and EC 1992," Journal of Common Market Studies 33 (4, 1995), pp. 501-526.

¹⁶On capital mobility, regulatory arbitrage, and exit, see among others, Robert H. Bates and Da-Hsiang Donald Lien, "A Note on Taxation, Development, and Representative Government," Politics and Society 14 (1, 1985), pp. 53-70; and William L. Cary, "Federalism and Corporate Law: Reflections upon Delaware," Yale Law Review 83 (March, 1974), pp. 663-705.

¹⁷John B. Goodman, "Do All Roads Lead to Brussels? Economic Policy Making in the European Community," in Norman J. Ornstein and Mark Perlman, eds., Political Power and Social Change: The United States Faces a United Europe (Washington, D.C.: AEI Press, 1991), p. 26, emphasis added.

been supportive of transferring authority to the EU. Moreover, if claims that issue-areas that are likely to cause regulatory competition and force a "race to the bottom" are the ones that should be centralized at the multilateral level were correct, then EU social policy should be one of the most centrally regulated policy areas.¹⁸ Yet, it remains one of the most decentralized. Moreover, this approach has problems explaining why national coalitions within the same issue-areas have very different structures across countries. Thus, focusing on the character of particular issue-areas does not provide an adequate explanation of the design of specific multilateral solutions within the EU.

While each of the three research approaches discussed here has made important contributions to central research themes in international political economy—and which for reasons of space and relevance I do not document here—they fail to account for why countries support diverse institutional solutions at the international level, and why individual states support divergent degrees of multilateral institutionalization in different policy areas. In fact, international relations as a discipline has not yet developed the analytical tools needed to study the details and complexity of different systems of advanced capitalism and how their integration into the global economy affects states' choice of multilateral cooperation. This project argues that understanding specific multilateral institutional preferences requires a theory that articulates how institutional preferences emerge (and change) and how they become policy. Thus, for the purposes of furnishing a richer understanding of the role that distinct national systems of capitalism play in determining states' preferences for multilateral institutions, this project turns to recent work in comparative political economy, economic sociology, and institutional economics. Specifically, I turn to work which analyzes the role of meso-level institutions at the national level in facilitating different modes of production and interest-group organization. The typology of market system I adopt was developed within these traditions, and I suggest that a keener appreciation of what David Soskice calls the "finer varieties of capitalism," will give us the tools for understanding the complex interaction between global economic processes, and the development of domestic policy responses and international policy goals.¹⁹ But before outlining the role of national production regimes as intermediary variables and how they shape governments' multilateral institutional preferences, it is appropriate to examine the meaning and hypothesized effects of the explanatory variable.²⁰

¹⁸See discussion in Paul Pierson and Stephan Leibfried, "Multitiered Institutions and the Making of Social Policy," in Stephan Leibfried and Paul Pierson, eds., European Social Policy: Between Fragmentation and Integration (Washington, D.C.: The Brookings Institution, 1995), pp. 1-40.

¹⁹David Soskice, "Finer Varieties of Advanced Capitalism: Industry- versus Group-Based Coordination in Germany and Japan," unpublished manuscript (Wissenschaftszentrum Berlin, January 1995), p. 2. See also footnote 3.

²⁰Most work designate production regimes as independent or dependent variables, but not as intermediary variables that mediate international influences to produce new policies at the domestic level. See, for instance, David Soskice, "Innovation Strategies of Companies: A Comparative Institutional Approach of Some Cross-Country Differences," in Wolfgang Zapf and Meinolf Dierkes, eds., Institutionsvergleich und Institutionsdynamik (Berlin: Wissenschaftszentrum Berlin für

3. Globalization, Variations of Capitalism, and the Domestic Sources of International Cooperation

The very nature of the explanatory variable in this study, globalization, makes it subject to different interpretations since it is thought to encompass—as the term suggests—everything on the globe. As two authors remark, the term globalization appears "endlessly capable of reinvention to describe many different types of change in world politics."²¹ That it qualifies as "an essentially contested concept" there is little doubt about, and this study does not attempt to resolve definitional quarrels.²² Rather, I adopt an explicitly economic conception of globalization to mean a process indicating an increase in the relative importance of international transactions to domestic exchange, and a process in which regulatory barriers to the transfer of goods, services, capital, and labor are insignificant. This definition is highly relative and suggests that states are not necessarily equally integrated into—or affected by—the global economy, but also that the process may be reversible. In the Western European context, however, the extent to which countries at a given time in the last few decades have differed in the degree to which they are exposed to economic globalization is insignificant. Thus, for analytical purposes we can treat the explanatory variable as a constant across countries of Western Europe in the same time-period.

A battery of data support the claim that the degree of economic globalization has been considerably higher in the 1980s and 1990s than in the preceding decades of the post-war era. Figures for trade, direct investments, capital transfers, and global production demonstrate clearly the extent to which Western Europe's economies are highly interpenetrated by global economic exchanges, and they show

Sozialforschung, 1994), pp. 271-289; Peter A. Hall, "Central Bank Independence and Coordinated Wage Bargaining: Their Interaction in Germany and Europe," German Politics and Society (Winter, 1994).

²¹Andrew Hurrell and Ngaire Woods, "Globalisation and Inequality," Millennium: Journal of International Studies 24 (3, 1995), pp. 447-470 Andrew Hurrell and Ngaire Woods, "Globalisation and Inequality," Millennium: Journal of International Studies 24 (3, 1995), p. 447.

²²For a discussion of "essentially contested concepts," see William E. Connolly, The Terms of Political Discourse (Princeton: Princeton University Press, 1983). For instructive discussions of the definition of globalization, see among others, Paul Hirst and Grahame Thompson, Globalization in Question (Cambridge: Polity Press, 1996), and R. J. Barry Jones, Globalisation and Interdependence in the International Political Economy (London: Pinter, 1995). It should be noted, however, that while some scholars have chosen to use the term "internationalization," I adopt the term globalization as it has two advantages over the former term. First, globalization avoids the term "nation" and thus deflects from the idea that exchange within the world economy takes place primarily between ("inter") "nations," that it is a construction by nations, or that it only affects domestic politics through the institutions of the nation-state. The term globalization says nothing *a priori* about which actors are central in a world economy, nor which help shape its character. Second, I reserve the term internationalization for a process that *originates within* the borders of a nation, while I use the term globalization to describe a characteristic of the international economic system.

large increases in the volume of exchange, as well as significant decreases in legal barriers.²³ For example, trade interdependence has increased significantly in the last three decades. OECD exports have roughly doubled as a share of GDP between 1960 and 1991 from 9.5% in 1960 to 21.8% in 1991.²⁴ This also true with regard to British and Swedish exports, and by 1992 these economies' openness (measured as the sum of exports and imports as a share of GDP) was roughly equal at 50%.²⁵ These tendencies imply, of course, that larger portions of domestic production are distributed in international markets and that international markets are growing in importance to domestic ones.

While the numeric increase in international trade is indicative of the trend towards higher levels of economic globalization, portfolio and foreign direct investments have increased even more dramatically than trade in goods and services in the last decade and demonstrate the extent to which financial interpenetration in Western European countries has risen.²⁶ More specifically, financial liberalization amounting to a reduction of 30% in legal barriers in less than three decades has dramatically increased international capital mobility,²⁷ and made it significantly cheaper and easier for owners of capital to relocate to new jurisdictions.²⁸ For example, portfolio capital outflows rose 14 times from \$15 billion

²³For a general overview, see Thomas Hatzichronoglou, "Globalisation and Competitiveness: Relevant Indicators," OECD Working Papers No. 4 (16, 1996).

²⁴OECD, National Accounts 1960-1991: Main Aggregates, Volume 1 (Paris: OECD, 1993). Calculations based on price and exchange rate levels of 1985 (tables 7 and 11).

²⁵In 1992, Britain registered 49%, and Sweden 54%. Data comes from Penn World Tables 5.1 (<http://cansim.epas.utoronton.ca:5680/pwt>).

²⁶For excellent and recent overviews of the topic, see Tariq Banuri and Juliet B. Schor, eds., Financial Openness and National Autonomy: Opportunities and Constraints (Oxford: Clarendon Press, 1992); Benjamin J. Cohen, "Phoenix Risen: The Resurrection of Global Finance," World Politics 48 (January, 1996), pp. 268-296.

²⁷Based on the extent to which four forms of capital controls (restrictions on capital accounts; bilateral payments between OECD-countries; bilateral payments with non-OECD countries; and deposit restrictions) have been lifted between 1967 and 1990, Beth Simmons demonstrates that the composite score of capital restrictions (each control is given a score of 1 or 0 depending on if restrictions were in place or not) went from an average of 1.7 in 1967 (maximum is 4 if all restrictions are in place) to 0.65 in 1990. This amounts to nearly a 30% reduction in legal barriers. See, Beth A. Simmons, "The Internationalization of Capital," paper presented at the conference "Politics and Political Economy of Contemporary Capitalism," Humboldt Universität zu Berlin (Berlin, Germany, May 26-27, 1995).

²⁸While the discussion over how capital mobility is best measured has been extensive in recent years, most definitions fail to go beyond two standard and insufficient types of definitions. One is based primarily on balance of payments data (see, John B. Goodman and Louis W. Pauly, "The Obsolescence of Capital Controls? Economic Management in the Age of Global Markets," World Politics 46 (October, 1993), pp. 50-82) and fails to recognize that economic actors do not only respond to capital flows after they have taken place, but also in anticipation of such movements. As such, balance of payments data is not sufficient to demonstrate the policy implications of capital mobility, but the role of expectations must be factored in. Another common way of defining capital mobility is to limit it to portfolio capital and to neglect other forms of capital, such as those that make

in the late 1970s to \$205 billion in the early 1990s.²⁹ In addition, foreign direct investment (FDI) has grown by nearly a factor of four between the early 1980s and 1990s, which means that it has increased roughly twice as fast as trade in goods and services. The growth in the annual average of incoming FDI in Europe between the periods 1982-87 and 1988-92 is startling, and shows a 256% increase in Britain and 378% in Sweden. These figures were considerable higher than the world as a whole, where the increase was 162%—again showing the extent to which European countries are, comparatively speaking, more exposed to global economic transactions.³⁰ The increasing ease with which producers can locate production outside their home-countries has allowed them to take advantage of reduced factor prices (especially labor costs), inducing a convergence of factor prices, and thus exacerbating international competition among suppliers.³¹ The effects of price convergence has led some firms to close down as it has become impossible for them to compete given the prices they pay for factor inputs. It has also led many companies to move their production abroad in order to take advantage of lower transaction costs and more profitable production elsewhere. Consequently—as FDI statistics suggest—the internationalization of production is today considerably higher than before the 1980s. Many large European companies employ significant numbers of people abroad; for example, among the world's 100 largest

up direct investments. While the movements of portfolio capital no doubt affect the policy choice of economic actors, the increasing ease of purchasing means of production in other jurisdictions has also increased. To estimate the increasing ease of moving capital across borders, we can observe the drastic decline during the last two decades in legal barriers that regulate the cross-national movement of capital and—in the European context more specifically—the establishment of the Single European Market that allows free mobility for goods, services, capital, and labor. See, for instance, Eric Helleiner, States and the Reemergence of Global Finance: From Bretton Woods to the 1990s (Ithaca: Cornell University Press, 1994), especially chapter 7; and Peter A. Vipond, "The Liberalisation of Capital Movements and Financial Services in the European Single Market: A Case Study in Regulation," European Journal of Political Research 19 (1991), pp. 227-244.

