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Country Analysis

Country analysis examines the economic strategy of the nation state. It takes a holistic approach to understanding how a country, and particularly its government, has behaved, is behaving, and may behave in the future. One of the government's tasks is to analyze its environment (global and regional) in order to interpret how best to serve the interests of the country. Government is also responsible for establishing the framework—the institutions and rules of behavior—through which the country develops its internal economic, political, and social structure and relates to its outside environment. Country analysts study how, and how well, a particular government does its job.

Effective country analysis requires synthesis of the concepts and analytical methods of economics, political science, and sociology. Ideally, country analysis builds upon and integrates those disciplines in the context of today and tomorrow in much the same way that the historian integrates them in studying the past. This integration remains an elusive ideal, however, and goes against prevailing trends in the study of economics, which has become increasingly abstracted from reality as it has evolved in the direction of mathematical modeling. One recent political economy text, for instance, noted that its country case studies were all subject to "solutions" using the proper economic theory—but warned readers not to try to relate the solutions to the particular countries, since the case studies did not accurately reflect the countries for which they were named! Country analysis as we understand it is something different; it is intended to relate to particular countries and only to use concepts that can be applied to specific countries on the basis of generally available data. Our cases sacrifice something in economic rigor in order to achieve a more balanced presentation of social and political realities.

The Uses of Country Analysis

Country analysis has long been practiced by government officials, particularly those in the foreign office or state department, as a way to interpret or anticipate the behavior of other governments. More and more, international bankers are using country analysis as a means of identifying prospective government borrowers, evaluating the credit-worthiness of existing or prospective borrowers, and anticipating changes in exchange rates.

Since World War II, country analysis has become more important both to economic policy makers in government and to senior managers in business enterprise, and for similar reasons. The establishment of trade rules under the General Agreement on Tariffs and Trade (GATT) and the establishment of an international monetary system supervised by the International Monetary Fund

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(IMF) have been key instruments in a concerted attempt by the noncommunist nations to develop a world economy. This commitment, coupled with these new institutions, has led to a very important reduction in trade barriers; the volume of world trade grew almost twice as fast as domestic economic activity from 1960 through 1973. With such progress toward an open world market, reinforced by lower relative shipping costs and greater licensing of technology to foreign companies, manufacturing, marketing, and finance have taken on a global perspective. Increasingly, multinational firms ask, "Where in the world should we build our next plant, raise our next loan, or launch our new products?" All of these decisions represent medium-term or long-term commitments, and at least implicitly require not only information about today's relative labor costs, tax rates, economic growth, and inflation rates but also judgments of future prospects. All of these key variables, as well as many others, are strongly influenced by government policies—hence the need to compare countries in terms of how they are managed.

Economic policy makers in government will increasingly need a similar perspective. As more countries try to attract investments to create jobs and enhance their citizens' standard of living, it will become increasingly important to look like an attractive country in which to invest. Since about 1970, this issue has become particularly important for the more developed countries, whose total employment in manufacturing has typically been declining. In many cases, this decrease in employment has been accompanied by trade deficits, weakening currencies, and rising inflation—a combination which threatens to push these countries' already high wages still higher in comparison with those of manufacturing sites such as Hong Kong, Korea, Malaysia, Singapore, and Taiwan. Recent interest in supply-side economics and industrial policy stems in part from a desire to promote investment, productivity, and jobs in manufacturing sectors exposed to competition from international firms and/or offshore sourcing by domestic producers.

Country analysis is particularly important in evaluating medium-term and long-term commitments. Short-term commitments, such as quarterly or annual production schedules, can be based on econometric models that forecast annual growth rates and seasonal or quarterly variations from trend. Such models may provide considerable precision over a short time horizon, typically 9 to 18 months. In projecting developments further into the future, however, a less quantitative methodology such as country analysis seems to work better.

In a world economy, developments in one country or region can have major influences elsewhere. An obvious example is the impact of oil prices on inflation and the balance of payments in oil-consuming countries. Likewise, social trends and new ideas have an extended impact that, while difficult to quantify for any given year, will lead to obvious changes over a longer period. Consider, for example, the cost impact of the spread of the closed shop and industrywide bargaining in the 1950s and the Great Society programs of the 1960s. Together these trends have contributed to the rising cost of doing business in the United States, a fact which has become more and more significant as U.S. manufacturing companies have evaluated where to locate new plants in the 1970s and 1980s.

Country analysis, though necessarily less precise than an econometric model, has an analytical framework of its own. The framework employs a relatively simplified view of an economy in order to relate economic, social, and political phenomena to each other, as well as to evaluate trends and possible aberrations within a particular economy. The two methodologies are obviously complementary, and in time they may merge. But at this writing they seem to attract people with different skills and orientations and thus to differ in the human dimension as well as in formal methodology.

A Framework of Analysis

Country analysis assumes that a nation state is a purposeful entity managed by a government. This is analogous to assuming a business firm to be a purposeful entity, even though its various members have only certain interests in common, and management makes only some, by no means all of the decisions. In a 1979 note entitled "Country Analysis and General Managers," then Harvard Business School Professor John W. Rosenblum explained:

> In both instances, of course, an extraordinary simplification is involved. Decisions, public and private, are the outcome of complicated processes of bargaining and negotiating and the use of power which we call politics. To assume a rational manager of the processes is certainly not of much descriptive value, or perhaps of much normative value. On the other hand, the framework provides significant aid to business managers in improving their predictions about the future directions of national economies. It does offer a useful format for the organization of data and a place to start in analyzing national policy.
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> The basic concepts of the framework are a combination of Business Policy and Industrial Organization ideas applied to the nation state. We sort environmental data into three major areas: performance, strategy, and context. By performance we mean how the economy has been doing along dimensions such as real GNP growth, inflation, unemployment, and balance of payments. Strategy includes the implicit or explicit choice of national goals as well as the policies (Industrial Organization would label these as conduct) being followed by the national government in pursuit of these goals. Context corresponds to the Industrial Organization concept of structure. We use this category to include the institutional, ideological, political, and physical "givens" that shape a government's strategic choices and the outcomes of these choices.
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> Having analyzed a national environment in terms of its performance, strategy, and context, country analysis turns next to relating these data to one another. The consistencies and inconsistencies that appear provide excellent clues as to what is likely and what is not likely to change in the future.

