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# Sovereignty@Bay: Globalization, Multinational Enterprise, and the International Political System

## Abstract

This article is concerned with only one aspect of the vast literature on MNE–state relations: the impact of the MNE on sovereignty, autonomy, and control. It argues that the mainstream literature of the sovereignty at bay era did not predict the end of the nation-state or conclude that sovereignty is critically compromised either in theory or practice. In fact, while the terms ‘sovereignty’, ‘autonomy’, and ‘control’ appear frequently in these discussions, they are rarely defined or even used precisely. At the end of the day MNEs are international or cross-border entities which are *of* the existing inter-state system firmly rooted in national territorial jurisdiction. The problems posed by the traditional MNE for both states and the inter-state system tend to involve issues of jurisdictional asymmetry, jurisdictional overlap and control, rather than sovereignty in its formal sense. The hierarchical or *Fordist* structure of the traditional MNE reinforces the core values of the modern international political system: state sovereignty and mutually exclusive territoriality.

## Keywords

MNE-state relations, globalization, international political system, multinational enterprise, inter-state system, state sovereignty

## Disciplines

Business Administration, Management, and Operations | International Business

**SOVEREIGNTY@BAY: GLOBALIZATION,  
MULTINATIONAL ENTERPRISE, AND THE  
INTERNATIONAL POLITICAL SYSTEM**

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## 1.0 INTRODUCTION

Although modern multinational firms date from the late nineteenth century, the term *Multinational Corporation* did not appear until 1960. At a conference at Carnegie Mellon University, David Lilienthal (1960) distinguished between portfolio and direct investment and then defined ‘Such corporations -- which have their home in one country but which operate and live under the laws of other countries as well..’ as multinational corporations.<sup>1</sup> It is of interest that from the start the multinational corporation was defined in terms of jurisdiction and potential jurisdictional conflict.

Given the considerable attention paid to foreign investment by economists since the late nineteenth century, one would have expected considerable discussion of the multinational corporation’s ‘special features’ well before 1960 (Fieldhouse 1986). The literature, however, focused primarily on the macroeconomic (and macro-political) aspects of capital flows, often in capital exporting countries. There was little interest in the political impacts of foreign direct investment (FDI) other than the somewhat abstract ideas of Marx and his followers about the internationalization of capital.<sup>2</sup> Lenin’s one line definition may be the best known: ‘If it were necessary to give the briefest possible definition of imperialism we should have to say that imperialism is the monopoly stage of capitalism’ (Lenin 1970, p 85).

That changed dramatically in the late 1950s and early 1960s. First, contributions by Edith Penrose, Stephen Hymer and John Dunning revolutionized the study of FDI approaching it as a function of the growth of the firm rather than the export of capital (Dunning 1976; Hymer 1976; Penrose 1959). One result of the shift in emphasis from capital flows to firm and transaction based theories of FDI was to draw attention to the broader economic (and non-economic) impact of MNCs on host and home countries.

The dramatic expansion of the Multinational Enterprise (MNE) after 1960 produced a ‘first wave’ of literature in the popular and academic press. The opening lines of Raymond Vernon’s best known book capture its tenor well: ‘Suddenly, it seems, the sovereign states are feeling naked. Concepts such as sovereignty and national economic strength appear curiously drained of meaning’ (Vernon 1971, p 3).<sup>3</sup>

In a seminal series of lectures two years before the publication of *Sovereignty at Bay*, Charles Kindleberger (1969, p 207) argued that the ‘nation-state is just about through as an economic unit.’ George Ball (1967) predicted increased conflict between the MNE, a ‘modern concept evolved to meet the requirements of the modern age’ and the nation-state which is ‘a very old-fashioned idea and badly adapted to serve the needs of our present complex world.’ *Global Reach*, a widely read polemic, cited Dow Chemical’s CEO’s dream of establishing his headquarters on an neutral island ‘beholden’ to no nation and concluded that the managers of global corporations are demanding ‘...the right to transcend the nation-state, and in the process, to transform it’ (Barnet and Muller 1974, p.16).

In this chapter I am concerned with only one aspect of the vast literature on MNE-state relations: the impact of the MNE on sovereignty, autonomy and control. I argue that the mainstream literature of the sovereignty at bay era (including Vernon’s book) did not predict the end of the nation-state or conclude that sovereignty is critically compromised either in theory or practice. In fact, while the terms ‘sovereignty,’ ‘autonomy,’ and ‘control’ appear frequently in these discussions, they are rarely defined or even used precisely.

At the end of the day MNEs are international or cross-border entities which are *of* the existing interstate system firmly rooted in national territorial jurisdiction. The problems posed by the traditional MNE for both states and the interstate system tend to involve issues of

jurisdictional asymmetry, jurisdictional overlap and control rather than sovereignty in its formal sense. The hierarchical or *Fordist* structure of the traditional MNE reinforces the core values of the modern international political system: state sovereignty and mutually exclusive territoriality. To the extent that MNEs served as a means for nation-states to exert, and even increase, national power they are sovereignty affirming rather than sovereignty violating (Bergsten, Horst and Moran 1978).

As we enter the twenty-first century sovereignty has become much more problematic; it is reasonable to describe it as ‘at bay’ or perhaps ‘@bay.’ The processes described under the rubric of globalization have compromised the basic idea of economic (and political) governance based on geographic jurisdiction. MNEs play a central role in that process as a result of dramatic increases in the scale of technology, the rise of strategic alliances, the emergence of an electronically networked world economy, and the increased importance of transnational actors and international civil society.