²⁹Bank for International Settlements, Sixty-Third Annual Report (Basle, 1993), pp. 90-91.

³⁰Trade and Industry Committee House of Commons, Competitiveness of UK Manufacturing Industry (Volume II: Memoranda and Evidence) (London: HMSO, 1993-94) Figures are drawn and calculated from: United Nations, World Investment Report 1994: Transnational Corporations, Employment and the Workplace (New York: United Nations, 1994). The figures for outgoing FDI are equally striking: Sweden exported 233% more in the 1988-92 than in 1982-87. In Britain the story is somewhat different (only a 81% increase) and—as will be explained in more detail below—is associated with the British government's strong efforts to make the UK into an attractive place for investment and to decrease incentives for UK companies to emigrate. Again, the figures for the world as a whole are also significant but somewhat lower than in Europe, and amounted to a 190% increase in outward foreign direct investment.

³¹Robert Zevin, "Are World Financial Markets More Open? If So, Why and With What Effects?," in Tariq Banuri and Juliet B. Schor, eds., Financial Openness and National Autonomy: Opportunities and Constraints (Oxford: Clarendon Press, 1992), pp. 43-83, presents data that shows that price convergence has taken place since the 1960s. For similar support relating to wages, see David Dollar and Edward N. Wolff, Competitiveness, Convergence, and International Specialization (Cambridge: The MIT Press, 1993). A theoretical discussion on the effects of price convergence is found in Jeffrey A. Frieden and Ronald Rogowski, "The Impact of the International Economy on National Policies: An Analytical Overview," in Robert O. Keohane and Helen V. Milner, eds., Internationalization and Domestic Politics (New York: Cambridge University Press, 1996), pp. 25-47.

manufacturing companies registered in European Union member-states in 1990, 57% had more employees abroad than at home.³²

As a consequence of the developments I have just outlined, governments have become more sensitive to international economic changes. Fearing that firms that will not be able to secure their competitive advantage in the future, governments have become increasingly concerned since the early 1980s with the promotion of industrial competitiveness. For instance, reductions in trade barriers have forced producers to be more competitive since they cannot rely on protected domestic markets nor on preferential treatment by a small number of trading-partners to remain in business. This concern has been further exacerbated by higher levels of capital mobility, because producers can now seek out the most profitable location for their investments without incurring significant transaction costs. As a consequence, governments have become increasingly concerned with their ability to keep domestic investments and to attract foreign investors.³³ Indeed, a number of studies suggest that higher levels of capital mobility and governments' fears that firms will disinvest have altered domestic balances of power between governments, business, and labor. While there seems to be some consensus among scholars that labor in Western Europe has lost significant power resources in the last two decades as a consequence to global economic changes, there is considerably less agreement on what effect integrated goods and capital markets have on the relationship between business and governments.³⁴ There is a tendency among scholars to argue that the erosion of barriers to mobility has given business stronger recourse to the exit option, and as such their power at the domestic level has increased.³⁵ However,

³²Calculations made from United Nations, World Investment Report 1993: Transnational Corporations and Integrated International Production (New York: United Nations, 1993) , Table I.10, pp. 26-27. Figures are based on 44 companies that report both foreign and total employment.

³³A point which is amply illustrated by a number of official publications on the future of competitiveness in Europe. See, inter pares, the three British white papers on competitiveness (Competitiveness: Helping Business to Win [HMSO, 1994]; Competitiveness: Forging Ahead [HMSO, 1995]; Competitiveness: Creating the Enterprise Centre in Europe [HMSO, 1996]); the German official report Bericht der Bundesregierung zur Zukunftssicherung des Standortes Deutschland (Deutscher Bundestag, Drucksache 12/5620, 1993); the Swedish Långtidsutredningen 1995 (Finansdepartementet, SOU 1995:4); or the European Commission's white paper on Growth, Competitiveness, Employment: The Challenge and Ways Forward into the 21st Century (Eur-Op, 1994).

³⁴On the position of labor in a global economy, see for instance, Miriam Golden and Jonas Pontusson, Bargaining for Change: Union Politics in North America and Europe (Ithaca: Cornell University Press, 1992); Sanford M. Jacoby, The Workers of Nations: Industrial Relations in a Global Economy (New York: Oxford University Press, 1995) ; and Lowell Turner, Democracy at Work: Changing World Markets and the Future of Labor Unions (Ithaca: Cornell University Press, 1991) .

³⁵For example, Henry Laurence, "Regulatory Competition and the Politics of Financial Market Reform in Britain and Japan," paper presented at American Political Science Association (Chicago, August 31-September 3, 1995); and Mark Aspinwall, "The Unholy Social Trinity: Modeling Social Dumping Under Conditions of Capital Mobility and Free Trade," West European Politics 19 (1, 1996), pp. 125-150. For an interesting discussion, see Horst Siebert and Michael J. Koop, "Institutional Competition versus Centralization: Quo Vadis Europe?," Oxford Review of Economic

this observation is much too simplistic since there are fundamental differences across countries. In fact, while all countries in Western Europe are subject to similarly high levels of international capital mobility, the effects on the domestic balances of power differ among them. While companies across Europe may threaten their host governments that they will exit, not all of them have the ability or incentive to do so. Phrased somewhat differently in a well-known aphorism: all companies may talk the talk, but not all are able to walk the walk. This paper suggests that, whether companies can—or whether governments expect that companies will—"walk," is a function of the domestic production regime in which companies are embedded and how it determines their relative power and their incentives to relocate to new jurisdictions. As the next section shows, the extent to which economic globalization has altered the ability and incentives for companies to relocate is fundamentally shaped by how national production regimes mediate external economic changes.

3.1. Variations in National Production Regimes and Two Competitiveness Strategies

The main hypothesis that I advance in this paper is that a state's production regime—defined as the "the organization of production through markets and market-related institutions"³⁶—determines what institutional solution countries will adopt to promote industrial competitiveness. We can distinguish between two general and coherent institutional strategies that are designed toward improving an industry's competitiveness: (1) price-competitive strategies which aim at controlling cost-developments in order to prevent goods from losing competitiveness by being priced out of the market; and (2) quality-competitive strategies that emphasizes product diversification and are designed to improve the value-added performance of producers.³⁷ While producers across Europe usually employ a combination of both measures, they tend to favor one or the other. In fact, a central proposition in this paper is that depending on the organization of the national production regime, producers will support institutional changes that will consolidate a particular strategy which has reaped competitive advantages in the past. As such, economic

Policy 9 (1, 1993), pp. 15-30. For a more cautionary note, see Geoffrey Garrett, "Capital Mobility, Trade, and the Domestic Politics of Economic Policy," International Organization 49 (4, 1995), pp. 657-87.

³⁶Soskice, "Divergent Production Regimes", p. 2. See also, David Soskice, "The Institutional Infrastructure for International Competitiveness: A Comparative Analysis of the UK and Germany," in Anthony B. Atkinson and Renato Brunetta, eds., Economics for the New Europe (New York: New York University Press, 1991), pp. 45-66; and Jill Rubery, "The British Production Regime: A Societal-Specific System?," Economy and Society 23 (August, 1994), pp. 335-354.

³⁷For the general differences between cost-competitive and quality-competitive market profiles, see Michael E. Porter, The Competitive Advantage of Nations (New York: The Free Press, 1990) . See also Richard Locke and Thomas Kochan, "Conclusion: The Transformation of Industrial Relations? A Cross-National Review of the Evidence," in Richard Locke, et al., eds., Employment Relations in a Changing World Economy (Cambridge: The MIT Press, 1995), pp. 359-384.

globalization does not produce convergent policy responses, but rather economic globalization contributes to the consolidation of either strategy.

Analyses of production regimes emphasize, "the ways in which the micro-agents of capitalist systems—companies, customers, employees, owners of capital—organize and structure their interrelationships, within a framework of incentives and constraints."³⁸ Here, I look closer at two distinct types of national production regimes: a liberal market economy (LME) represented by Britain, and a coordinated market economy (CME) exemplified by Sweden.³⁹ These production regimes differ along two variables: the organization of the business community and the product market strategy. The organization of the business community is determined by the degree of coordination within the business community (high or low) and captures the extent to which business associations, employers federations, chambers of commerce and the like provide public and club goods for members. These organizations are the link between individual firms and offices of the government and social groups, and thus present one of the most important features of the meso-level institutions that link governmental institutions with society. While LMEs like Britain are characterized by low levels of business coordination, CMEs such as Sweden tend to have a highly coordinated business community and thus a more dense set of meso-level institutions for negotiations between organizations representing government offices, employers, and workers.⁴⁰ Product market strategies are determined by the extent to which national industries are dependent on whether products are cost- or quality-competitive. Cost-competition is typically associated with basic manufacturing and sophisticated services, while quality-competition is related to production of advanced and high-technology products.⁴¹ As a consequence, LMEs tend to have more deregulated labor markets and a strong presence in mass-manufacturing, while CMEs tend to have institutions for social concentration and R&D intensive industries. There is an institutional affinity between low levels of business coordination and the production of cost-competitive goods on the one hand, and between high degrees of business coordination and the production of high quality goods on the other. The reason for the affinity of the latter pair is because producers want to ensure an institutional infrastructure that provides public goods such as a strong education system and a well-developed transport infrastructure, as well as wage-bargaining structures that prevent wage-drift and

³⁸Soskice, "Finer Varieties of Capitalism," p. 2.