These concepts are used in a three-step process of identification, evaluation, and prediction or scenario generation. Thus the first step is to identify the strategy, context, and performance. This identification involves a certain amount of evaluation, as when the analyst must choose between what a government says its strategy is and the seemingly contradictory actions that it takes. Identification of performance also may involve evaluation, as in calculating changes in productivity, employment, or inflation. But in general, the identification phase consists of filling in a checklist of performance indicators, categories of key policies, and contextual factors.

Evaluation requires connecting the various elements to explain what is happening and why. It is here that the analyst can draw upon theories from the underlying disciplines. It is important to keep an open mind, however, to see whether any theory fits the data for a given country, or which of several competing theories seems to fit best.

After looking at performance, strategy, and context in the past and present, much as the historian would, the country analyst projects into the future. Skillful country analysts may be able to predict certain immediate developments, such as more or less unemployment. But with a somewhat longer time horizon—say three to five years—few important predictions can be made with great confidence. There are too many variables and too many uncertainties. Under these circumstances the analyst can formulate alternative scenarios to represent broadly different outcomes. One scenario, for example, might represent the evolution of a country following electoral victory by a conservative party while another might represent victory by the liberals or the left. Each scenario would be consistent with all known facts, and each would be composed of mutally consistent elements. The better the underlying country analysis, the richer the scenarios might be. And the analyst could then examine how the interests of the firm or government would be affected by the alternative scenarios.

The Role of Theory

Country analysis requires theory to explain causal relationships and to guide the selection of data. Even the lengthy cases in Harvard Business School's Business, Government, and the International Economy course contain only a microscopic fraction of the data available on the country and the time period described. Explicitly or implicitly, some idea or theory has guided our selection of data. As E. H. Carr observed in *What Is History?*, facts are like fish in the ocean. They are there in seemingly endless quantities, yet the kind of fish you catch depends in part on where you fish and what equipment you use. Even fishermen use theory.

Of the disciplines underlying country analysis, economics seems to have made the most progress in the development of theory. Some of it has proven very powerful in explaining causal relationships. Some of it, though generally accepted for a while, has been proven incomplete or even erroneous with the accumulation of further evidence. And the phenomena to be evaluated and explained are so complex that several rival theories can flourish at any given time. Thus the Keynesian, monetarist, and Marxist might each have a different explanation of inflation in a particular country.

Some theory is essential, some is unnecessary, and some gets in the way, as when one school of thought argues with another with little or no reference to the data at hand. We have given considerable thought to the role of theory in country analysis and have tried to build in an appropriate amount, partly through the cases and partly through readings. In each case we have tried to present data that would be grist for the mill of competing economic theories. The monetarist will find data on money supply and interest rates. For the Keynesian there is information on public spending and deficits. For others we include data on income distribution, concentration of power, and labor-management relations.

We have not made an equivalent effort to provide all the kinds of information relevant to competing theories in political science. The motives of particular individuals are underemphasized, except in rare cases, as is the bureaucratic process. We also include less information on diplomatic and military relationships than students of imperialism or cold war alliances would expect. The relatively heavy emphasis on a country's economic and social development has seemed appropriate for our intended audience: the government official interested in economic and social policy; the banker; and the executive of a business enterprise affected by the global economy.

The Role of Values

Evaluation involves values and a point of view as well as theory. Values, like questions of taste, have only a limited susceptibility to analysis. But it is important to recognize their presence, since analysts' values can cause them to misperceive data or to misinterpret a desirable outcome as a likely one. To keep values from interfering with country analysis, we suggest the following guidelines.

First, the analyst should set aside his or her own views and begin with the perspective of a key actor in the situation. Identify that person's values, since they can have an important bearing on the outcome of the situation. By adopting the point of view of the practitioner (e.g., president or prime minister) rather than trying to be both judge and jury, the analyst can make a more meaningful evaluation of the situation.

Second, in evaluating each situation the analyst should look for cause and effect, and for probable consequences. This should be a value-neutral exercise of attempting to anticipate or explain an outcome. If the analyst is not careful, his or her own values may get in the way of an effective evaluation, perhaps leading to an optimistic or pessimistic assessment rather than the most accurate and probable one.

Finally, in some circumstances the analyst may want to decide whether he or she likes the outcome of the evaluation. This step is obviously vital when the goal of the analysis is to inform a decision whether to vote for a particular political candidate or proposed piece of legislation. But it is ordinarily not an important part of country analysis.

Identification: Performance, Strategy, and Context

Performance

Most countries regularly publish data on economic performance. Since the development of the national income accounting system, these data have been reported in a form that permits comparisons over time and across countries. Familiarity with this accounting system is essential for effective country analysis.

The analyst should also be aware of the accounting system's limitations. It measures only economic performance, and generally only those aspects that show up in the money economy; thus it misses the barter economy and the black market economy. The output measured in GNP includes a car wash purchased from the local garage, but not one bartered in exchange for a few hours' loan of the car. The moonlighting carpenter who insists on payment in cash and fails to report that income is part of a gray market economy not measured by the usual performance statistics.

Performance indicators abound. Which ones should be included in a particular analysis depends on the question at hand. Certain indicators, however, are so important that they should always be examined. The country analyst should always identify external economic performance as measured by the balance of payments statement and the exchange rate. Internal economic performance should at least include measures of aggregate results in terms of output, prices, and employment. It should include such performance measures on the supply side of the economy as saving, investment, productivity, wage increases, unit labor costs, and utilization of capacity, as well as such demand-side measures as the distribution of income by various demographic characteristics (area, age, ethnic group, and so on).

Certain social performance indicators are also important to an in-depth analysis. Income distribution data represent a useful base for social and political as well as economic analysis. Coupled with measures of population growth (or decline) and migration, such data can indicate which regions are considered more or less attractive. Net out-migration may reflect a shortage of jobs or political repression. Another important social indicator is educational achievement in particular professional or skill categories as well as average years of schooling completed. Public health and nutrition indicators can be important too, particularly in low-income countries.

Social indicators are no more precise than economic measures. Since they are often a focus for media and political attention and are sometimes the criteria for determining state grants or subsidies, they may be subject to controversy and manipulation. With both federal grants and congressional seats at stake, for example, recent U.S. Census figures for some of the large cities in the Northeast were hotly disputed. Which performance indicators to look for, and in what degree of detail, depends on the questions facing the country analyst. But any compilation should include major social as well as economic indicators.