I next turn to a brief review of the nature of the modern interstate system and the meaning of autonomy, control and sovereignty. I will then discuss (rather than review) the ‘sovereignty at bay’ literature, arguing that the impacts of MNEs on states and the state system were limited and did not threaten territorial sovereignty directly. Last, I will examine the impact of globalization and the MNE on states and sovereignty.

## **2.0 THE POST-WESTPHALIAN SYSTEM**

The Peace of Westphalia, which ended the Thirty Years War in 1648, is generally accepted as marking the end of medieval universalism and the origin of the modern state system (Krasner 1993).<sup>4</sup> The medieval to modern transition entailed the *territorialization* of politics, the replacement of overlapping and interlaced feudal hierarchies by geographically defined

territorially sovereign states. It entailed the evolution of political geography from ‘scattered islands of political power’ to solid block of authority in which one ruler had final authority (Strayer 1970, p 31).

The cardinal organizing principle of the modern state system is the division of the globe’s surface into mutually exclusive geographically defined jurisdictions enclosed by discrete and meaningful borders (Ruggie 1993). Joseph Camilleri and Jim Falk (1992, p 238) argue that *the* primary function of the state is the organization of space; that ‘The spatial qualities of the state, understood as a geometric entity with precisely demarcated boundaries, is integral to the notion of sovereignty and international relations theory.’ The modern state – and perhaps modernity itself – are inherently geographic constructs; political authority is based upon, and defined by, geographical parameters (Anderson 1986; Spruyt 1994).

Robert Keohane (1993) observes that sovereignty is typically discussed rather than defined. Formal sovereignty is a legal concept: within an exclusive territorial enclave demarcated by unambiguous borders each state is recognized as supreme and independent of outside authorities in the exercise of authority (Barkin and Cronin 1994; Jarvis and Paolini 1995). *Internal sovereignty* defines the legitimization of the state vis-à-vis competing domestic claimants. It assumes a monopoly of force within its territory, the ‘...undisputed right to determine the framework of rules, regulations and policies within a territory and to govern accordingly’ (Held and McGrew 1993, p.265).

*External sovereignty* is a more amorphous construct. It underlies or legitimates the modern interstate order by assuming both mutually exclusive territoriality as an organizing principle and mutual recognition by like (i.e. territorially defined) units that each state represents a specific society within an exclusive domain (Barkin and Cronin 1994; Ruggie 1983). External

sovereignty defines relations among states in the international system, and indeed, the system itself in terms of an absence of central authority (Hall 1999; Reinicke and Witte 1999).<sup>5</sup>

Autonomy is a political idea that a state can make its own decisions about how it will deal with internal and external problems (Keohane 1993). Autonomy is related to control and policy effectiveness, the belief that territorial sovereignty translates into unambiguous control over economies and economic actors, for example, and that policy effectiveness is not constrained by outside forces. (It has also been described as operational sovereignty.) The line between autonomy and internal sovereignty is far from sharp; Kenneth Waltz (1969, p 96), for example, defines sovereignty in terms of a state deciding ‘...for itself how it will cope with its internal and external problems.’

In his retrospective review of *Sovereignty at Bay* ten years after its publication, Vernon (1981, p 517 ) expresses concern that readers remember the title of the book rather than its message; that he is unfairly associated with the argument that the nation state is ‘...done for, finished off by the multinational enterprise.’ However, both the title and the opening lines of the book, which argue that concepts such as sovereignty seem ‘curiously drained of meaning,’ appear unambiguous. The apparent contradiction between these two statements is resolved when one pays closer attention to what Vernon actually means by ‘sovereignty.’ In *Sovereignty at Bay*, (and his other writing) he is concerned with autonomy and control, with the problems posed by overlapping and intertwining jurisdictions rather than formal or legal sovereignty.

I argue that despite the ‘end of sovereignty’ arguments which abounded during the reaction to the first wave of multinational expansion, the traditional MNE did not compromise sovereignty in any fundamental sense. It certainly did constrain autonomy and control and thus may be said to have placed some limits on the *implementation* of internal sovereignty. However,



it reinforced the critical system defining construct of external sovereignty: mutually exclusive territoriality, borders, and geographically-based political and economic governance.

### **3.0 SOVEREIGNTY AT BAY?**

Vernon justified the title *Sovereignty at Bay* in terms of three propositions, none of which dealt with sovereignty directly: most governments will be reluctant to give up the advantages of the MNE; given the global interests of the MNE subsidiaries can never respond single mindedly to the interests of any single jurisdiction; and the network of the MNE cannot escape serving as a ‘conduit’ through which states exert influence on other states (Vernon 1981). A broader review of the literature of the sovereignty at bay era reveals four major interrelated sets of problems that MNEs pose for states and the state system:

- ?? The distribution of the costs and benefits associated with the MNE. This applies both within and across states;
- ?? Jurisdictional asymmetry between the state exercising economic governance through control over geographic territory and the international network of the MNE and its affiliates;
- ?? Jurisdictional conflict and overlap and ‘underlap,’ including the problem of extraterritoriality; and
- ?? A weakening of national control over the economy and economic actors.

The issue of the distribution of costs and benefits arising from MNEs is certainly important, especially in the North-South context. However, most of the discussion of this issue revolves about transfers of resources, capabilities and/or power among states (or among groups within states) within the existing system. Furthermore, to the extent that the distribution of costs and benefits of multinational enterprise relates directly to my primary concern here, it is subsumed

under the rubric of ‘national control.’ Thus, my discussion will thus focus on the first three issues.