³⁹Other countries that fit the LME profile include: Australia, Canada, New Zealand, and the United States. Countries that fit the CME category include: Germany, Switzerland, and most Northern European countries. A variant of CMEs is found in Japan and South Korea, which Soskice call Group-Coordinated Market Economies. See, Soskice, "Divergent Production Regimes."

⁴⁰For a general comparison between the organization of employers in Britain and Sweden, see James Fulcher, Labour Movements, Employers, and the State: Conflict and Co-operation in Britain and Sweden (Oxford: Oxford University Press, 1991) .

⁴¹Cf. Wolfgang Streeck, "Productive Constraints: On the Institutional Conditions of Diversified Quality Production," in Social Institutions and Economic Performance: Studies of Industrial Relations in Advanced Capitalist Countries (London: Sage, 1992).

wage-inflation. All these aspects are thought to be provided by coordinating employers, because as a group they will have more influence over government policy, as well as the ability to prevent fellow-employers from free-riding in the development of skilled labor, or to poach workers from each other. Conversely, the institutional affinity between low degrees of business coordination and the production of cost-competitive products is because it discourages centrally organized labor unions that can put upward pressures on wages and social regulations, and also because in a deregulated labor-market where skill-levels are low, competition among workers tends to reduce the price of labor rather than increase it since employers can easily replace a low-skilled worker if his or her demands are too high.

Specifically, this paper argues that together the degree of business coordination and the product market strategy of industry provide the central clues to understanding how economic globalization gets filtered through domestic institutions to produce identifiable policy and institutional preferences, as well as which multilateral institutional preferences will be adopted as policy.

3.2. Central Propositions: Sources of Institutional Preferences, Influence, and Policy Outcomes

An explanation of government policy positions needs to be able to account for the sources of the dominant policy and institutional preferences in a country, as well as how these become policy. Thus, we need (1) a theory of preference formation that explains why and what specific policy and institutional reforms are demanded by social groups, as well as (2) a theory of when and why particular policy and institutional preferences will be supplied by governments. This section is designed to provide a set of propositions along these two trajectories, while section IV tests these propositions in case-studies of Britain and Sweden. First, I develop a set of propositions with regard to what institutional preferences will emerge in LMEs and CMEs that operate in a global economy (Propositions 1-2). Specifically, in this context, I look closer at multilateral institutional preferences in the areas of industrial and social policy. Second, I examine the effects of economic globalization on the balances of power in LMEs and CMEs (Propositions 3-4). For this purpose, I use Albert Hirschman's familiar taxonomy of economic and political actors' alternatives to expressing dissent or influencing outcomes: exit, voice, and loyalty.⁴²

⁴²I use exit to designate attempts by one actor (business) to sever its relationship with another actor (government); voice refers to an actor's attempt to raise its concerns verbally in order to change existing circumstances; and loyalty signifies an actor's willingness to retain the relationship, often because this is seen as a way to increase the power of the voice option. See, Albert O. Hirschman, Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States (Cambridge: Harvard University Press, 1970) .

High levels of trade and capital mobility have led some observers to conclude that "footloose" capital does not need national governments to achieve its goals.⁴³ It is argued that these firms can simply involve in regulatory arbitrage and move to the location that suits them best. This is not entirely accurate, however, since a company will only move if it can secure the institutional infrastructure that it requires to remain competitive and if this can be done with increased profits. Thus, producers of cost-sensitive products will only relocate to where production costs are lower, while manufacturers of quality-competitive goods will only relocate if they can secure a place for production where they can develop advanced manufacturing goods with better profit-margins. Note, however, that in the former case, product development and manufacturing can take place in the same location, while in the latter case product development must take place in a setting where quality-competitive product development is sustained, while assembly can be made elsewhere. In other words, even if they have the ability to relocate, producers in LMEs have few incentives to do so since the institutional infrastructure that will sustain their competitive advantage in cost-competitive products already exists at home. In contrast, however, producers in CMEs have strong incentives to maintain the bases for product development at home, while they may gain additional cost-advantages if they relocate assembly to a location where production is cheaper.

The process of economic globalization has further consolidated this situation. For instance, high levels of economic openness have enlarged the markets and shortened the product cycle for producers of quality-competitive goods since they can spread the costs of R&D across a larger market. As a consequence, firms with high R&D intensity have both been presented with the prospect of larger profits, but also been forced to more rapidly upgrade their products in order to remain competitive.⁴⁴ Since upgrading must be done more rapidly, producers are today more dependent on operating in the correct institutional environment than before the onslaught of international competition. Furthermore, since these institutional advantages tend to develop over long periods of time, the benefits from a sudden relocation are unlikely to generate a situation that will sustain the development of advanced products. Thus, with increased international competition, producers of quality-competitive products will both seek access to larger markets to sell their products in order to afford future product developments, as well as work to shape their domestic institutional environment to enable product innovation.⁴⁵ Conversely, increased economic openness has stiffened competition among producers of cost-competitive products and forced these to lower their costs of production to remain competitive. In a global economy, basic industries have few prospects of

⁴³Robert B. Reich, The Work of Nations: Preparing Ourselves for 21st-Century Capitalism (New York: Vintage, 1991)

⁴⁴Timothy J. McKeown, "The Global Economy, "Post-Fordism," and Trade Policy in Advanced Capitalist States," paper presented at the conference "Politics and Political Economy of Contemporary Capitalism," Humboldt Universität zu Berlin (Berlin, Germany, May 26-27, 1995) , pp. 4-5.

⁴⁵Cf. Porter, Competitive Advantage of Nations, and Robert Wade, "Globalization and Its Limits: Reports of the Death of the National Economy Are Greatly Exaggerated," in Suzanne Berger and Ronald Dore, eds., National Diversity and Global Capitalism (Ithaca: Cornell University Press, 1996)

significantly increasing their value-added performance by adopting new production-technology because these acquisitions will undermine their competitive advantage as low-cost producers. Instead, these producers will seek access to cheap imports, and work to construct a domestic institutional environment that will maintain downward pressures on factor costs. Thus, economic globalization tends to consolidate the institutional structures of both CMEs and LMEs, which ensures producers operating in these regimes continued competitive advantages in their markets.

For instance, developments in wage levels tend to contribute to a continuation of a given product-market strategy. Contrary to expectations that economic openness and capital mobility will cause global wages to converge, this has not taken place.⁴⁶ Instead, increased wage compression is occurring within skill-levels, while simultaneously there are larger discrepancies between skill-levels.⁴⁷ This development suggests that although all types of industries are exposed to price competition, those that primarily rely on cost-competitive strategies are less able to upgrade to a more skilled workforce and instead must concentrate on cutting their costs. Conversely, those industries that use high-skilled labor will be forced to continue developing their products to increase their value-added performance in order to stay competitive. Thus, economic globalization does not produce convergent product market strategies across industrialized countries; instead, globalization consolidates existing industry profiles. However, this is not to say that producers do not attempt to shape the domestic institutions that will sustain the competitive advantage on which they depend.⁴⁸ Rather, it suggests that when existing institutional structures need to be upgraded to deal with new circumstance, producers will attempt to shape the economic institutions that determine their ability to remain competitive.

If the central suggestion in this paper is that the structure of national production regimes determine responses to economic globalization and cause changes in institutional choices, then we should be able to observe institutional affinities between different production regimes and international institutional preferences as well. The two most central issue-areas in governments' efforts to increase their competitiveness in recent years have been the structures of industrial

⁴⁶See discussion in Richard B. Freeman, "Are Your Wages Set in Beijing?," Journal of Economic Perspectives 9 (3, 1995), pp. 15-32.

⁴⁷Dollar and Wolff, Competitiveness, Convergence, and International Specialization, chapter 6; and McKeown, "The Global Economy, "Post-Fordism," and Trade Policy in Advanced Capitalist States," p. 15.

⁴⁸Governments are crucial in several ways: namely, in providing the appropriate regulatory framework; in maintaining a macro-economic policy that supports their production strategies; in closing deals with foreign countries that ensure compliance and monitoring that facilitate the international interests of firms; as well as in contributing to high-cost research programs. For all these reasons, the interdependence between governments and business tends to be pervasive—albeit fluctuating—depending on production regime and the attributes of the global economy. See discussion in Yao-Su Hu, "Global or Stateless Corporations Are National Firms with International Operations," California Management Review 34 (2, 1992), pp. 107-136.

and social policy, where issues relating to the use of subsidies and labor-market flexibility have been subject to extended debate. If the general framework adopted here is correct, then we should be able to observe identifiable preferences in these two issue-areas.

Indeed, with regard to social policy issues, producers' institutional preferences are very different in LMEs and CMEs. Since producers in LMEs are sensitive to cost increases and cannot reap profits from value-added techniques, they want an institutional structure that puts downward pressures on wages and social regulations. As a consequence, employers will insist on firm-level bargaining in order to ensure that downward pressures are maintained, and resist the emergence of peak-level negotiations between employers and labor-unions. Producers' domestic agenda of labor market deregulation is mirrored at the multilateral level, where LMEs oppose any regulatory measures that limit the ability of employers to set the form and contents of negotiations with the workforce. As a consequence, producers in LMEs have been opposed to EU-wide regulations in the social policy area.

The situation is very different in CMEs where producers compete primarily in quality-competitive markets, since production requires highly skilled workers and an institutional environment that fosters product innovation to ensure continuous good performance in terms of value-added. Thus, producers are not primarily concerned with wage-levels. Rather, their preoccupation lies with creating an incentive structure that contributes to increased skill-formation as well compensation packages that will ensure producers that investment in employees' training will pay off in the future. While past efforts to prevent competition among skilled labor that would drive up wages were primarily dealt with through peak-level negotiations between strong employer and union organizations, this trend has been reversed in recent years towards a more decentralized firm-level wage-bargaining system. The reason for this switch is largely associated with efforts by advanced producers to delink the wage-structure from the non-tradables sector and to use flexible wage-setting arrangements that offer incentives for skilled workers so that advanced product development is continuous.⁴⁹ In line with their preferences for a decentralized labor-market, producers in CMEs will oppose multilateral agreements that infringe on their ability to determine domestic developments. However, they will support multilateral regulations that aim at minimum upward harmonization in areas such as health and safety, non-working time compensation, and business-labor consultation, since these are seen as areas necessary to retain a skilled workforce, but which at the same time impose similar rules on competitors.

Thus, we can formulate two general hypotheses in the context of social policy:

⁴⁹Torben Iversen, "Power, Flexibility and the Breakdown of Centralized Wage Bargaining: Denmark and Sweden in Comparative Perspective," *Comparative Politics* 28 (4, 1996), pp. 399-436.