Strategy

The concept of a unified national strategy is obviously a simplification. For many Americans it may even seem a contradiction in terms. With a pluralistic, democratic system and the checks and balances among independent branches of government, how can there be a strategy? Yet for many countries, and particularly a more centralized democracy such as Japan or France, identification of a strategy is relatively easy. Americans, who are used to witnessing a continuing battle between the executive and legislative branches, may be at an initial disadvantage in learning to accept this concept and likewise in learning how to identify the strategies of other governments.

Goals. In identifying a national strategy, it is important to look for goals as well as policies. A country may have many goals, some more real than others, some more important than others. The analyst should always identify a country's priorities in at least three areas—autonomy, productivity, and equity—and if possible get a sense of their relative importance at the particular time.

Autonomy means freedom from foreign domination. For Canada the goal may be autonomy from U.S. economic and cultural influences. For Pakistan or Saudi Arabia it may be defensive capability to withstand foreign diplomatic and military pressures as well as internal security against domestic unrest. For France and Germany it may include not only autonomy from Russian military pressures, but also influence in NATO and the Common Market. Goals of autonomy may involve not only territorial integrity but the capacity of the government to continue its rule of the country. The best corporate analogy may be management's desire to avoid a takeover.

Productivity creates wealth and over time a rising standard of living. In the short run, however, it requires work, saving, and investment, which may dictate a sacrifice in standard of living. It also requires that performance—i.e., work, saving, and investment—be rewarded.

Beyond the baking of the pie, there is always the question of dividing it—the problem of equity. The search for equity can emphasize equality of opportunity or equality of results. Equity and efficiency or productivity may be partly inconsistent, and tradeoffs will be required. This balancing is like that of a firm making tradeoffs between higher investment for long-term growth and lower investment to boost short-term profitability and cash flow.

Goals are like the motor of the system. Since they are often implicit and always somewhat contradictory, it is important to try to be explicit in stating them and in noting which ones appear to have highest priority at a given point in time.

How can one identify such goals and priorities? One way is to read the public statements of leading politicians, and usually this is a good place to begin. Tracking the behavior of politicians and in particular observing their key policy choices is an important second step. When one has to choose between words and behavior, behavior is generally a better bet. Face-to-face interviews with top politicians or their close associates are also valuable, as they allow the analyst to appreciate nuances and give the politicians a chance to explain the compromises that have been made. First-rate country analysis requires field work, particularly to identify the strategy of the government in power.

Policies. The second component of a national strategy is the policies designed to achieve the goals. It is well to think of a *policy mix*, implying compromise, because many policies cost money to implement and thus compete with one another for funds, while others affect productivity and the ability to generate income and/or foreign exchange. Policy choices are thus constrained by the resources available, the administrative structure of government, and political realities.

Foreign/defense policy. For a short-term evaluation it may be possible to neglect foreign and defense policies, perhaps on the assumption that there will be little change. With a long-term perspective, however, it is important to identify whether a country is oriented toward territorial or political expansion, the status quo, or a "lower profile." Expansion normally will entail risks and require resources; a lower profile may free up resources. An active expansionist policy is also likely to increase the influence of top military leaders in numerous aspects of governmental policy making. For a country like Mexico, one might expect the status quo to be maintained with the help of a minimal army. For Japan, on the other hand, the 1980s seem likely to be an era of increased political responsibility and increased military spending.

Fiscal policy. Policies governing revenue and spending are lumped together under the heading of fiscal policy. Here the analyst should look for (1) changes in spending priorities as reflected in budget allocations for various programs, (2) changes in tax incidence, as reflected in the share of revenues from various types of taxes, and (3) changes in budget surplus or deficit. In addition, the analyst should identify tax and spending policies that are tied to general economic conditions. Some countries, for example, have a progressive income tax that raises rates not only as real income rises but also as inflation pushes up nominal incomes. Other countries have indexed their tax rates to a measure of inflation. On the other hand, some countries rely heavily on indirect taxes such as sales taxes, which may rise less than incomes in a boom and fall less in a recession. Maintenance of high indirect taxes may exacerbate a severe recession by reducing purchasing power, and may thus be a destabilizing element. Progressive income taxes are often described as automatic stabilizers because tax liabilities decline more than proportionately in a recession and rise more than proportionately in a boom, thus helping to dampen the cycle or to stabilize the economy. Automatic spending stabilizers also exist, such as transfer payments that begin automatically with loss of a job in a recession.

Monetary policy. Policies that influence the supply of money, its price, and/or its convertibility into foreign currencies are considered monetary policies. In a money economy, the supply of money has a significant impact on the level of economic activity. More money typically leads to more demand, more production, and more jobs. Too much money, however, leads to rising prices or inflation. Control of the rate of growth of the money supply is thus a key element in any economic strategy.

Like other commodities, money has a price that is a function of supply and demand. Its price in foreign currencies is measured by its exchange rate. Its price at home is measured by a rate of interest, after correction for inflation.

Monetary policy aims to influence the rate of monetary growth, the rate of exchange, and domestic interest rates. Often it involves compromise among conflicting objectives, such as constraining domestic supply and allowing domestic interest rates to rise in order to maintain the exchange rate. The analyst needs to look at all three elements—supply, exchange rate, and domestic interest rates—and particularly to examine various measures of the growth of the money supply. These measures may show different trends, and at present it is not clear which is the right one to use.

Incomes policies. Many countries have experimented with wage-price policies, sometimes in an attempt to reduce inflation, sometimes as a means for redistributing incomes, and sometimes with both objectives at once. Because controls are difficult to administer in a market economy, their use has traditionally been restricted to temporary emergencies such as wartime. Acceleration of inflation since World War II has led to the imposition of price controls for long periods (over 30 years in France) and likewise to peacetime wage controls in numerous countries, including Canada, the United Kingdom, and the United States. The analyst should identify both the purpose of the policies and the means of implementation, e.g., mandatory controls with the force of law, suggested guidelines backed by incentives for compliance and/or penalties for violation, or "voluntary" guidelines.