### 3.1 Jurisdictional Asymmetry

Over sixty-five years ago in an article about the League of Nations, *The Economist* (1930) argued that the ‘supreme difficulty of our generation’ results from economics and politics perpetually ‘falling out of gear with one another.’ While the world economy has been organized into a single ‘all-embracing’ unit, the international political system remains partitioned into sovereign national states. This asymmetry between economics and politics manifest when the centrally controlled, transnational, multinational enterprise confronts an international political order organized in terms of territorially sovereign states has given rise to what James Rosenau (1992) calls the problem of governance without government.

There is a lack of correspondence between the scope of the multinational enterprise and the jurisdictional reach of the nation-state either singularly or collectively. The MNE is not accountable to any authority which matches its scope or which represents the aggregate interests of all of the countries in which it operates (Vernon 1971). The MNE’s ability to operate as a world-wide system combined with the limited view and scope of authority of any national government creates asymmetries of both information and jurisdiction.

While MNEs are, in theory, responsive to all of the national jurisdictions in which they operate, in practice, none has complete control, either individually or collectively. No single territorial state has sufficient information to fully understand the operations of an MNE. Furthermore, authority cannot be summed across jurisdictions; each nation attempting to regulate the MNE through the portion ‘residing’ within its borders may not provide sufficient leverage over the firm as a whole to achieve policy objectives.

Many of the authors writing in reaction to the first wave of MNE investment dealt with this topic directly. In a well known article, Ball (1968, p 164) argued that there is a ‘lack of phasing between the development of our archaic political and modern business structures,’ that the political boundaries of nation states are too constricted to allow the mobilization and deployment of the factors needed for production and consumption. He went on to note the problem of governance of the international firm, given the asymmetry between its scope and that of national authorities, and called for the evolution of some sort of supranational political structure. Recognizing that was not likely, he suggested ‘denationalizing’ MNEs as a second best solution, governing world corporations through a treaty-based international companies law administered by an international institution.

### 3.2 Jurisdictional Conflict and Extraterritoriality

The subsidiary of an MNE is both a local corporation -- typically incorporated under local law -- subject to the same rights and responsibilities as any other national firm *and* a unit in a multinational network under the control of its headquarters. In Vernon’s (1977, p 193) words, ‘...each affiliate includes the elements of a double personality. It is an entity created under the laws of the country in which it operates, responsive to the sovereign that sanctions its existence. Yet at the same time, as a unit in a multinational network, each affiliate must be responsive to the needs and strategies of the network as a whole.’

This duality was responsible for much of the MNE-state conflict during the sovereignty at bay era. Citizens of one country ‘resident’ in another create situations of jurisdictional overlap or conflict: do the tax codes, regulations, or laws of the home or host country apply? Multinational networks also served as vehicles facilitating the extraterritorial reach of one state

into the domain of another: conduits or transmission belts ‘through which the power of one sovereign state is projected into the territory of another’ (Vernon 1977, p 177).

In an early proposal for a ‘GATT’ for multinational firms Paul Goldberg and Charles Kindleberger (1970 , p 298) concluded that ‘fortunately’ the substantial and recurring problems posed by the international corporation were limited to taxation, antitrust policy, balance of payments, export controls and securities regulation. They note that ‘Each has a common denominator: the international corporation is either unregulated, having slipped between the cracks of national jurisdictions, or is cabined by the overlapping regulation of two countries having varying political or economic goals.’

As Bergsten, Horst and Moran note, ‘Perhaps the messiest issue confronting policy makers is allocating taxable income within the multinational enterprise.’ To some extent, jurisdictional conflict is a zero-sum game, ‘US tax gains must come from the multinationals or from foreign tax authorities’ (1978, p 211). Furthermore, the problem of ‘underlap’ is certainly significant; corporate tax revenues as a proportion of the total have fallen over the past decade, at least in part due to the difficulty of collecting taxes from MNEs.

Antitrust actions are also responsible for jurisdictional conflict. Differences between American and European law, for example, led to conflicts over actions of subsidiaries of US multinational firms. Perhaps more important, American courts have held that non-nationals can be held responsible for acts committed outside of US territory that restrict competition in the US market. This has led to situations -- the ICI-Dupont case, for example -- where American courts required action which the British courts then prohibited (Rubin 1971). (Anti-trust conflicts have abated over time as American and European competition policies have converged.)

Last, attempts to extend a country's jurisdictional reach extraterritorially through a multinational network was responsible for a great deal of the conflict 'caused' by multinational firms during the 1960s and 70s. Jack Berhman, for example, found that 12 of 16 conflicts among Atlantic countries arising from the activities of MNEs involved American attempts to apply The Trading with the Enemy Act extraterritorially.<sup>6</sup> Similarly, David Leyton-Brown found that most of the 61 public conflicts he studied in Canada, Britain and France involving multinationals involved extraterritoriality (both were cited in Nye Jr. 1974).

While the combination of internal sovereignty and mutually exclusive jurisdiction gives the state control over everything that transpires within its borders, or within its territory, international law extends that jurisdiction to the actions of nationals abroad (Rubin 1971, p 11). Thus '...international law is considered to give a state jurisdiction over conduct within its own territorial borders, and over the actions of its own nationals anywhere.' That being said, territoriality is generally considered to prohibit *extraterritorial* acts, the prosecution of foreigners for acts committed outside of a state's territories (Craig 1970).