Proposition 1a: The more sensitive a country's industry is to cost-competition, the stronger its support for decentralized labor-market regulations and its opposition to multilateral rules that will impinge on producers' ability to put downward pressures and individually determine wages and social costs.

Proposition 1b: The more sensitive a country's industry is to quality-competition, the stronger its support will be for a mixture of non-standardized forms of payment and decentralized wage-setting as long as this does not produce wage inflation. On the multilateral level, this translates into support for common policies in areas that contribute to skill-formation and employee retention, but the rejection of common institutions for wage determination.

In contrast to the diverging policy and institutional preferences of LMEs and CMEs in the social policy sphere, we expect them to share their preferences in the area of state subsidies because in both cases subsidies tend to increase the price of production for non-recipients and distort the level playing-field. The logic behind their positions, however, differs somewhat at the margins. For cost-competitive producers in LMEs, the reason is associated with the negative effects of subsidies on producers' ability to sell goods in a market where competitors are supported by external subsidies and therefore can undercut prices. In a cost-competitive environment, the non-recipient has little recourse to lowering its costs and selling at a lower price, and out of fear of being disadvantaged, producers tend to support the elimination of state subsidies. For quality-competitive producers the reason is that subsidies will redistribute the wealth in the economy from profit-making enterprises (often those in sun-rise industries) to declining sectors. So, while they may not be competing in the same markets, producers of quality-competitive goods are not willing to support the expensive prospect of keeping declining industries alive. However, since producers in CMEs tend to have high R&D intensity, they will be supportive of non-discriminatory horizontal projects that support innovative product developments and that distribute the burdens of such projects across many firms or give it to governments or the EU. Thus, despite slightly different reasons for their support of strict limits on state subsidies, both LMEs and CMEs will support the same general policies and institutional structures.⁵⁰ However, we should be able to detect a more intensive level of commitment to the abolition of discriminatory subsidies in LMEs as they are more directly affected by the distribution of subsidies than producers in CMEs which do not lose in relative but absolute terms, while we should see a stronger commitment by the latter for horizontal programs that support the development of advanced technology (e.g. R&D, education, etc.). Thus, we have the following proposition:

⁵⁰This is in contrast to state-led market economies (e.g. France), where producers tend to be more supportive of subsidies.

Proposition 2: Producers in LMEs and CMEs will reject discriminatory industrial policies as these increase the cost of products when the market is distorted, but will support horizontal strategies that aim at leveling the playing-field as the competition that this implies will put downward pressures on costs. However, the more sensitive the producers are to quality-competition, the stronger will support be for horizontal programs that stimulate product development.

So far, I have discussed the sources of institutional preferences among the business communities in LMEs and CMEs, but it remains to be explained if and why these preferences will become government policy. For this I turn to examine the effects of globalization on domestic balances of power. Contrary to the suggestion that economic globalization awards owners of mobile capital with increased voice across countries, I incorporate the manner in which business is organized to illuminate in what context economic globalization awards business more power. More specifically, I argue that where the business community is able to inflict severe penalties (intentionally and unintentionally) on governments if these do not adopt the preferences of business, business' voice will be stronger. Thus, voice will be strengthened where exit by business is seen as a credible strategy by governments. If economic globalization is kept constant across two different countries, threats of exit will be more credible where they have incentives to move and where they are more organized. Conversely, where business is poorly organized and where there are few incentives to move, business will not be able to inflict severe penalties on governments and thus governments will have more leeway in determining the political agenda.

The high degree of business coordination in CMEs has historically afforded industry with considerable political influence because it pools the resources of the vast majority of employers, which can be used to strong-arm labor with the help of multi-sectoral lock-outs or to influence government decisions by jointly working for or against particular proposals.⁵¹ While these resources in the past were used in a relatively closed domestic setting, economic globalization characterized by lower barriers to mobility has endowed organized business in CME with recourse to the exit option. Unlike in LMEs, however, the threats of exit from business in CMEs are more credible because they are more homogenous and coordinated, but also because in CMEs there are incentives to move if the assembly of advanced products can be done cheaper elsewhere. The voice of organized business in CMEs is strengthened by the

⁵¹See for example, Peter Swenson, "Bringing Capital Back In, or Social Democracy Reconsidered: Employer Power, Cross-Class Alliances, and Centralization of Industrial Relations in Denmark and Sweden," World Politics 43 (July, 1991), pp. 513-544; and Charles E. Lindblom, Politics and Markets: The World's Political-Economic Systems (New York: Basic Books, 1977) .

fact that advanced manufacturers tend to be larger employers, which has spin-off effects for employment in firms that subcontract, as well as in the service industry.⁵² In contrast, in LMEs where downward pressures on cost already exist, threats of exit are not credible since there are few incentives for cost-sensitive producers to locate to new jurisdictions. In liberal market economies, the state is relatively isolated from business pressures, and can largely avoid the structural power of business, and as such, high levels of capital mobility will not necessarily endow holders of mobile assets with more influence. This is due to the fact that LMEs' orientation towards cost-competitive products is typically embedded in regulatory frameworks that carry low costs for producers, and therefore their incentives to move are low.

Thus, business has both the means to organize collectively as well as the structural means to influence government choice in CMEs, while they do not in LMEs. This is because governments in CMEs are highly dependent on business to provide high-skill jobs and sustain success in foreign markets, and because with low barriers to mobility, firms can more credibly threaten to emigrate. As such, in a coordinated economy, business can more easily prevail on governments to adopt the type of international institutions that they prefer, while in liberal economies, business' voice is largely a function of the government's willingness to cooperate. We then have the following proposition:

Proposition 3: Where low barriers to mobility prevail, business' voice and exit functions are strengthened in CMEs, while they tend to be muted in LMEs. Thus, loyalty should be rewarded to a higher extent in coordinated market economies than in liberal ones.⁵³

Hence, a final proposition with regard to the difference between liberal and coordinated market economies would read:

Proposition 4: In LMEs business' inclusion in decision-making is subject to a government's willingness to include business, while in CMEs the business community's influence on government policy is a function of business' need to include the government.

⁵²Cf. Stephen S. Cohen and John Zysman, Manufacturing Matters: The Myth of the Post-Industrial Economy (New York: Basic Books, 1987); and Pontus Braunerhjelm, "Svenska underleverantörer och småföretag i det nya Europa," Industrins Utredningsinstitut (1991) .

⁵³Unlike Hirschman, Exit, Voice, and Loyalty, I do not treat these categories as exclusive, but I suggest that in some settings one form of response may have strong implications for another form of response.

4. Comparing Domestic Capitalisms and International Commitments: The Cases of Britain and Sweden

So far, this paper has advanced a set of propositions relating to how a globalized world economy is mediated by different domestic production regimes to cause divergent country responses in some areas (social policy and labor market regulations) while they tend to converge in others (industrial policy and state aid). The next section tests these claims in more detail in Britain and Sweden, which respectively represent a liberal and a coordinated market economy.

4.1. Britain

Scholars have been accustomed to thinking of Britain as a country in decline and as a country of failing industry, rising unemployment, and strong ambivalence to the European Union. There is no dearth to book titles professing the sentiment that within the EU, Britain is the "odd one in."⁵⁴ Yet, in the last couple of years, a new sense of optimism has prevailed in Britain and by comparative standards to its partners in the EU, Britain is doing better than before in employment and economic growth. Of course, in comparison to the average European post-war record, the British story is far from rosy. While the Tory leadership under John Major reluctantly admits that things were not always good during the Thatcher Premiership—best captured in a bold pre-election poster stating "Yes, it hurt. Yes, it worked."—it today stresses the virtues of those reforms and how they help make Britain the "Enterprise Centre of Europe" where producers can underbid competitors elsewhere through low production and social costs.⁵⁵

Understanding Britain's competitiveness strategy and its relationship to the EU during the past decade-and-a-half requires brief references to the basis of its production regime, which is defined by low levels of coordination among employers and a cost-competitive market orientation.⁵⁶ As the first industrialized country, British firms tended to be small and were overtaken in technological sophistication by late industrializers (e.g. Germany, USA). Despite the onslaught of international competitors in the 20th century, British companies did not significantly restructure their production techniques or product markets, but remained in a situation that has

⁵⁴Will Hutton, The State We're In (London: Vintage, 1996); Eric Roll, Where Did We Go Wrong? From the Gold Standard to Europe (London: Faber and Faber, 1995); Roy Denman, Missed Chances: Britain and Europe in the Twentieth Century (London: Cassell, 1996); Stephen George, An Awkward Partner: Britain in the European Community (New York: Oxford University Press, 1990) .

⁵⁵HMSO, Competitiveness: Creating the Enterprise Centre of Europe (London: HMSO, 1996). This is the third annual White Paper commissioned by the UK government.

⁵⁶For more details, see Rubery, "The British Production Regime."

later been described as a low-wage and low-skill equilibrium.⁵⁷ British companies are internationally competitive in consumer goods and service industries (e.g. insurance, banking), but not in industries that require highly skilled workers, long-term financing, or costly R&D.⁵⁸ In fact, compared to their European countries, Britain ranks very poorly in terms of its domestic infrastructure, its science and technology base, as well as the skill-level of its workforce (see Table 1 for a comparison with Sweden). Devaluations in the 1970s further consolidated a situation that favored cost-competitive industries, and no major restructuring towards industries competing on value-added has taken place.⁵⁹ Instead, British policy since the mid-1980s has been directed towards securing cost-advantages by deregulating the domestic labor-market, as well as weeding out inefficient firms which required state subsidies by attracting foreign direct investment and encouraging competition among producers. Additionally, Britain has resisted EU-level agreements that regulate social policy issues, and worked to secure international markets for exports and the supply of cheap imports. As such, domestic reform programs have been backed-up by the government's efforts at the EU-level, and has served to promote the cost-competitive advantage of British manufacturers.

—Table 1 about here (Competitiveness Rankings)—

There is a lack of coordination among employers and industry in Britain, and the Confederation of British Industry (CBI) has no mandate from its members to negotiate directly with trade unions. Instead, its main functions are confined to lobbying in Britain and internationally (most notably in Brussels); to providing legal assistance to members; and to shaping public opinion. There have been times when the CBI was considered so weak that even the Labour Party attempted to strengthen CBI's organization so that CBI could support policy and institutional reforms relating to employment.⁶⁰ Low degrees of business coordination in Britain are not a historical accident, however, but part of a larger strategy by British industry to secure downward pressures on costs in the manufacturing industry. Since British producers prefer to compete on costs, remaining uncoordinated allows them to take advantage of large pools of unskilled labor which are willing to offer their hands at

⁵⁷D. Finegold and D. Soskice, "The Failure of Training in Britain: Analysis and Prescription," Oxford Review of Economic Policy 4 (3, 1988).