Income maintenance programs should also be identified. Some governments have established programs to provide certain minimum standards of nutrition, health, and income to eligible citizens. Food stamps, general relief, and aid for dependent children are examples of U.S. income-maintenance policies. Unemployment insurance and social security are technically insurance-based programs paid for by the subscribers, although benefits have tended to outstrip income.

Foreign trade and investment policies. Foreign trade and investment policies regulate the flows of trade and capital in and out of a country. As such they are a critical element in an economic strategy. For example, Canada followed a policy of relatively high import tariffs as an incentive for foreign businesses to invest directly in Canada. Japan, on the other hand, adopted strict controls on foreign investment following World War II to prevent foreign firms from gaining undue influence during the rebuilding of its economy.

Trade policy includes tariff and nontariff barriers to imports, and also a growing array of incentives to export. Increasingly, in recent years, it has included informal bilateral arrangements such as “orderly marketing agreements” designed to limit trade flows while preserving the open frontiers agreed to in successive rounds of multilateral trade negotiations.

The analyst must pay careful attention to how foreign trade and investment policies are implemented. For example, some countries, including the United States, have antidumping policies which prohibit sales in the market country at prices lower than in the manufacturer’s home country. During the 1960s and 1970s, however, such legislation was only reluctantly enforced. Similarly, while Canada’s Foreign Investment Review agency has the power to prohibit most foreign investments, including takeover bids, in practice it focuses on improving the terms of such arrangements rather than trying to stop them. Less formal trade and investment controls exist in some other countries, such as France, Italy, and Japan.

Industrial policy. While most of the advanced industrial nations have established income maintenance programs and graduated tax systems to favor some degree of income redistribution, a smaller number have developed industrial policies to promote the competitiveness of domestic industry. The recent downturn in economic growth has increased interest in such policies and provoked lively disagreement concerning their scope and content.

At the macroeconomic level, industrial policy may take the form of various across-the-board measures intended to improve business performance. For example, a government may decide to exempt the first so many dollars of interest and dividend income from taxes as a means of promoting savings and investment. By contrast, a tax policy designed to favor income redistribution might apply steeply progressive rates on interest and dividends. Likewise, overtime earnings can be taxed at high rates to “spread the work” or at low rates to give an additional incentive for work. Depreciation schedules and inventory valuation rules also affect earnings, taxes, and incentives to reinvest. Capital gains taxes affect the rewards for risk taking, particularly in smaller businesses or new ventures. The value-added tax, which is rebated on exports, is thought to be more favorable to industry than the income tax.

In addition to noting the general measures, the analyst should look for evidence of a selective industrial policy. Selective policies would favor one industry over another, requiring bureaucrats and politicians to substitute their judgments for those of the capital markets. Where selective policies exist, it is important to note whether they favor “winners” or “losers.” While one would presume that the goal of such policies would be to accelerate the development of industries in which the country has a good chance of success, history shows that in most democracies most of the money has gone to obvious losers for obvious political reasons. Industrial policies must be carefully identified before the analyst can judge whether they actually promote improved industrial performance.

Social policies. We have already touched on some aspects of social policy, such as income maintenance schemes. Labor policy can also be very important, and the analyst should note whether public policy favors strong unions, favors collective bargaining but tolerates or supports company unions, is indifferent to unions, or is actively hostile.

Educational policies deserve similar scrutiny. Educational spending’s share of a budget is easily observed, but it is at least as important to note who controls the spending (federal or local authorities), how much curriculum experimentation is practiced, how much choice is open to students, and what balance has been struck between academic and vocational subjects or institutions. While quality of education is always somewhat subjective, it can be illuminating to compare teachers’ salaries with those of steelworkers, truck drivers, or white collar workers. Student-teacher ratios may also be a useful indicator of quality.

Population policies are increasingly common and seem likely to become more important. In France, for example, they are designed to promote increases in the birth rate, immigration, or both. In other cases, notably China, they are designed to reduce the birth rate and perhaps to reduce immigration as well. Administration of the restrictive policies has proven tricky, often because of religious and cultural opposition, and the analyst needs to look beyond policy statements or budgetary outlays to gain an appreciation of how the policies are actually implemented.

It is also important to note the policy toward organized religion, particularly in the Moslem world and in the less developed countries. In a few Moslem countries, systematic government attempts have been made to secularize the state, as in Turkey under Kemal Ataturk or Iran under the Pahlavis. In most Moslem countries, however, church and state have been inseparable since Mohammed's journey to Medina to mediate a political dispute. Policy toward the Catholic church varies among Latin American countries, and over time within a country. Under a dictatorship, organized religion may well be the country's only independent institution. In such cases the government's policy toward the church is a vital element in the analysis.

Context: Identification and Evaluation

Governmental goals and policies are formulated within the context of a particular time. The context may be thought of as the "givens," the country's constraints and resources. For analytic purposes it is often useful to separate the context into domestic and international components, and then to subdivide the domestic component into its political, ideological, institutional, and physical parts.

A country's context can be specified in terms of a virtually infinite number of elements; the physical context, for example, would include a country's size, population, climate, navigable waterways, proximity to various other countries, percentage of arable land, and so forth. In class discussions, we assume students have made this list for themselves, and we focus only on those aspects that have an important bearing on the analysis. An evaluation of Egypt, for example, would be incomplete without recognizing the importance, both politically and economically, of the Suez Canal. In the political context, it is less important to catalog the articles of a constitution, form of government, or number of deputies in parliament than to establish whether the government works, whether it has strong support or perhaps a polarized legislature, and whether it tolerates a free press. Similarly, the important institutional issue is not so much how many banks or unions or chemical companies there are, but how they function as entities, and whether they work together or tend to conflict with each other. Our cases assume the analyst will have enough institutional knowledge to do much of the identification work with little text to help; the text is to aid in making first-order evaluations of how the parts work and second-order judgments of the extent to which they work together.

The international component can best be described in comparative terms, as though countries were all friendly competitors more or less richly endowed in particular areas and more or less well organized to capitalize on their human and other resources. In identifying key elements of the international context, it may be useful to establish each country's areas of relative strength and weakness. A simple expedient is to keep a list of key areas designated (+) or (-). For some components, this evaluation will probably be easy. For others, the analyst may have to raise another question: relative to what? For France the most relevant standard of comparison is probably Germany, but it is less clear what standard to use for Germany. For many countries the choice of such a standard should be based partly on the strategy (the French would like to keep up with the Germans), partly on physical realities such as proximity, and partly on historical relationships (as between New Zealand and the United Kingdom). As we have already emphasized, a country's context is virtually limitless; the point is to identify those components that potentially are major sources of strength or weakness relative to an appropriately chosen comparative standard.