Although the US government accepts the principle of territoriality, it also argues that it has jurisdiction over its nationals anywhere, and that control -- and ownership -- determine nationality (Craig 1970). That ambiguity makes determining the 'nationality' of the subsidiary of a multinational firm problematic.

The case of Fruehauf in France is not atypical. In 1964 the Treasury Department learned that Fruehauf's French subsidiary had entered into a contract to supply trailers to a French truck manufacturer for assembly and eventual delivery to China. At that time US commercial relations with the PRC were prohibited by the Trading with the Enemy Act, but were both legal and

encouraged in France. Treasury demanded that the American headquarters of Fruehauf force their subsidiary to withdraw from the contract, under penalty of the law.

Several points are of interest here. First, France considered the subsidiary a French firm subject to French law and policy while the American government clearly considered it subject to its law and policy. Second, the US Government did not go to the subsidiary directly, but exercised its control over the headquarters located within the borders of the US and thus exercised its will through the hierarchical structure of the MNE. While there is no question that Fruehauf 's corporate headquarters is a US firm within US jurisdiction, from a French point of view, the US government implemented its law extraterritorially through the subsidiary of a multinational.

While the results of this particular case were mixed, the Trading with the Enemy Act was applied regularly from the 1950s to the 1970s and in most instances US multinationals prevented their subsidiaries from doing business with proscribed countries (Kobrin 1989; Rubin 1971).<sup>7</sup> Major efforts to apply American law through the network of MNEs culminated in the early 1980s when the Reagan administration attempted to prevent construction of a Soviet natural gas pipeline into Western Europe through the extraterritorial enforcement of export controls, using both FDI and licenses as vehicles. While the episode caused serious problems for a number of firms, it ended in failure due to the united and vigorous opposition of most European countries (Kobrin 1989). (The Helms-Burton legislation which attempts to sanction Canadian and European firms doing business with Cuba certainly indicates that the US Government has not given up trying to extend its reach abroad.)

### 3.3 National Control

The emergence of MNEs has diminished state control over both economies and economic actors. To some extent, the loss of national control over the domestic economy resulted from increasing interdependence; multinational enterprise can be seen as effect rather than cause in that regard, as a vehicle rather than prime mover. One can argue that it is developments in the technology of communications and transport as well as increases in the scale, pace and complexity of product and process technology that account for both interdependence and the MNE, and that it is really the former – including the emergence of a global financial system – that accounts for diminished national control over economic actors and economic policy. In Robert Gilpin's words, (1975) '...national economies [are] enmeshed in a web of interdependence from which they cannot escape.'

Be that as it may, the multinational enterprise is the primary agent of interdependence and its increasing importance limits state control over the domestic economy. As I have argued elsewhere (Kobrin 1997), MNEs organize international economic transactions through internalization; MNEs are the vehicle through which production has become international and factors of production such as management, labor and technology have become mobile internationally. That combined with the increasing linkages between trade and foreign direct investment certainly diminishes the ability of national governments to control domestic economies and economic policy (Stopford and Strange 1991).

Multinational enterprises are transnational organizations which have their own interests which may or may not be closely related to the interests of the various nations where they are resident (Huntington 1973). As Vernon observed, the 20<sup>th</sup> century was one in which governments took the task of promoting the welfare of their citizens upon themselves. In

modern societies, political leaders find themselves dependent on the private sector, on the nation's enterprises, to achieve this and other goals. Thus, there is an inherent conflict between the need of the state to accomplish its objectives through business firms and the broader objectives of the MNE. 'Whenever the loyalty and commitment of a substantial enterprise in the economy seems ambiguous, tension is unavoidable' (Vernon 1977, p 15).

There is a marked asymmetry in scope of operations and objectives between the nation-state and the MNE, between 'the global strategies of MNE's designed to advance corporate profitability and growth, and the strategies of governments intended to promote the economic and social welfare of their citizens'(Dunning 1991). Put simply, the MNE is global and the nation-state local.

While there is no reason to assume that the MNE and a state will have conflicting objectives, there is no reason to assume that they will be identical or even overlap substantially. They are very different entities. Given the increased reliance of governments on the private sector to accomplish economic objectives, the emergence of multinational enterprise has resulted a higher probability of a divergence between state and firm objectives. Increased economic interdependence and the system optimizing nature of the MNE has reduced the degree of control that governments exert over their economies and economic actors.

### 3.4 The Modern State System and the MNE

While internal sovereignty is absolute in theory, it is rarely absolute in practice. The 'exclusive right to determine the framework of rules, regulations and policies within a territory' is compromised every time a state enters into a bilateral treaty or agrees to conform to the rules of an international organization. While, again in theory, the absence of a central authority makes each state the final arbiter of whether or not it will abide by treaties and remain in an



international organization, the interdependent world economy of the last half of the 20<sup>th</sup> century imposed serious constraints on states' room for maneuver (Keohane and Nye 1977).

External sovereignty, on the other hand, is much closer to an absolute construct. In the modern interstate system economic and political governance are a function of borders and geographic jurisdiction. The defining principles of the system are mutually exclusive territorial sovereignty and mutual recognition by like units. Compromising external sovereignty compromises the state and the system.