⁵⁸For an overview of British industry, see Porter, The Competitive Advantage of Nations, pp. 482-507. There are some notable exceptions, including the pharmaceutical industry.

⁵⁹Tony Buxton, Paul Chapman and Paul Temple, "Introduction," in Tony Buxton, et al., eds., Britain's Economic Performance (London: Routledge, 1994), pp. 1-8. See also, Margaret Sharp and William Walker, "Thatcherism and Technical Advance: Reform Without Progress," in the same volume.

⁶⁰Wyn Grant, Pressure Groups, Politics and Democracy in Britain, 2nd edition (London: Harvester Wheatsheaf, 1995), pp. 83-84. For details on CBI, see Wyn Grant and David Marsh, The CBI (London: Hodder and Stoughton, 1977).

lower prices, while if employers were coordinated the trade unions would have gained bargaining strength and put upward pressures on wages and social programs.⁶¹

Understanding the specific preferences of British industry in matters relating to state subsidies and labor-market reform, and its position within the European context on these issues requires us to first look at the broad picture of British EU-policy. Britain decided not to join the European Economic Community at its inception in 1957, and did not enter until 1973. During this time, of course, Britain which was already losing important markets in newly independent colonies also lost access to important European consumers. From having accounted for almost half of British trade (48.7%) in 1955, the Commonwealth constituted as little as 11% in the late 1980s. In contrast, Western Europe which only represented 26.8% of British trade in 1955, made up a full 59.3% in 1988.⁶² But despite its strong trade dependence on the EU, Britain's relations with its EC partners has been rather cantankerous, and it has resisted administrative reforms within the EU that would decrease the government's control over the contours of its economy—especially any reforms that would harmonize social standards upwards. It bears pointing out that the event that signaled the renaissance of the EC in the mid-1980s—the Single European Market—was very much a priority of Britain and illustrates compellingly the main interest of Britain in the EU.

Open and free markets for goods, services, and labor—especially if many of its competitors have higher costs of production—by far remain Britain's most important goal. Thus, British industry is particularly invested in ensuring that the Single European Market is fully implemented, and that all sectors of the economy are covered, including public procurement, civil aviation, and energy. Moreover, as Proposition 2 predicted—industries which primarily compete on costs will reject state subsidies and support a multilateral policy that strictly enforces the abolition of discriminatory industrial policies—British industry has made strong and centralized controls that will prevent discriminatory state subsidies a chief goal in its efforts to enhance their international market presence.⁶³ Its support for horizontal subsidy schemes aimed at developing R&D-intensive industry and the EU's so-called Framework Programmes (FP), which are designed for such purposes and aid a relatively small number of advanced manufacturers, is moderate and considerable lower than that of Germany, France, and Sweden.⁶⁴ The reason for British reservations is associated with the relatively small number and size of R&D-intensive industry in Britain, and a conviction that the current FPs favor countries,

⁶¹For details on the organization of British employers, see Fulcher, Labour Movements, Employers, and the State.

⁶²Nicholas Costello, Jonathan Michie and Seamus Milne, Beyond the Casino Economy: Planning for the 1990s (London: Verso, 1989) , p. 43.

⁶³Confederation of British Industry, Shaping the Future: A Europe that Works (London: CBI, 1995) .

⁶⁴Author's interview with Peter Bunn, Director of EU Internal, Trade Policy and Europe Directorates, Department of Trade and Industry (London: June 19, 1996) .

which—unlike Britain—have many large companies with high R&D-intensity and government intervention. As such, Proposition 2 is supported in the British case.

While British producers generally share their preferences with other member-states over EU's role in controlling and serving to abolish state subsidies, they differ significantly in their preferences over the organization of EU social policy. As companies who regard their advantage in cost-competitive production as a central feature of industrial competitiveness, British firms have been strongly in favor of domestic labor-market deregulation and equally strong opponents of EU's Social Protocol. Today, British producers have a significant competitive advantage over their European competitors in manufacturing (especially those in Northern Europe) since hourly wages and the social contributions by employers are significantly lower than those of their competitors (see Figure 1). The basis for this, they argue, is the highly deregulated labor-market in Britain, and to maintain this advantage producers have been adamantly opposed to any reforms that may impose more regulations. Echoing the domestic institutional preferences of employers, British producers have carefully guarded Britain's singular opt-out from the Social Protocol (agreed by the other EU member-states in December 1991) in order to prevent EU-regulations from eroding British industry's cost-competitive advantage.⁶⁵ Instead, British industry has supported the so-called Essen Declaration—which asserts the importance of increasing the flexibility of work organization and reducing non-wage labor costs—and other programs which are deregulatory in nature and give the primary responsibility to employers and workers in the national labor-market.⁶⁶ Thus, Proposition 1a is also vindicated.

—Figure 1 about here (Comparative Manufacturing Costs)—

While the empirical record vindicates propositions 1a and 2, what evidence do we have that proposition 3 and 4—relating to the balance of power between governments and business—are correct? The answer to this question is found through a closer analysis of the relationship between the British government and the business community. The situation before Margaret Thatcher took office in 1979 has been described as one where "British policies encourage[d] a situation in British business where there was neither co-ordination nor competition, but rather a collusive and cosy world of low productivity, slow growth and declining

⁶⁵CBI, A Europe that Works, and Author's interview with Dick Eberlie, Director of Brussels Office, Confederation of British Industry (Brussels: July 2, 1996) .

⁶⁶Author's interview with Nicola Whitlock, Section for European Affairs, Confederation of British Industry (London: June 19, 1996) . See also, Essen European Council, "Bulletin of the European Union, December 1994.

competitiveness."⁶⁷ The Thatcher government set out to change this situation, and its policy was characterized by a strong government offensive against the trade unions and a strategy of non-engagement with business. The basic premise was that if the power of labor could be decreased and markets be allowed to determine the allocation of resources, British companies would flourish and become internationally competitive again. Despite initially having detrimental effects on British industry, the Thatcher government did not fear that its reforms would force British companies to emigrate since there was no other location in the EU where British producers could retain their competitive advantage. Instead, the Thatcher government made the Single European Market its main objectives along with programs that would attract foreign direct investment. While the business community supported SEM, they were initially opposed to the government's attempts to attract FDI, but were unable to make its voice heard. The government's logic behind attracting FDI was grounded on the presumption that non-EC firms would be compelled to invest in the UK because production was cheaper than many other EU countries and because production in Britain provided access to the SEM.⁶⁸ At the same time, an influx of FDI was thought to enhance the productivity of British companies and crowd out poorly performing companies.⁶⁹ Since the government's efforts to attract foreign investors and its proclamation that direct subsidies to poorly performing industries would end, many British manufacturers were initially opposed to the Thatcher agenda. Despite this opposition, the Thatcher government calculated that its policy of disengagement would not significantly cause companies to relocate abroad. Instead, the government calculated that dependence of British producers on a production regime that would guarantee low social and wage costs meant that they preferred to manufacture in Britain, and as such the credibility of business' exit threats was low.⁷⁰

Over time, however, British producers have become strong supporters of Tory reforms, and in particular the Tory emphasis on a deregulated labor-market. Moreover, since 1992 the Major government's drastic repeal of the Tory Party's

⁶⁷Geoffrey Jones and Maurice Kirby, "Competitiveness and the State in International Perspective," in Geoffrey Jones, et al., eds., Competitiveness and the State: Government and Business in Twentieth-Century Britain (Manchester: Manchester University Press, 1991), p. 17.

⁶⁸Trade and Industry Committee, House of Commons, Competitiveness of UK Manufacturing Industry (Volume II: Memoranda and Evidence) (London: HMSO, 1993-94) , p. 31, reports that the UK has attracted 40% of Japanese FDI and more than a third of US FDI between 1951 and 1992/3. See also, Stephen Thomsen and Stephen Woolcock, Direct Investment and European Integration: Competition among Firms and Governments (London: Pinter Publishers, 1993) .

⁶⁹The government has also used so-called challenge programs—that is, programs that let producers compete for state allocated funds for innovate and superior performance—to enhance competition among business. The rationale behind this strategy is that it will force competitive "laggards" to improve their performance or close down, and thus ensure that UK business improves its competitive positions vis-a-vis outsiders. See in particular, HMSO, Competitiveness: Creating the Enterprise Centre of Europe.

⁷⁰Author's interview with David Higham, Director, Domestic and World Economy, Department of Trade and Industry (London: June 20, 1996) .

previous policy of disengagement from the UK business community was changed towards one that would facilitate the interests of business.⁷¹ The chief reason behind this change was an observation that deregulated markets at home were not sufficient to develop the strength of British firms, but more importantly, increased European integration through the SEM required that the British government looked after the interest of British firms and ensure that they were not discriminated against. For instance, the Major government has actively included British industry in many of its programs, and the CBI—which had been on a collision course with the Thatcher government—describes its current relations with the Major government as one of "Partners for Success."⁷² However, from CBI publications and interviews, it is clear that industry does not expect to determine the agenda of the government or that they take its inclusion for granted.⁷³ Rather, the current relationship between the government and the business community is designed to ensure that British companies have access to European markets on the same terms as their competitors, and to promote the interests of British industry in various EU policy-areas. There is a wide-spread perception that if the UK government does not protect the often particular interests of British industry in the EU, then the competitive advantage of British industry in cost-competitive markets would decline as a consequence of EU reforms. To ensure that this will not happen and to ensure that a solid basis for economic growth exists for the future, the current British government has invested large resources to secure an appropriate institutional environment that protects the institutional infrastructure that provides British firms' with a cost-competitive advantage. This should not be interpreted to suggest that the business community has acquired more power over the government—a good example of the business community's limited influence is its failure to convince the government to improve the transport infrastructure in Britain, which has remained one of the very central themes of the CBI⁷⁴—but should be seen within a larger context of the government's efforts to stimulate economic growth for the purposes of a strong economy, and ultimately to improve its own chances of political success.

Overall, the British case demonstrates that the leader in policy and institutional reforms has been the government, and not the business community.

⁷¹For a basic background, see Jeremy Richardson, "Doing Less by Doing More: British Government 1979-1993," West European Politics 17 (3, 1994), pp. 178-197.