Political context. It is useful to begin a description of the domestic context by diagnosing the political situation. The analyst should note the form or structure of government, the mechanisms designed to guide a transition of power from one leader to the next, key power blocs, and the extent of popular support. In addition, the analyst should note how politicians finance their campaigns and what standards of honesty and/or conflict of interest apply. Again, the goal should be an evaluation of the areas in which a government seems to work well (+) and those in which it is less effective (-).

In democratic countries the timing of elections and the parliamentary margin held by the incumbents are particularly important to note. Weak governments facing elections are not likely to make unpopular decisions. Dictators or stable majorities such as the Liberal Democratic party in Japan have a better record for taking a longer-term view when measures unpopular to important constituencies are involved. In all countries, democratic or otherwise, it is also important to note the coalition of interests that supports government, the opposing interests, the degree of consensus, and the processes through which deals are made and/or confrontations brought about. In many countries, parliament does more to make headlines than to make policy; the analyst should be alert for other "corridors of power."

Institutional context. Since the 1930s, if not before, the most significant institution in most countries has been government. This institution not only has military and police powers, it has grown in size and responsibility. In many countries it has direct responsibility for more than one-third of GNP and sets rules and regulations governing most of the remainder. The analyst should determine the structure of government and in particular should note which agencies are more or less independent. The United States, with three independent branches of government, differs sharply from most of the other democracies, which unite executive and legislative functions. The United States is also somewhat exceptional in having a central bank technically independent of the government, although the German central bank is still more "independent." In addition, the analyst should try to develop a sense of the competence and honesty of the bureaucracy and key public officials. In some cases governments are so corrupt that it is as important to understand the informal government as the official system.

Next the analyst may wish to consider the business institutions: banking, commerce, transportation, and manufacturing. This analysis in particular should make comparisons of structure, technology, management practices, and financial strength. It should look for any mechanisms that regulate competition, including cartels, informal understandings, or interlocking directorates managed through banks. Again the analyst should award a (+) to each important sector that represents an actual or potential strength in international competition.

The agricultural sector should receive a similar analysis. How large is it, how productive, how much locked in by subsidies to producing high-cost items, how influential a political force?

Labor should be noted as a separate category. What share of the work force is unionized? Through what structure? What changes in unionization are taking place? How are unions financed? How are union leaders chosen? Has collective bargaining been established, or is it still an issue? How do union members and union leaders view attempts to increase productivity—as a threat to jobs? a necessity for export competitiveness? perhaps both? At what level do negotiations take place? How politicized are the unions? Finally, are labor relations a strength or a handicap relative to competition?

Religious institutions play a key role in many countries, particularly in those with Catholic and Moslem majorities. Religious leaders can be more or less militant, more or less willing to accommodate a particular government. Moslem sects differ from one another not only in religious doctrine but in their views of church-state relationships and the desirability of Western-style industrial progress. In the more developed countries the separation of church and state seems to have been firmly established, yet legislation on divorce, abortion, and birth control can sometimes bring down a government.

Ideological context. A closely related element is that of ideology, or how a society "ought" to be organized. George C. Lodge has described ideology as the bridge between nearly universal values, such as family, love, and equity, and the real world of science and industry, wealth and poverty. Ideologies spell out the "rights" and "duties" of the members of a society, the powers that should reside in its key institutions, and even some aspects of how these powers should be used.

For some purposes the analyst may not need to know much about any particular ideology. But one should at least note whether there is broad consensus or serious ideological tension or conflict. Where tension exists, the analyst would do well to study the minority's ideologies to understand the focal points of tension, how the system might accommodate them, and how it might be changed if the minority came to power.

The analyst should make a tentative judgment as to whether the ideological component is a strength or a weakness. Normally consensus would seem to be a strength as an aid to unity of purpose and successful implementation of a strategy. But some ideologies may be noncompetitive in themselves, calling either for an "end to progress" or for a redistribution of rights and duties such that the society has more rights than it can afford. Some analysts believe the United Kingdom, and perhaps the United States, may have established more rights than the country can afford, while others have suggested that many of the Moslem revolutionaries in the Middle East would like to halt the spread of Western practices if not indeed to "turn back the clock."

Physical context. The physical context includes the stuff of geography and demography. Besides noting such obvious features as arable land, deepwater harbors, mineral resources, climatic conditions, and population density, the analyst may expand the importance of the findings by drawing some connections. Within OPEC, for instance, the countries with "big oil" have small populations, while those with big populations have relatively little oil. Linking these elements is essential to an understanding of the production and pricing strategies of OPEC members. The recent discovery of "big oil" in Mexico adds a new element, making Mexico the most populous country to have very large reserves. Japan, with a population of over 100 million inhabiting a mountainous archipelago the size of California, is another example of a country whose physical context is particularly significant.

The international context. Global competition among countries is governed by a framework of rules formulated and enforced by international institutions. Since World War II the international trade system has been subject to rules established under a General Agreement on Tariffs and Trade (GATT). Formulation of the rules rests upon periodic negotiations among member countries, as does their enforcement. In contrast, the international monetary system is under the supervision of the International Monetary Fund, an institution with increasingly powerful authority in both rule making and enforcement. Although the United Nations was created to develop and enforce rules in the political sphere, the effect of Security Council vetoes and a General Assembly voting structure that bears little relationship to power realities has been to make the UN little more than a court of world opinion with ancillary, largely noncontroversial development programs.

Real power still rests with sovereign countries, and the international context seems destined to be dominated by the shifting and partially conflicting interests of the industrialized countries, the oil producers, and the less developed countries. Just how this context might evolve is obviously uncertain, yet its evolution affects all countries. Since 1973 the rising price of oil may have been the key element producing change on a world scale. Besides shifting wealth and power to the oil producers, the oil situation has created an imbalance of international payments that threatens both to disrupt the trade and payments systems and to interfere with the relatively rapid economic growth all countries have enjoyed since World War II. National differences in productivity growth rates have been another key element, particularly the dramatic increases achieved by a number of East Asian countries.