The question at hand is whether the rapid growth of multinational enterprise from the late 1950s through the early 1980s -- what I have called the sovereignty at bay era -- actually compromised formal sovereignty. There is certainly a point where degree becomes kind, where the erosion of autonomy and control over an economy and economic actors renders the presumptive right of states as the supreme authority within their borders relatively meaningless. While the line between autonomy and internal sovereignty is diffuse, I do not believe that it was crossed by the traditional MNE which is a creature of national jurisdiction, responsive at least to some degree, to home country government control.

To the contrary, MNEs of the sovereignty at bay era actually reinforced the core values of the post-Westphalian state system. Legally, there is no such thing as a multinational corporation as incorporation is possible only under national law. The multinational enterprise 'must content itself with stringing together corporations created by the laws of different states' (Vagts 1970, 740). The MNE is an assemblage of national corporations and thus a creature of national jurisdiction, its very existence 'conditioned upon a grant from the state' (Berle and Means 1939).

The nationality and control of the vast majority of MNEs remained national rather than multinational (Hu 1992). During the era in question, transnational actors (i.e. a MNE) linked interest groups (i.e. national subsidiaries) across borders but were dependent on access to territory to do so. In that sense they are sovereignty affirming: ‘The national governments who control access will thus be strengthened...the growth of transnational operations does not challenge the nation-state but reinforces it’ (Huntington 1973). Similarly, Krasner (1995) argues that transnational actors require the basic structure of the modern state system, multiple centers of authority, to exist.

In conclusion, the primary problems raised by the MNE during the sovereignty at bay era involved those of jurisdictional conflict (underlap and overlap) and extraterritoriality; they involved conflict between territorially defined states. The question was whose jurisdiction, whose laws and regulation, applied? While that makes the principle of mutually exclusive territoriality more difficult to apply in practice, it certainly does not make it less valid. MNEs remained dependent on access to territory to function and on national jurisdiction for their legal identity.

The problem posed by the traditional MNE is one of national regulation of international phenomena and certainly is not new. The various attempts at governance of the MNE over the last three decades have involved international cooperation among sovereign states and international organizations that are comprised of sovereign states as members. These certainly include the various attempts at the United Nations and OECD to develop codes of conduct for MNEs and the ill-fated Multilateral Agreement on Investment (MAI) negotiated in the mid-1990s (see Brewer and Young 1998; Kobrin 1998). All of these efforts represent attempts to exert some degree of control over the MNE through international action. Again, the issue here is

control and autonomy rather than sovereignty.

I now ask whether globalization has changed this conclusion. Whether ‘...the sovereignty of the nation state [has] remained intact while the autonomy of the state has altered, or has the modern state actually faced a diminution of sovereignty in the face of the globalization of politics?’ (Held, McGrew, Goldbaltt and Perraton 1999, p 52).

#### **4.0 GLOBALIZATION AND THE MNE**

The world in which the traditional MNE found itself was international rather than global, a profoundly geographic world of territoriality and borders.<sup>8</sup> An international economy is unambiguously *modern*; it involves relations between sovereign units of the post-Westphalian state system and hierarchically structured, often vertically integrated, discrete economic actors.

International transactions are cross-border economic and political interactions which assume the existence of clearly defined, delineated and separable national markets and nation states (Kobrin 1998). The expansion of MNEs during the sovereignty at bay era was consistent with this framework: most MNEs are national firms with a clear center or home country which engage in international operations and require access to territory to function.<sup>9</sup>

Globalization is difficult to define precisely. As David Held et al note, it is in danger of becoming the cliché of our times: a ‘big idea which encompasses everything from global financial markets to the Internet but which delivers little substantive insight into the contemporary human condition’ (1999, p 1). It is important to note that globalization transcends economics, it includes social, cultural and political processes which are enmeshed in a larger ‘global’ order; forms of social, political and economic organization beyond the pale of the state (Albrow 1997).

Globalization implies both deep integration and interconnectedness; networks of relationships between a large number of heterogeneous social, cultural, political and economic organizations. 'The spatial reach and density of global and transnational interconnectedness weave complex webs and networks of relations between communities, states, international institutions, non-governmental organizations, and multinational corporations which make up the global order' (Held, et al. 1999, p 27).

I have argued elsewhere that globalization represents a fundamental change in the mode of organization of the world economy ( and world politics) that compromises territorial sovereignty, systemic change comparable in scope to the emergence of the post-Westphalian state system in Europe in the 17<sup>th</sup> century (Kobrin 1997; Kobrin 1998). The question here is whether the MNE -- which is both a cause and effect of globalization -- compromises territorial sovereignty to the point where the phrase 'sovereignty at bay' is meaningful literally. MNEs in a global world economy impact the modern interstate system and sovereignty in multiple ways, all obviously interrelated:

1. MNEs are agents of deep economic integration and the internationalization of production;
2. A dramatic increase in the scale of technology in many strategic industries renders minimal effective market size larger than that of even the larger national markets;
3. Networks are replacing hierarchies and markets as modes of economic integration;
4. Non-territorial networks are developing into a transnational 'civil' society linking a variety of economic, social and political actors electronically. MNEs represent nodes of private authority in the international system; and
5. Markets are migrating to cyberspace or some combination of physical and virtual space.

#### 4.1 Deep Integration

By the late 1990s, 60,000 Transnational Corporations with over 500,000 foreign affiliates accounted for about 25% of global output. The United Nations Programme on Transnationals concluded that ‘...international production ... is at the core of the process of globalization’ (UNCTAD 1999, p xvii, xix). Deep integration and the mutual interdependence are a reality; the internationalization of production implies that MNEs coordinate international economic flows. It is difficult, if not impossible, to disentangle the complex transnational production networks of the MNE which would allow a state to exert a significant degree of control over the system.