⁷²See, Confederation of British Industry, Partners for Success: Improving the Competitiveness of UK Business—The Role of Government (London: CBI, 1993)

⁷³See, for example CBI, Partners for Success. In three interviews that I conducted with CBI officials in their London and Brussels offices, as well as in conversations with two members of the Cabinet Office's Competitiveness Division, this situation was clearly affirmed. The interviews were conducted in June and July 1996. The role of the UK business community in aiding the government's competitiveness agenda, as well as other central aspects of that strategy, are covered in detail in the British government's three White Papers on the topic. See, HMSO, Competitiveness: Helping Business to Win (London: HMSO, 1994); HMSO, Competitiveness: Forging Ahead (London: HMSO, 1995); HMSO, Competitiveness: Creating the Enterprise Centre of Europe (London: HMSO, 1996) .

⁷⁴Author's interview with Nishit Dattani, Research Assistant, Manufacturing and International Markets, Confederation of British Industry (London: June 25, 1996) .

Over the last fifteen years, the government has consistently adopted policies that producers have initially been strongly opposed to, and which they only later have come to support. Thus—as propositions 3 and 4 suggested—despite business' opposition to many reforms, they did not exit nor was their loyalty significantly rewarded. In many ways the British government has been successful in achieving its objectives: the UK is the primary destination of extra-European FDI; its inflation has declined (despite its exit from the European Exchange Rate Mechanism in 1993); and it has improved its growth rates in recent years. Containing state subsidies across Europe through centralized EU-level institutions, stressing the importance of labor market flexibility, promoting a minimal of EU social policy, and taking advantage of its opt-out is not only consistent with the British production regime, but has also served to preserve its longevity. Indeed, the British response to economic globalization and problems with industrial competitiveness have not caused Britain to withdraw from multilateral organizations or to alter its production regime; rather, British policy has been designed to preserve its existing comparative institutional advantage that provides low-cost production and to carefully assess which policy-areas in the EU best serve its goals.

4.2. Sweden

If Britain has been hailed by some as ending its period of decline and even as a model of deregulation, Sweden is the inverse: celebrated in the past for its economic governance structures, it is today in deep economic crisis.⁷⁵ A country traditionally seen as a stable corporatist regime that managed to combine low levels of unemployment, competitive industries, and a cradle-to-grave welfare state, Sweden has in the last decade undergone two major and unexpected changes. It has abandoned what is commonly referred to as the Swedish Model and its corporatist system of interest intermediation, as well as rescinded its claims of neutrality and joined the European Union. While a number of studies nicely document the sources of the Swedish Model's demise, there are few comparable accounts of why Sweden sought to become a member of the EU or what its policy position is in various issue-areas.⁷⁶ More importantly, however, there is no account

⁷⁵Like in the British case—albeit at a slightly smaller scale—a set of books that have become prominent in public debates are indicative of the situation and public mood in Sweden. Assar Lindbeck, et al., Turning Sweden Around (Cambridge: MIT Press, 1994); Walter Korpi, Halkar Sverige efter?: Sveriges ekonomiska tillväxt 1820-1990 i jämförande belysning [Is Sweden Slipping? Sweden's Economic Growth in Comparative Perspective, 1820-1990] (Stockholm: Carlssons, 1992); Jonas Pontusson, "Sweden: After the Golden Age," in Perry Anderson, et al., eds., Mapping the West European Left (London, New York: Verso, 1994), pp. 23-54; Stefan Fölster, et al., Sveriges systemskifte i fara? Erfarenheter av privatisering, avreglering och decentralisering [Sweden's Structural Adjustment in Danger? Experiences from Privatization, Deregulation, and Decentralization] (Stockholm: Almqvist & Wiksell, 1993) .

⁷⁶On the end of the Swedish Model, see inter alia Villy Bergström, Varför överge den svenska modellen? (Eskilstuna: Nationalekonomiska Föreningen och Tiden, 1993); Bo Elmbrandt, Så föll den svenska modellen (Stockholm: T. Fischer & Co., 1993); Leif Lewin, "The Rise and Decline of Corporatism: The Case of Sweden," European Journal of Political Research 26 (1994), pp. 59-79; Per-Martin Meyerson, Den Svenska Modellens Uppgång och Fall (Stockholm: SNS Förlag, 1991);

that links recent domestic reforms and its multilateral institutional preferences or considers the implications of one for the other. Yet, recent changes in Swedish domestic reforms and institutional preferences within the EU are closely connected with the effects of global economic changes on the Swedish production regime. In this section, I demonstrate that these two developments are intimately linked and can be understood with reference to challenges that the Swedish production regime faced in an increasingly competitive world economy. As in the British case, I discuss the Swedish production regime and the sources behind Swedish multilateral institutional preferences with regard to subsidies and labor market flexibility, as well as address why a particular policy eventually emerged.

The Swedish production regime is characterized by highly coordinated employers and the production of advanced goods of high quality.⁷⁷ Sweden compares favorably—unlike Britain—with other industrialized countries on the grounds of its science and technology base, infrastructure, and the quality of employees (see Table 1 above). In fact, Sweden has the highest R&D-intensity in the world, and expenditure in advanced research has increased despite a recession in recent years (see Table 2 for a comparison with Britain). The organization of employers and the product market strategies of industry date back to the historical compromise between private industry and the labor movement in the 1930s, which embodied the three principles of the protection of private ownership of industries; no state intervention in industrial relations; and a commitment to using substantial parts of the profits from industrial growth for an expanding welfare state.⁷⁸ What later became known as the Swedish Model reached its mature state in the late 1950s and combined a strong commitment to an open Swedish economy exposed to international competition with a generous welfare state and full employment. The basic idea was that with a solidaristic wage policy that would avoid inflationary pressures and with international exposure to competition that would select the competitive firms, Sweden would be able to guarantee full employment, generous social policies and competitive firms. A key feature of the Swedish Model was that labor-market negotiations were structured around peak-level negotiations between the Swedish Confederation of Employers (SAF; Svenska Arbetsgivareföreningen) and the Swedish Trade Union Confederation (LO, Landsorganisationen). Centralized bargaining assured employers that wage-bargains would cause little wage-drift or production stoppage, and it assured organized labor that they would be

Victor A. Pestoff, "The Demise of the Swedish Model and the Rise of Organized Business as a Major Political Actor," Department of Business Administration, University of Stockholm (1991) . For good discussions of Swedish EU-policy, see Paulette Kurzer, Business and Banking: Political Change and Economic Integration in Western Europe (Ithaca: Cornell University Press, 1993); Jacob Gustavsson, "The Political Economy of Foreign Policy Change: Sweden and the European Integration Process," paper presented at Conference The Nordic Countries in a Rapidly Changing World (Oslo, Norway, November 1-3, 1995) .

⁷⁷Porter, The Competitive Advantage of Nations, pp. 331-355.

⁷⁸For authoritative studies of the post-war Swedish political economy and the Swedish Model, see Jonas Pontusson, The Limits of Social Democracy: Investment Politics in Sweden (Ithaca: Cornell University Press, 1992) and Nils Elvander, Den Svenska Modellen: Löneförhandlingar och Inkomstpolitik, 1982-1986 (Stockholm: Allmänna Förlaget, 1988) .

awarded comparatively high and rising real wages. This arrangement was also seen as an important source of continuous product innovation based on skill-development. The model was originally premised on the idea that unprofitable firms would be closed down, and workers would be retrained and guaranteed jobs in efficient companies. In the long-run, with the efficiency of industry guaranteed, the result would be real wage increases and an expanding welfare state. Governmental industrial policy was seen as superfluous under this mandate, and labor market flexibility was given by the mutual commitment of employers and workers to profitable and growth-oriented businesses.

—Table 2 about here (R&D Expenditure)—

In the 1970s, however, a number of reforms took place that challenged the basis of the historical compromise and undermined the viability of the Swedish Model. Producers abroad underbid Swedish industry in many of that country's strong manufacturing industry (e.g. textiles, shipbuilding) and forced large close-downs. Increasing demands for direct state intervention were raised and the government championed a policy of compensation for declining industries to maintain full employment.⁷⁹ At the same time, the trade union movement and the Social Democratic Party launched ambitious plans for new labor market regulations, all of which employers later would try to repeal by claiming that the reforms challenged the basic premises of the post-war settlement.⁸⁰ The labor movement, on the other hand, defended these reforms by claiming that they were designed to force Swedish companies to invest at home, to contain their investments abroad, and to force employers to honor their commitment to the historic compromise.

By the early 1980s massive disincentives for domestic investment had emerged, and unprecedented outflows of direct investment by Swedish firms took place at an increasing rate throughout the decade (Figure 2). A series of devaluations in the 1970s and early 1980s—most notably one of 16% in 1982—were designed to reduce the incentives of companies to emigrate and to boost the

⁷⁹Pontusson, Limits of Social Democracy, Chapter 5.

⁸⁰ The 1976 Law of Codetermination (Medbestämmandelagen) can be seen as the apex of a wave of labor market reforms and required employers to consult workers if managerial decisions affected the status of employees. The same year, LO floated a proposal that would increase the collective ownership of industries by transferring a percentage of firm profits to funds that were controlled by worker interests. The basic idea behind this proposal, called the Wage Earners' Funds (Löntagarfonderna), was to give workers a profit motive that would furnish the basis for moderate wage demands and guarantee non-inflationary growth. As one observer astutely notes, however, unlike in other countries, this meant that Sweden collectivized the most profitable firms rather than the least successful (Pontusson, The Limits of Social Democracy, p. 453.) In the end, the Wage Earners' Funds became the most divisive political issue in the 1980s, and became a rallying cry for the business community.

attractiveness of Swedish exports.⁸¹ In addition, industrial policies of the 1970s which had been constructed to rescue declining firms were replaced with one that was supposed to promote advanced manufacturing and product innovation. The premise of the government's massive devaluation in 1982 was that workers would accept a temporary decrease in living standards and exercise wage restraint in order to ensure that the devaluation was not eaten up by spiraling wage demands. The policy was successful to begin with since it rode on a booming world economy, but labor shortage and higher employment growth in high-skilled jobs provided the basis for higher wage demands and wage drift, and ultimately inflation ate up the competitive advantage that the devaluation strategy had produced. Thus, instead of providing the basis for a strong manufacturing industry, these reforms ended up diminishing the prospects for innovative development.⁸² While the strategy of the early 1980s at first seemed successful, the first half of the 1990s showed a drastic turn towards the worse and brought unprecedented levels of unemployment (a jump from 1.8% in 1990 to 9.8% in 1994), along with negative growth.⁸³

—Figure 2 about here (Swedish Investments)—

—Figure 3 about here (Reinvested Earnings)—

Sweden is a country heavily dependent on international trade: almost 60% of GDP was accounted for by exports and imports, and over 55% of its world exports went to the EU.⁸⁴ High disincentives to invest at home and similarly high incentives to invest abroad (especially during the lead-up to the Single European Market) resulted in a scenario where unemployment rose at home, where significant employment growth only took place in Swedish companies abroad, where the earnings of Swedish companies abroad were invested outside Sweden, and where foreign companies in Sweden decided to take their profits out of Sweden (see Figure 3). Spearheading efforts to change the institutional structures that had caused this situation and to develop an institutional structure that would promote competitiveness in the future were SAF and the Federation of Swedish Industries (SI; Sveriges Industriförbund).⁸⁵ The Executive Director of SAF, Ulf Laurin, claimed

⁸¹See, Lars Jonung, "Rivstart eller snedtändning?," in Lars Jonung, ed., Devalveringen 1982: Rivstart eller snedtändning? (Stockholm: SNS Förlag, 1991).