Evaluation

Evaluation is to country analysis what diagnosis is to medicine. It is the process of observing the "vital signs" and performing the necessary special tests to describe the patient's condition, developing a theory of the cause(s) and a prognosis for the future based on "similar cases." Evaluation is in considerable measure an art of fitting a hypothesis to the facts, checking the hypothesis with other facts, discovering new symptoms, revising the diagnosis, and so on. Physicians begin from a base in anatomy and physiology—they know the parts and how they work under normal conditions. And they know how to read and interpret the test results. This is roughly equivalent to the identification phase of country analysis, which also teaches about the basic components, how they relate, and how to read the vital signs of an economy.

Physicians seem to learn evaluation best by working with a senior practitioner—i.e., on rounds with a staff member at a hospital. Anatomy and physiology can be spelled out in texts and taught by lectures; diagnostic skills seem most readily learned through apprenticeship to a skilled clinical examiner. Similarly, the identification aspect of country analysis can be spelled out in a text, complete with a checklist. Evaluation seems best learned through practice, first in a classroom with guidance from a faculty member, later in the real world with give-and-take among various experts. The following discussion can merely suggest how to begin; only sustained practice in the face of ever-changing reality can develop the art of sound evaluation.

The analyst should review all the performance indicators to make a broad judgment on how well the country is doing. Is performance getting better or worse, and is it better or worse than that of another country or group of countries? The point is not so much to calculate ratios as to note trends and comparisons. The analyst may mark a (+) beside those indicators that show strength or improvement and a (-) beside those that show relative weakness or deterioration over time. Thus, inflation that has come down from 6% to 4% might merit a (+) for improvement. In the 1960s, when 4% inflation was high for an industrial country, it might have merited a (-) as a weakness. But after 1973 a 4% rate of inflation would almost surely be a sign of relative strength.

Performance can also be evaluated relative to goals. A simple counting of goals achieved or not achieved is a start. But it is also important to evaluate clusters of performance indicators together. For example, a deteriorating trade balance is normally a sign of weakness. If the profitability of domestic firms is also declining, the country is in more serious trouble, like a company that reports declining market share and declining profits at the same time. It is as if one plus one equaled three or four, or even six. Likewise, in evaluating employment data the analyst should note not only the unemployment rate but the participation rate. Rising participation in the labor force means more people are finding jobs, whether or not more people are involuntarily out of work. On the other hand, rising unemployment in a country with a low and/or declining participation rate suggests much more serious trouble.

Since 1973 an increasing number of countries have suffered from declining performance, particularly in comparison with the 1960s. For any given country one must ask, "How serious is the situation?" The analyst needs standards of reference for such a question: serious compared with what? Three principal standards are available: past performance; the performance of other countries, particularly major competitors; and the goals of the government. The analyst should give particular attention to the second and third standards. If performance falls short of both governmental goals and the performance of competing countries, it is likely to produce tensions in the political leadership and demand for changes.

Diagnosing the Causes

If the country's performance is disappointing, the next step is to attempt a diagnosis of the causes. Sometimes this will be a fairly easy or obvious process. In other cases there will be competing explanations, often buttressed by competing theories. The situation of the United Kingdom is a good example. Decade after decade of substandard performance has caused the country to slip from its position as the world leader in industrialization to that of a third-rate industrial power with a standard of living only half what today's leading countries enjoy. Theories of causation abound. Conflicting diagnoses help account in part for successive decades of ineffective management of the U.K. economy.

For example, some analysts point to mismanagement in U.K. fiscal policy, noting both that government spends too large a proportion of GNP and that the tax system has had a particularly adverse effect on the incentive to work. Government spending has risen as a share of GNP in almost all industrial economies since World War II, but Britain, the Netherlands, and Sweden have been leaders. This spending must at some point be financed by taxes, and rising spending means higher taxes. Tax incidence can be aimed at incomes, through the income tax, or at consumption, through sales or value-added taxes. While there are no accepted standards of how much spending is too much or of how much disincentive effect income taxes have on blue- or white-collar workers, the analyst should attempt comparative evaluations of each factor. One crude standard might be: Is the situation bad enough to drive business or individual residents out of the country in search of lower tax burdens? Or, is it bad enough to discourage existing companies from making new investments? Or, is it bad enough to discourage a prospective investor from starting a new business? A yes answer to any of these questions would suggest the policy has had a cost in terms of reduced investment and probably in terms of reduced employment and productivity growth as well. Countries compete with one another to attract investment, and that investment is often the kind that has high productivity. If government policy discourages new investment, it may be necessary to compensate by increasing unemployment benefits or providing public sector jobs, either of which requires higher taxes and thus raises the possibility of a vicious circle.

Other analysts find excessive growth in the money supply a basic cause of difficulty. Too much money leads to inflation, a high-cost, uncompetitive economy, and a shifting of investment and jobs elsewhere. While inflation would normally lead to a declining value for the currency, "stop-go" policies were used to maintain the pound. More recently Britain's new oil wealth has led to a strong pound, perhaps exacerbating the country's problems.

To evaluate monetary policy, money supply should be related to GNP both in nominal and in real terms. The analyst should determine whether money supply is growing more or less rapidly than available goods and services, and compare this finding with previous experience in the particular country. Has monetary growth been a cause of past inflation? Is monetary growth more or less rapid in relation to real GNP than in the past? Whose demand for money is growing most rapidly, that of government borrowers, businesses, or consumers? Does monetary policy act only to control supply, or does it attempt to ration available supply among competing users? If so, how? Does monetary policy adjust the exchange rate in accordance with the competitive or cost positions of key exporters and importers in the country? If not, why not?

Still other analysts would cite income-maintenance programs as major problems in Britain and the United States, among other countries. In evaluating income-maintenance policies the analyst should note not only eligibility criteria and total cost, but also benefit levels relative to after-tax wage levels. Increasingly, critics charge that such programs are not only costly but constitute a disincentive to work because recipients may receive almost as much without working as they would net after taxes by working. (By working for cash and not reporting it while receiving benefits, they may in fact receive even more.) The process for determining initial eligibility and allowable additional income is important. So too is any process for monitoring abuse of the program.