With the internationalization of production political-economic emphasis has shifted from trade to investment and thus, from border controls to the domestic regulatory framework at large, blurring the line between ‘domestic’ and ‘international’ to the point where the distinction may no longer be meaningful. Everything from environmental to health and safety regulations affect both international as well as domestic investment and can, and have, been taken as constraints on ‘trade’ or restrictions on international competitiveness.

In 1991 John Stopford and Susan Strange (1991, p 1) argued that upheavals in the international political economy had resulted in a mutual interdependence which limits state’s options; ‘...firms have become more involved with governments and governments have come to recognize their increased dependence on the scarce resources controlled by firms.’ Again, the issue here is whether deep integration has reached the point where degree has become kind, where national autonomy and control have eroded to the extent that internal sovereignty has become problematic.

## 4.2 The Scale of Technology

In sectors such as semiconductors, aerospace, pharmaceuticals, biotechnology or telecommunications a competitive R&D budget cannot be sustained by sales in even the largest national market (Mytelka and Delapierre 1999). International expansion is a necessity if a firm is to fully amortize the enormous research and development expenses associated with rapidly evolving process and product technology. These dramatic increases in the cost, risk and complexity of technology render national markets problematic both as the primary units of the state system and as vehicles for control over the economy and economic actors.

First, in these strategic sectors even the largest national markets are too small to be meaningful economic units; they are no longer the ‘principal entities’ of the world economy. National markets are *fused* transnationally rather than linked across borders. Put differently, in these industries the market, in the most fundamental sense, no longer coincides with the state.

Second, and as a result, states have become increasingly dependent on MNEs to maintain technological competitiveness. MNEs are required to integrate or fuse markets to achieve the scale necessary to support the development of technology. Attempts to exert control over MNEs may limit access to technology and negatively affect national competitiveness.

## 4.3 Networks and Alliances

Increases in the scale of technology are one of the primary drivers of a significant change in the mode of organization of the world economy: the shift from hierarchical *Fordist*<sup>10</sup> multinational firms to networked alliances, many of which are not based on equity links. Increasingly, network metaphors are used to describe the emerging world economy: a transition from standardized mass production to flexible production, from vertically integrated, large scale organizations to disaggregation of the value chain and horizontally networked economic units

(Michalet 1991; UNCTAD 1994). In Dunning's (1994) terms, hierarchical enterprises are being replaced by alliance capitalism.

A networked world economy entails a complex web of transactions rather than a series of dyadic or triadic cooperative arrangements between firms. A large multinational firm may well be involved in tens if not hundreds of alliances linking various parts of its organization with others. These webs of alliances are multilateral rather than bilateral and polygamous rather than monogamous (Dicken 1994).

Networks and alliances affect state control, autonomy and sovereignty directly. As noted above, the vast majority of traditional, hierarchical MNEs are responsive to their headquarters government; even the most international have a clear center in terms of operations and management. That is not the case for alliances and the emerging knowledge-based networks.

Networks are diffuse and relational rather than hierarchical. It is difficult, if not impossible, to locate the center and discrete borders do not exist. Many alliances are not equity based, but rather constellations of companies or parts of companies tied together -- often on a project basis. It is far from clear which, if any, government, represents the home country and whether any state can exert substantial regulatory control over these networks of firms. States are enmeshed in a web of interdependence where the costs of extrication are becoming prohibitive. Incorporation under a national legal system and access to territory are much less critical for alliances than MNEs during the sovereignty at bay era.

Firms (Nike is a classic example) may be disaggregated to the point that the firm approaches a name attached to a large number of subcontractors, a 'virtual' corporation (Cutler, Haufler and Porter 1999). The degree of control or even knowledge of the firm's center,

much less the home country government, over labor practices or environmental standards of subcontractors in other countries is questionable.

Mytelka and Delapierre (1999) argue that new, global, knowledge-based networked oligopolies are emerging in industries characterized by technologies characterized by very high costs and risks in research and development. Again, the impact of these new forms of organization is to disengage the market from the state (and from state control) and to increase dependence of the state on the MNE for technology and technological development.

#### 4.4 MNEs, Transnational Actors and Global Civil Society

In their 1971 book Robert Keohane and Joseph Nye define transnational relations as ‘...contacts, coalitions, and interactions across state boundaries not controlled by the central foreign policy organs of governments’ (Nye and Keohane 1971, p xi). Transnational organizations are autonomous or quasi-autonomous actors in world politics; they command significant resources, extend their reach across national borders and can influence world politics directly; without the mediation of the state foreign policy apparatus. While there are a wide variety of transnational organizations, the prototype is certainly the multinational enterprise.

The increased salience of multinational enterprise (and other transnational actors) results in what James Rosenau has termed a dual system of sovereignty bound and sovereignty free actors coexisting together (Rosenau 1990). Significant transnational actors compromise the core principles of the modern interstate system: the supremacy of the state domestically and the idea of a system constructed in terms of, and limited to, mutual recognition by functionally equivalent units.

The importance of transnational actors, and global ‘civil’ society in general, has increased dramatically with the emergence of the Internet and the world wide web. Space and distance are



no longer barriers to the linking of interest groups and advocacy organizations across borders: Greenpeace, Amnesty International, Neo-nazi hate groups and terrorist organizations are all linked tightly via the Net. The successful opposition to the Multilateral Agreement on Investment (MAI) negotiated at OECD and much of the opposition to the World Trade Organization during the Seattle meeting in 1999 was organized electronically by very large numbers of geographically disparate groups over the Web (Kobrin 1998).