⁸²Lars Vinell, "Devalveringarnas effekter på industrin," in Lars Jonung, ed., Devalveringen 1982: Rivstart eller snedtändning? (Stockholm: SNS Förlag, 1991).

⁸³European Commission, Employment in Europe 1995 (Brussels, 1995); OECD, Economic Outlook 58 (December 1995).

⁸⁴IMF, Direction of Trade Statistics (Washington, 1993).

⁸⁵By far the best recent account of the demise of central aspects of the Swedish Model and the role of employers in altering the corporatist structures in Sweden, is Jonas Pontusson and Peter

that Sweden was not facing the inevitable consequences of "structural shortcomings," but that the devaluation strategy constituted the "hangman's medicine" and had prevented Swedish industry from restructuring.⁸⁶ In the early 1990s, SAF listed as its major goals deregulation of domestic and international markets, "decorporatization," and stronger integration with the European Union.⁸⁷ Employers argued that in a global economy, previous corporatist practices would not allow them to respond flexibly to international price changes, but instead demanded that the labor-market be deregulated and bargaining decentralized to the firm-level. More specifically—as Proposition 1b predicted—Swedish employers wanted to increase the flexibility in pay practices so that they could retain and encourage skilled labor, which was essential to retaining industrial competitiveness.⁸⁸ Moreover—and contrary to early arguments on countries with corporatist legacies—Swedish employers strongly rejected EU-regulation that would impinge on their ability to determine firm-level wage-determination.⁸⁹ In contrast to the position of British industry, however, their Swedish counterparts have been more willing to allow EU-level regulation in social standards since these typically are seen as a way to retain a skilled workforce. Finally, as Proposition 2 hypothesized, the product market strategies of Swedish industry have made producers highly adverse to discriminatory and compensatory forms of state subsidies, while they have been more supportive of horizontal programs that contribute to advanced product development than their British counterparts.⁹⁰

Swenson, "Labor Markets, Production Strategies, and Wage Bargaining Institutions: The Swedish Employer Offensive in Comparative Perspective," *Comparative Political Studies* 29 (April, 1996), pp. 223-250. Although, I fully agree with their general argument and approach, Pontusson and Swenson's failure to consider the fundamental role played by Sweden's institutional integration into European structures of economic cooperation (first EFTA and EEA, and ultimately the EU) and their crucial importance in making domestic reforms credible and lasting, oversimplifies the story. On a less important point, the sole emphasis on SAF as the representation of employers fails to give credit to the importance of SI in shaping economic policy in Sweden.

⁸⁶Ulf Laurin, "Farväl till överståtligheten," in SAF, *Farväl till korporatismen!* (Stockholm: SAF, 1991), pp. 18, 9-10.

⁸⁷To achieve their objectives, SAF unilaterally resigned from trilateral institutions and ended peak-level bargaining which forced the decentralization of wage settlements, and, with few exceptions, their goals in decentralization and an end to corporatist wage-determination have been successful. For the details, see, Pontusson and Swenson, "The Swedish Employer Offensive in Comparative Perspective;" Andrew Martin, *Wage Bargaining and Swedish Politics: The Implications of the End of Central Negotiations* (Stockholm: Trade Union Institute for Economic Research, 1992).

⁸⁸Iversen, "Breakdown of Centralized Wage Bargaining," and Pontusson and Swenson, "The Swedish Employer Offensive in Comparative Perspective."

⁸⁹For an early account of the prospects of a European-level system of corporatism, see Louka T. Katseli, "The Political Economy of European Integration: From Euro-Sclerosis to Euro-Corporatism," *The International Spectator* 24 (3-4): 186-195.

⁹⁰For SI's position on different policy areas, see Industriförbundet, *Det ekonomiska läget: Att återvinna välståndet* (Stockholm: Author, 1995) . I am grateful for clarifications offered in interviews with Olle Allgård, Director of Brussels Bureau, Swedish Employers' Federation (Brussels: November 28, 1996); and Niklas Bergström, Brussels Bureau, Swedish Federation of Industry (Brussels: November 28, 1996) .

But what indications are there that the institutional preferences of Swedish industry—such as support for a deregulated labor-market and a centralized EU industrial policy—was adopted as policy by the Swedish government? The answer to this question requires us to put the institutional preferences of Swedish industry in a larger context and consider the reasons for why Sweden joined the EU in 1995. Membership in the EU was considered crucial by industry to secure access to the most important markets and avoid discriminatory practices from members of the EU, but more importantly, membership in the EU was a strategy to consolidate the domestic objectives of Swedish industry that were vested in reconstructing a competitive production regime in Sweden. Membership was considered crucial as a means to induce efficiency in Swedish manufacturing and close out inefficient subsidized companies in exchange for secure new markets in Europe. We could say that Swedish industry traded subsidies at home for a stable market structure abroad that came with EU-membership. But, how was organized business in Sweden able to influence the government to seek membership on business' terms? Answering this question allows us to refer back to the language we used in section III.

The Swedish case is almost a text-book example of how the exit, voice, and loyalty options work in an open economy where there are strong incentives for domestic producers to move abroad. In combination with financial deregulations in the late-1980s, the emergence of EU's internal market, and strong disincentives to invest at home, gave Swedish producers ample incentives to emigrate. A coordinated business community which in the past had been deeply committed to developing an institutional infrastructure which sustained competitiveness in advanced manufacturing goods, had been given few reasons in the 1980s to believe that the Swedish government would alter its policies and provide a basis for the quality-competitive to flourish in the future. Instead, strong disincentives had been built up, and when the opportunity and incentive to move within the borders of the EU emerged, Swedish business invested record numbers of direct investments in the EU. As Figure 4 clearly shows, Swedish firms were clearly committed to establishing a base within the EC before the Single European Market took effect in 1992. The Swedish government was acutely aware that this trend would continue if stronger incentives were not offered for companies to invest in Sweden, and thus gave into the exit threats of the business community.⁹¹ Some observers might say that remaining outside of the Union (but retaining access to the internal market through the European Economic Area) could have made Sweden a more attractive site for investment, since it would be able to underbid its competitors within the EU. This alternative was not a real option for Sweden, however, since staying outside the Union was synonymous with losing the quality-competitive industry which was

⁹¹The government's concerns about capital flight and firms emigrating are amply illustrated by former Finance Minister Kjell-Olof Feldt, *Alla Dessa Dagar...i Regeringen 1982-1990* (Stockholm, 1991); and Feldt, *Rädda Välfärdsstaten!* (Stockholm, 1994), especially chapter 6.

the backbone of the Swedish economy and anathema to the interests of all political parties, labor, and business.⁹²

—Figure 4 about here (FDI to EU)—

As Proposition 4 suggested—in contrast to the British case—exit threats were highly credible in the Swedish context because the incentives to emigrate existed and business was highly coordinated. Swedish industry wanted to secure a production regime that would provide a basis for future competitiveness, and if it was denied access to it in Sweden, most business were going to leave Sweden. It was thus incumbent on the Swedish government to send a clear signal to the business community that they would be given more voice in domestic politics, and that loyalty would be continuously rewarded if Swedish industry invested in Sweden. To make this commitment credible, the government initiated a number of reforms that covered increased flexibility in labor market regulations and the abolition of direct subsidies to industry at home, and—most significantly—a strong commitment to the EU including its horizontal industrial policy and its policy of limited interference in social affairs. It should be noted, however, that since the business community had more to gain from Sweden being an EU-member and a government committed to rebuilding an institutional infrastructure that would recapture Swedish industry's competitive advantage in quality-competitive product markets, it had—as Proposition 5 suggested—strong reasons for attempting to persuade the government to change policy rather than simply abandoning Sweden and move abroad.⁹³

4.3. Brief Comparative Notes on Britain and Sweden

As the case-studies make clear, in the wake of a highly integrated world economy in the 1980s and 1990s, Britain and Sweden—two diametrically opposed production regimes—have neither developed the same domestic policy responses, nor have they adopted the same multilateral institutional preferences across the board. Instead, both have sought to promote their distinctive national comparative institutional advantages. A crucial difference between the two countries was the role played by the Single European Market, which gradually developed over the 1980s and came into effect in 1992. Britain as a member of the EC saw the internal market as an opportunity to attract foreign direct investment that wanted access to the internal market and offered low production costs. Indeed, in Britain, attracting FDI has been a major part of the Conservative Party's strategy to discipline labor,

⁹²Vinell, "Devalveringarnas effekter på industrin;" and SOU 1994:6, Sverige och Europa: En samhällsekonomisk konsekvensanalys (Stockholm: Norstedts, 1994), especially part II.

⁹³See discussion in SAF and Industriförbundet, Ökad konkurrenskraft: För Europa och Sverige! (Stockholm: Authors, 1994).

exchange employment in efficient industries for lay-offs in declining enterprises, and consolidate its presence as a low-cost producer of manufacturing goods. As Proposition 3 suggested, the business community in Britain was unable to punish the British government when the Tory government pursued policies to the detriment of business. Low incentives and organizational capacity prevented business from gaining voice in domestic affairs, and instead the British government determined the agenda of reforms (Proposition 4). The government was very successful in these objectives, and today—with support from business—proudly announces low costs of production as its main asset.⁹⁴

In Sweden, on the other hand, the emergence of the internal market gave the business community strong incentive to emigrate—which it had not had earlier—and to establish a basis within the EU in order to guarantee access to its most important markets. These threats were particularly credible because the business community was highly coordinated, and had suffered the negative consequences of a number of reforms in the 1970s and 1980s (Proposition 3).⁹⁵ Membership in the EU thus became a way of guaranteeing that Swedish industry in the future would have access to its main markets, but also that the Swedish government would reassert the country's comparative institutional advantage in advanced manufacturing.