For countries without income-maintenance programs, it is important to note whether some other institution, such as local government or the business enterprise, plays such a role, or whether it is fulfilled by the extended family. Japan and Singapore have systems of income maintenance very different from those of the United States or Canada or the United Kingdom, with more responsibility falling on the family and the enterprise, and much less on the central government. Some analysts argue that these differences affect not only savings rates but also the incentive to work.

After analyzing various components of the strategy, the analyst should look for major inconsistencies in the overall strategy. While the goals always involve certain inconsistencies or trade-offs—as between results in the short and long term—the policies should support the priorities. Canada, for example, welcomed foreign investment to help boost economic growth and the Canadian standard of living. Successful implementation brought foreign domination of many key industries. When, in the late 1960s, Canadians became increasingly concerned about their autonomy vis-à-vis the United States—with its Vietnam war, burning ghettos, and TV culture—the policy of welcoming foreign investment became inconsistent with the rising priority given to the quest for autonomy. Increased economic difficulties in the 1970s, on the other hand, have caused another shift in priorities and less rigorous enforcement of Canada's Foreign Investment Review Act.

A second and much more difficult task is to look for inconsistencies between the strategy and the context. A strategy may be internally consistent yet unrealistic in light of the resources at hand or the productivity of the firms. Or it may be politically unrealistic if opposed by farmers or unions or bankers. A strategy may also be unrealistic in the international context, for example, if other countries are reluctant to accept increased imports of particular kinds from a particular country.

Analysis of the fit between the strategy and the context is the area in which good analysts are most likely to distinguish themselves from the less skillful. There are an almost infinite number of dimensions for such analysis. The framework sketched out above provides only the basics, the elements that need to be checked each time, like the temperature and pulse of the patient. From there on the analyst needs additional data to understand the performance symptoms of a country and to explain them in terms of its strategy and context.

History suggests that particular care should be devoted to the analysis of the context. Policies are relatively easy to change, particularly where the executive and legislative functions of government are united. Institutions are much more difficult to change, and some with deep historical roots are *very* difficult to change. If a strategy requires major contextual change, the analyst should carefully examine just how such change is to be accomplished and how fast, and at what political and economic cost. Likewise it is important to look for competing ideas or strategies supported by powerful groups or institutions, ideas that may at some point gain increased support and force a change in strategy from within.

No diagnosis is complete without consideration of a country's "quality of management" or political leadership. However intangible or elusive such "quality" may be, competent leadership is likely to adjust effectively to new developments, and inept, corrupt, or unrealistic management is not. Put another way, skillful leaders can do more with less than their less skillful counterparts can.

To complete the diagnosis, the analyst should identify the key problems causing the unsatisfactory performance. In a schematic diagram, for example, one might draw arrows to show inconsistencies or draw circles around particularly troublesome contextual elements or around particularly unrealistic goals or policies. Here the analyst should take care to distinguish urgent problems from more basic or fundamental ones. Typically one must resolve the crisis before attending to longer-term chronic problems, but all too often the long-term problems are ignored until they too become acute. The analyst should be careful to note both and to be sure which is which.

Evaluating the Remedies

Some problems seem to solve themselves. During the mid-1970s, for example, American journals were filled with alarm about a "capital shortage," an anxiety which proved as exaggerated as the fear of a dollar shortage in the late 1950s. Spontaneous adjustment, like the invisible hand, solves a good many problems. Muddling through seems to pass for remedy for others.

When changes in strategy are being considered, the analyst can subject each option to the same tests used for the existing strategy, that is, tests for internal consistency and consistency with the various key elements of the context. The analyst should try not to be unduly skeptical or hypercritical. The real world seems to have a tolerance for small inconsistencies, and a seasoned analyst will not require a perfect fit before concluding that something is reasonable or "workable." On the other hand, any new policy that presupposes major institutional or ideological change in order to be effective should be regarded with some skepticism.

If analysis suggests that none of the options deemed politically feasible for the government in power will solve the problems, and if the country's problem is both serious and acute, attention shifts to a change in government as a potential remedy. Evaluation of prospective new leadership may reveal whether it will have "better ideas" or fewer constraints for solving the problems at hand. The analyst should also consider the method by which a transition in government might take place.

Analyzing the Future

Analysis of remedies moves us from the present to the future. However difficult such analysis may be, this is the ultimate target—to try to anticipate and evaluate future developments and to prepare for them.

Business and military planners have invested considerable time and thought in methodologies for analyzing the future. To date, their approaches have differed quite sharply. Most businesses have represented the future environment by a forecast, often by a consensus forecast representing a compromise between optimistic and pessimistic views. The military, on the other hand, has often formulated alternative futures or scenarios and evaluated strategies against these multiple futures. The difference in methodologies is of fundamental importance if the environment can change rapidly and/or in unexpected ways. Forecasting, particularly consensus forecasting, was generally adequate in the context of the political stability and relatively smooth growth of the 1950s and 1960s. But forecasting tends to obscure the key risks and opportunities of a turbulent period such as the 1970s. Since the worldwide environment seems likely to remain turbulent in the 1980s, the analysis of alternative futures would seem to be an indisensable element in good planning, for both business and government.

Conceptually the planning problem can be shown in a matrix, as shown in *Figure A.*[1]

Alternative strategies should be evaluated against alternative futures or scenarios, rather than against a consensus forecast. Even if the analyst does no more than to fill in the cells of the matrix with (+) signs for good outcomes and (-) signs for bad ones, perhaps with (++) for very good and (--) for very bad ones, the exercise is likely to be useful. Some strategies may look either very good or very bad, depending on which future is assumed to occur. Then one must ask whether the government can tolerate a really bad outcome. Which dimensions are most sensitive? Are there less

[1] Original state-of-the-art work in the development of scenario methodologies has been done by X. A. Corporation of Paris, France. Thus far the methodological breakthroughs remain unpublished.

risky strategies that are acceptable for most if not all of the hypothesized futures? If not, can they be developed, and developed in time?