MNEs are only a part of this emerging world of relatively autonomous transnational actors. They are, however, an important part. Ronald Diebert (1997, p ix) has characterized the post-modern world order as 'a place inhabited by de-territorialized communities, fragmented identities, transnational corporations, and cyber spatial flows of finance.' A world that is a pastiche of multiple and overlapping authorities. (Also see Kobrin 1998).

MNEs have emerged as a source of private authority in world politics. In many cases, the governance of international economic transactions falls under the provenance of the private sector, of MNEs, rather than sovereign states or international organizations; 'Private actors are increasingly engaged in authoritative decision-making that was previously the prerogative of sovereign states' (Cutler, et al. 1999, p 16).

There is no question that the emergence of significant transnational actors and a global 'civil' society have transformed the inter-state system and directly affect the construct of sovereignty. They further blur the line between the domestic and the international, compromise the idea of states as the ultimate authority domestically, limit the importance of access to territory, and raise questions about the definition of significant actors in the international system.

#### 4.5 MNEs and Cyberspace

Markets, and MNEs, are migrating to cyberspace as electronic commerce grows rapidly in both the business to consumer and business to business spheres. We are entering an era when information in the form of an electronic book, a symphony, movie, software, or medical advice will be exchanged for information in the form of electronic cash (Kobrin 1997).

Electronic supply networks are becoming common. General Motors, Ford and DaimlerChrysler have announced plans for a multibillion dollar supply network (AutoXchange) that may grow to include both Renault and Nissan. Several large petroleum companies, including Shell, have also formed electronic supply networks.

While this is not the place for a complete exploration of the impact of the information revolution on states and the state system, it is clear that the movement of markets and MNEs to cyberspace will have serious implications for a system based on geography and sovereign territoriality. If software, for example, is imported in the form of disks and manuals it is subject to border controls, tariffs and the like. However, if it is transmitted digitally--downloaded from the Internet -- control becomes problematic and autonomy is directly constrained.

The Indian software industry has evolved from sending Indian programmers abroad to work at a client's site (known as 'body-shopping') to satellite linkages through which programmers physically situated in India work directly on the client's host computer, wherever in the world it is located (Kobrin 2000). If an Indian programmer located in New Delhi edits a program on a computer in New York there is no question that economic value has been created. Did the transaction take place in India or the US? Which jurisdiction gets to tax it or control it? Does either government even know that this sort of transaction has taken place?

In a fundamental sense, cyberspace is inherently non-geographic characterized by non-territorial spaces that, to some extent, are subjective. Cyberspace destroys rather than weakens the significance of physical location (Post 1996, p 159). It is difficult to map physical space onto cyberspace; Net addresses are relational organizational constructs and often do not reflect physical location. Servers routinely shift clients from 'location' to 'location' to balance loads; a buyer can log on to any server remotely. Following just three or four hypertext links removes any sense of physical location -- one could be in Bangalore as well as Boston. The chief executive of Shell Services International discussing their Web based electronic supply network was quoted as saying 'we don't actually know where we procure' (Financial Times 2000).

During the sovereignty at bay era the multinational enterprise was at the center of jurisdictional conflict. Most MNE-State conflict, however, involved questions of overlap and ambiguity; territorial jurisdiction, per se, was not at issue, rather the problem was sorting out whether jurisdiction should be based on location or nationality. In the era of the internet and electronic commerce the issue is not jurisdictional conflict, but whether the basic idea of territorial jurisdiction is still relevant.

## **5.0 SOVEREIGNTY@BAY**

Strange (1996, p 95) believes that '...the center of gravity in world politics has shifted ...from the public agencies of the state to private bodies of various kinds, and from states to markets and market operators.' She argues that the authority of the governments of all states has weakened as a result of technological and financial change and the integration of national economies into a single global economy.

The thesis of the first part of this paper is that while MNEs of the sovereignty at bay era may have compromised state autonomy and control, and while they may have facilitated

jurisdictional conflict and extraterritorial actions, they did not compromise fundamentally formal sovereignty in either its internal or external sense. The question at hand is whether that conclusion still applies given the massive changes in the world economy subsumed under the rubric of globalization.

I believe that the answer is a qualified ‘yes.’ I see no evidence that the nation state will become obsolete, that other sources of allegiance and identity will replace it.<sup>11</sup> However, globalization is weakening territorial sovereignty to the point where economic and political governance based primarily on geographic jurisdiction may no longer be viable. The MNE is a primary actor in this process, it cannot be separated from globalization. It acts as both cause and effect, motivator and agent. Many of the changes wrought by economic globalization are made manifest through the strategy, structure and operations of the MNE.

Degree has become kind; the attenuation of authority and control has compromised the idea of the state as the ultimate domestic authority. Strange (1996, p 72) puts it well. She argues that the state as an institution is not disappearing, but rather the metamorphosis brought on by structural change in the world economy means that states are no longer entitled to make the exceptional claims they once did. ‘It [the state] is becoming, once more as in the past, just one source of authority among several, with limited powers and resources.’

The globalization of production has political as well as economic impacts: it transforms both the creation and distribution of wealth and ‘...the context in which, and the instruments through which, state power and authority are exercised’ (Held, et al. 1999, p 281). The deepening of integration, fusion of markets, shift to networked organizations, and migration to cyberspace have dramatically changed the relationship between states and firms and raise serious

questions about the continued viability of economic governance exercised through territorially defined national markets.