In analyzing the basis of British and Swedish comparative institutional advantages—the former relying on institutions that put downward pressures on costs and maintain cost-competitive production, while the latter sustain institutions for quality-competitive production—we can explain the source of their divergent multilateral institutional preferences. They are both highly dependent on trade with their European partners, and thus support institutionalized forms of free trade. Since both countries fear that industrial subsidies awarded in other countries may harm their own industry, both strongly support non-discriminatory industrial policies and far-reaching centralization within the EU in this area so that the Union can monitor and enforce non-discriminatory policies (Proposition 2). In Britain the reason is primarily because industry is sensitive to costs and would thus easily lose competitive advantages if subsidies were awarded elsewhere. In Sweden, the government budget and the domestic market is too small to sustain advanced manufacturing if other larger countries (e.g. France) use targeted industrial policies, and thus Sweden's preference is also for strict limits to subsidies and a strong

⁹⁴HMSO, Competitiveness: Creating the Enterprise Centre of Europe.

⁹⁵We can note, for instance, that employment in Sweden's ten largest firms abroad increased by 75% between 1975 and 1991. By 1991, 59% of the total workforce of the ten largest companies were based outside of Sweden! Calculations are based on statistics reported in SOU, Långtidsutredningen 1995 (Stockholm: Fritzes, 1995), p. 113, table 4.8. Telling evidence is also provided in Pontus Braunerhjelm, "Nyetablering och småföretagande i svensk industri," in Thomas Andersson, et al., eds., Den långa vägen: Den ekonomiska politikens begränsningar och möjligheter att föra Sverige ur 1990-talets kris (Stockholm: Industrins Utredningsinstitut, 1993), pp. 91-118, in particular Figure 4.5. Considering that large companies make up a very considerable part of employment, this is a matter of great concern to governments and employees in Europe. Ferner and Hyman note that as much as 28% of total employment in Europe is made up of 13,000 companies with more than 500 employees. See, Anthony Ferner and Richard Hyman, ed., Industrial Relations in the New Europe (Oxford: Blackwell, 1992), p. xviii.

centralization of industrial policy within the EU. With regard to social policy and labor-market flexibility, Britain has rejected EU-policy in the area and opted-out of the majority of social policy legislation as that is seen as putting upward pressure on costs (Proposition 1a). In contrast, Sweden supports some forms of EU social policy since that levels the playing field, but more importantly Sweden insists that the parties in the labor-market themselves can devise institutions for cooperation so as to promote a policy that will guarantee the development of highly skilled labor for its industry (Proposition 1b).

In the context of the empirical details provided in this section, it becomes clear why increased economic globalization—somewhat counterintuitively—does not spell an end to producers' interests in developing appropriate institutions at home, but why economic globalization requires producers to protect that home-base in order to succeed abroad.⁹⁶ Indeed, Britain and Sweden—while both genuinely committed to European integration—see multilateral cooperation more as a way of anchoring their domestic objectives than an attempt to make their old home-bases obsolete. But what are the larger implications of this finding and the vindication of the propositions in section III? In the following conclusion, some areas are addressed that allow us to begin uncovering the important role played by national production regimes in mediating global economic changes and in shaping the direction of institutional change in Europe.

5. Conclusion: Domestic Production Regimes and Support for International Institutions

In the epigraph to this paper, David Yoffie suggests that to ensure competitiveness in the future, governments and business must actively attempt to change existing institutions. The French proverb, on the other hand—"The more things change, the more they remain the same"—can be interpreted to imply that altering institutions is associated with maintaining the status quo. Despite the apparent conflicting conclusions of these two phrases, they in fact both speak to a central point in this paper: in a global economy, business and governments seek to make change in the margins of existing institutions in order to adapt to new realities and maintain the essence of the production regimes in which they operate. This paper shows that there is a tension between retaining parts of existing institutions (efficient or not) and adopting new ones. National production regimes are relatively stable constructions in which producers in a predictable fashion can calculate their benefits, and as such they will not look for the type of major changes that a transition to a new production regime involves. Fundamental changes of production regimes will not allow those

⁹⁶As Porter writes: "Competitive advantage is created and sustained through a highly localized process...While globalization of competition might appear to make the nation less important, instead it seems to make it more so. With fewer impediments to trade to shelter uncompetitive domestic firms and industries, the home nation takes on growing significance because it is the source of skills and technology that underpin competitive advantage." The Competitive Advantage of Nations, p. 19.

who constructed them to make use of their institutional comparative advantages, and, therefore, the architects of change will be reluctant to completely abandon existing domestic institutions. This does not mean, however, that business and government will not attempt to adapt certain aspects of national institutions to new realities. Indeed, as this paper shows, economic globalization has led to a number of changes in policy and institutional choices at the domestic level, as well as to changes in states' preferences for the institutions of international cooperation. And, as demonstrated in both the British and Swedish case, these changes have been consistent with differences in their respective production regimes and have been designed to update existing institutions to new external economic circumstances.

In contrast to research in international and comparative political economy that either treats national economic institutions as easily transformed or as rigid constructs—and, sometimes even as epiphenomenal—this paper has pointed at the largely predictable nature of current institutional developments to which national production regimes contribute, as well as to the consequences that economic globalization has for different states' choice of international institutions. The central message that this paper conveys is that the deep-seated economic institutional configurations that comprise national production regimes provide a crucial clue to understanding why a number of domestic and international reforms in industrial and social policy went hand-in-hand in the 1980s and 90s, and why they differed across countries according to the particular logic associated with differences in the level of coordination in the business community and product market strategies. In those cases where institutional change was slow or lacking (e.g. Britain in the 1970s, Sweden in the 1980s), problems of industrial competitiveness emerged, which were subsequently dealt with by gradual reforms in accordance with the profile of particular production regimes—and not according to some optimal solution that a convergence argument would profess. The belated response in Britain and Sweden encompassed a number of reforms at the national level, but also included a renewed commitment to European economic integration. However, their respective responses differed in significant ways, and a central question that this paper addresses is what the source of different institutional preferences for international cooperation are. The answer, I suggest, is found in a closer analysis of how economic globalization has an impact upon the workings of national production regimes. In particular, the paper highlights the consequences of economic globalization on the institutional preferences of societal groups and the domestic balance of power between governments and business. Understanding the central role of production regimes in mediating global economic changes to produce specific institutional choices, I argue, allows me to contribute to three important contemporary research themes in international political economy.

First, contrary to the widely-held notion that forces associated with globalization (above all increased capital mobility) spell the inevitable victory of holders of mobile capital over governments and labor as they can "exit" the confines of the national economy, this paper demonstrates that the extent to which exit, voice, and loyalty are exercised is fundamentally conditioned by the structures of domestic production regimes, and how these regimes are situated in the global economy. In this context, the emphasis on the differences in production regimes showed how these regimes influence the interaction between the global economy

and domestic politics on the one hand, and on the other hand how the relations between domestic interest groups and governments will lead to new economic policies. In bringing attention to this aspect of domestic politics, the paper seeks to make a contribution to on-going research that explores the link between the organization of domestic politics and international cooperation. It does so by widening the concept of "domestic" to encompass a more complex—and ultimately more accurate and rich—understanding of how national-level characteristics associated with the organization of capitalism determine the terms on which states engage by internationally, and why there is considerable variance in their policy and institutional preferences.

The second implication for current research is associated with the demand for international institutions by domestic groups and their supply by national governments. Rather than falling into the functionalist trap—where it appears as if the situation that won out was predetermined and "necessary"—this paper has demonstrated the politics behind domestic and international institutional preferences, as well as the affinity between different domestic production regimes and multilateral policy preferences. In other words it explains both the sources of policy preferences, and when these preferences will be adopted as policy by governments. As such, the paper has also rejected the notion that states in a global world economy have similar domestic economic policy preferences or that a consequence of economic globalization is preference convergence with regard to the shape and content of multilateral cooperation.

Finally, this framework provides the tools for analyzing other issue-areas as well and for explaining why institutional preferences diverge across countries. For example, linking the notion of national production regimes to preferences for international cooperation, we can address why CMEs like Sweden and Germany that produce quality-competitive goods (and thus usually produce at higher costs) are strong supporters of a European Monetary Union because they are very vulnerable to competitive devaluations.⁹⁷ Conversely, LMEs' emphasis on cost-competitiveness makes them less interested in EMU as long as the macro-economic environment is relatively stable since retaining the exchange rate is an important adjustment tool. Thus, this framework explains why EMU has a very low level of priority in Britain since that would take away any future ability of the UK government to boost British exports through currency devaluations.⁹⁸ Furthermore, we can explain why countries like Sweden and Germany as CMEs are willing to go ahead with a mini-EMU in 1999, since many of the countries which look to qualify for EMU are competing in similar product markets, and if the option of devaluation is gone,

⁹⁷ Author's interview with Magnus Lemmel, Chief Executive Officer, Sveriges Industriförbund (Swedish Federation of Industry), Stockholm, Sweden: June 22, 1996; Author's interview with Hans-Joachim Haß, Head of Section, General Trade and Industry, Bundesverband der Deutschen Industrie (Federation of German Industry), Bonn, Germany: April 25, 1996.

⁹⁸ Author's interview with Christopher Moir, Department of Trade and Industry (London, United Kingdom: June 20, 1996) . However, Britain will have reason to seek membership once others with similar product markets are members, because it will then be able to rely on its deregulated labor-market to adjust wages as a means to retain cost-competitiveness.

these two countries will be able to use their higher levels of productivity to improve their economies without fearing that someone would underbid them in their main markets.

Overall, the case-studies in this paper demonstrate the ways in which global economic challenges were mediated by the institutions of the British and Swedish production regimes to bring about a set of policies and institutional choices consistent with the propositions developed in section III. By joining a theory of institutional preference formation with a theory of interest aggregation and policy outcomes, this project explains why states have divergent multilateral preferences, as well as why individual states will support varying degrees of economic institutionalization in different policy areas. In doing so, the project contributes to theories of economic policy-making and international cooperation and provides a parsimonious—yet rich—theory of policy adoption and institution-building which accounts for cross-country variations at the domestic level as well as why states' support for multilateral cooperation varies in different issue-areas. As such it extends the scope of much research on the domestic sources of international economic cooperation, as well as deepens our understanding of the role played by international economic changes on the multilateral institutional preferences of domestic interest groups.