Figure A Planning Matrix

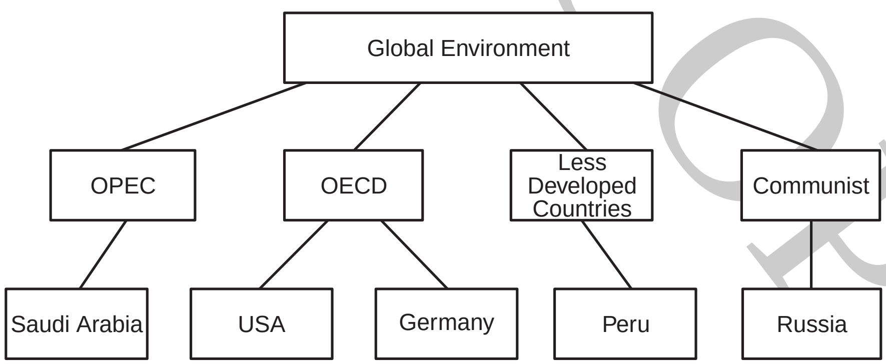
Alternative Strategies	F1	F2	F3	F4
S1				
S2				
S3				
S4				

Alternative Futures

Scenarios can be developed at various levels—for example, global, regional, or national. Global scenarios have been developed around world supply of and demand for oil, recognizing the ensuing implications for oil prices, the balance of payments of exporters and importers, the recycling load on the banking system, and so on. While relatively little of this work has been published, an article by André Bénard, a managing director of Royal Dutch/Shell, is an example of some of the work being done by a company that has been a pioneer in this field.[2]

Obviously the various levels of scenarios connect, and for the major countries they interact (see *Figure B*). This presents conceptual problems. It also presents country analysts with a challenge—to develop and master the data necessary for construction of soundly reasoned scenarios. Conceptually one can generate scenarios ad infinitum, and with little thought or expense. But to develop scenarios that can be of real use in the planning process involves an expense that will be beyond the means of most companies.

Figure B Interlocking Scenarios



Pierre Wack and Edward Newland, the principal architects of the Shell system, note that scenarios describe alternate "worlds" of internally consistent elements. These scenarios are fundamentally different from sensitivity analyses in which a single parameter is varied. Combining the various elements into a coherent view of a possible future requires careful analysis of the forces

[2] See "World Oil and Cold Reality," *Harvard Business Review*, November/December 1980, pp. 91–101.

that drive the system, not a mechanical extrapolation of one or two key variables. Similarly, a scenario is not just a story of what might happen. Such stories are a dime a dozen and, however entertaining, cannot provide a useful input to a decision-making process. Meaningful scenarios must be based on careful analysis of the key components of country analysis. In particular, they must try to recognize which elements of the future are already largely determined ("in the pipeline") and which are critical, yet uncertain. Combining the uncertain elements into two or three scenarios representing a broad but plausible range of possible outcomes can be particularly helpful to decision makers because the task challenges their often implicit notions of both predetermined elements and causal relationships. Departing from the probabilistic notion of the decision tree, which theoretically maps all futures and their expected values, scenario analysis develops fewer, less precise maps of the future, but ones that may have more impact on decision makers because causal links between the present and the future are emphasized.

Scenarios for auto company Y in country X could be developed schematically as shown in *Figure C*. The global environment can be symbolized by the price of oil, country response can be symbolized by the broad strategic alternatives such as raising gasoline and oil taxes to reduce consumption, and company options can be symbolized by alternative power sources. While this scheme shows how the pieces fit together, it is critical to note that the "world of $80 oil" is very different from the world of $20 or $30 oil. It grows more slowly, interest rates are higher, unemployment is higher, and auto sales are lower—among other things.

Figure C Scenario Analyses for Energy

Global Environments
Symbolized by Oil Prices

Consuming Country X	$10	$20	$40	$80	Auto Company Y
S1 Muddle through					S1 Stick with 6-8 cylinder autos
S2: Reduce oil consumption					S2: Downsize to 4 cylinder autos
S3: Restructure economy to pro-mote exports & reduce oil consumption					S3: Restructure for diesel engines
S4:					S4: . . . .

Some analysts are intrigued by mathematical theorems for "solving" the matrix for the best answers. Experience suggests, however, that the primary value of the exercise lies in recognizing assumptions and key variables, not in attempting rigorous solutions. Indeed, the experience of the Royal Dutch/Shell planners is that asking management to use more than two scenarios is a mistake, not only because it is cumbersome and complex but because it shifts attention to probabilities and matrix solutions and away from more fundamental questions. There are also important unsolved problems of how to aggregate divisional plans and cash flow projections based on alternate scenarios rather than a single forecast.

Scenario analyses are also being used to evaluate country risk or "sovereign risk," for example, the possibility of nationalization of assets in a particular country. In these cases the analysts focus on changes in government or regime and not just changes in economic policy. Several consulting firms are active in this area. X. A. Corporation, of Paris, has made a number of methodological innovations, including a scheme for showing scenarios along political rather than economic dimensions. One of the challenges for the future is to develop a scheme that facilitates presentation of the economic and political dimensions at the same time.

The scenario builder will confront innumerable problems, partly because the field is ill defined if not really new, partly because it attracts quacks as well as serious analysts, and partly because the administrative dimensions may be as complex as the analytical ones. Different people and/or subunits of an organization are likely to favor different scenarios, in part because the hypothesized environment would be favorable to them.

Scenario analysis can be helpful in illuminating different views of the future. Such analysis allows managers to be explicit as to whether they differ about the likelihood of one future or another, or merely of some components of the future, or whether they disagree about its implications for a particular strategy. The analyst would do well to remember, however, that no analytical methodology can solve these human or administrative problems. Patient, sensitive listening and discussion may well turn out to be an essential if seldom-mentioned skill for the successful analyst.

Summary

The country analyst faces a good many challenges. One is to do the field and library research for a sound analysis of a single country. Another is to have access to sound analyses of other countries and key industries, such as oil, so as to assemble a good picture of the environment. A third is to develop predictive skills or a method of scenario generation that represents sound analysis rather than rough guesswork. Fourth, there are numerous conceptual challenges in connecting this analysis of the environment to the strategic options of the decision makers, whether in government or industry. And last, but hardly least, innumerable administrative issues must be considered if all this analysis is to have an impact on real-life organizations. While country analysis may be a rather old art, its use in strategic planning is at best rudimentary in most organizations.

Country analysis today consists primarily of questions and challenges rather than well-established theory or practice. When it is well done, however, it can enable the sponsoring organization to avoid some surprises and spot opportunities before others do. Thus in many situations the potential benefits of country analysis outweigh its obvious conceptual and administrative risks.