Interdependence has deepened to the point where the costs of policy autonomy are prohibitive. More important the networked and relational structure of MNEs and of the world economy makes it almost impossible for any state, or all states collectively, to disentangle the web. The sharp distinction between the domestic and international that was a fundamental characteristic of the modern political-economy is now diffuse. In many instances, it is virtually impossible to distinguish between domestic and international production, actors or policy. (Is where a product is made still a relevant question? Or the nationality of a networked strategic alliance?)

Furthermore, economic and political space no longer coincide. Markets are 'larger' than states and, more important, economies and economic actors (e.g. virtual firms) are increasingly non-territorial. John Ruggie (1993, p 172) puts it well arguing that a nonterritorial 'region' has been created in the world economy, '...a decentered yet integrated space-of-flows, operating in real time..' which exists along side national economies. While these conventional 'space-of-places' [national economies] continue to engage in economic relations which are mediated by the state, '...in the non-territorial global economic region, however, the conventional distinctions between internal and external are once again problematic...'

The emergence of MNEs as transnational actors, and the rise of international civil society in general, challenges the idea that international politics is the sole province of sovereign states in the formal interstate system (Deibert 1997). MNEs are certainly not completely autonomous actors. However, they have enough autonomy to function as significant actors in the system. The idea of private political authority is no longer an oxymoron (Cutler, et al. 1999).

Perhaps most important looking to the future is the emergence of the Internet and electronic commerce. One of the primary arguments for the continued viability of internal and external sovereignty was that MNEs (and other transnational actors) require access to territory to function. In that sense they were sovereignty affirming, reinforcing the core values of the post-Westphalian system.

The Net and electronic commerce render that argument problematic. Krasner, who has always argued for the dominance of states in the system, recognizes that technology has weakened the authority of states and the bargaining power that flows from the ultimate right to grant access to territory. In cases where technology facilitates ‘disembodied transnational movements’ state authority is weakened (Krasner 1995). (He does go on to argue that further erosion of state control is not evident).

As noted above, geographic jurisdiction does not relate to cyberspace. To the extent that markets migrate to cyberspace, and especially to the extent that digital transactions gain in importance, territorial sovereignty will not provide the basis for effective or efficient economic governance. That certainly raises questions about the viability of an interstate system constructed on the basis of mutually exclusive geography and the recognition of and by, and *only* of and by, like units.

The emerging world order is likely to involve a range of heterogeneous units in multiple, interwoven and overlapping layers of governance. Effective economic (and political) governance may well involve governments, the private sector (MNEs), a broad range of civil society groups and international organizations. The meaning of sovereignty may evolve to mean no more than a very prominent seat at the table in international negotiations. Furthermore, the line separating what is domestic and what is international is rapidly being erased in many issue

areas.

States will not disappear and will certainly continue to play a major, if not the major role in the international order. That however, is not the same as saying that they will remain the supreme authority domestically or the only constituent units of the international system. This time around, sovereignty in terms of both domestic authority and mutually exclusive territoriality may really be 'at bay.'

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<sup>1</sup> D.K. Fieldhouse corroborates Lileinthal's first use of the term and provides an interesting intellectual history of the development and use of *multinational enterprise* (Fieldhouse 1986). Lileinthal defined direct investment in terms of '... industrial or commercial operations abroad which directly involve corporate managerial responsibility.'

<sup>2</sup> For example, Marx and Englel's famous statement from the Communist Manifesto that 'Modern Industry has Established the World Market.'

<sup>3</sup> To be fair, Vernon certainly did not predict the end of the nation-state or the end of sovereignty. As he has pointed out, the book's subtitle, 'The Multinational Spread of US Enterprises,' is a much more accurate descriptor of its contents. The title did, however, squarely raise the issue.

<sup>4</sup> Krasner argues that the conventional view is wrong and Westphalia did not represent a clean break with the past; that political organizations based on territoriality existed before 1648 and that universal institutions long outlasted it. None-the-less, it is a convenient point of demarcation when thinking about the origin of the modern state system.

<sup>5</sup> One explanation suggested for the spread of sovereign territorial institutions, that it is important for our purposes here, is that it allowed respective jurisdictions, and thus limits to authority, to be specified precisely through agreement on fixed borders (Spruyt 1994).

<sup>6</sup> For a review of American attempts to apply the Trading with the Enemy Act extraterritorially see (Kobrin 1989).

<sup>7</sup> Using Multinational networks to extend jurisdictional reach extraterritorially was not limited to the US, or even to headquarters countries. During the 1973 oil embargo, for example, Saudi Arabia and some of the other Arab states were able to use the networks of the oil multinationals to prevent virtually any Arab oil from being delivered to the boycotted countries (Nye Jr. 1974).

<sup>8</sup> The concept of international affairs is relatively recent, dating from the late 18<sup>th</sup> century; it was not relevant before the emergence of territorially defined nation states. The *Oxford English Dictionary* attributes the first use of the term *international* to Bentham in 1780 in a discussion of international jurisprudence in which he explicitly states that the word is a new one.

<sup>9</sup> Some of the material in this section is drawn from (Kobrin 1997).

<sup>10</sup> See (Harvey 1990) for a discussion of Fordism and post-modernity.

<sup>11</sup> See (Appadurai 1996) for an argument that the state is becoming obsolete.