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Explicating political hazards and safeguards: a transaction cost politics approach

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We apply the logic of comparative institutional analysis to the question of the governance of the relationship between private investors and the government. We consider two strategies that investors may follow: lobbying for the creation of a specialized political governance structure and relying on more general political mechanisms to influence policy in a given industry on an ongoing basis. We identify political hazards as a crucial determinant of the choice of political governance and the transactional attributes that give rise to such hazards. Finally, we highlight shift parameters in a nation's institutional environment that influence the choice between specialized and generalized political governance mechanisms.

1. Introduction

The hazards present in transactions between the government and a private party differ from those in transactions between two private parties. In the former case, both the government and the broader polity on which the government relies for support must be explicitly incorporated into an investor's choices about the appropriate form of political governance. The hazards originate in the possibility that once an investor has sunk the capital necessary to conduct business operations in a country, the government may at some future point face incentives to renegotiate the terms of investment in order to redistribute the investor's returns to other groups—such as competitors, suppliers and consumers—that provide it with political support. These hazards are greatest in environments with weak formal institutional supports for private property but also exist under stronger property rights regimes as well.

This paper considers the nature of such political hazards and evaluates two stylized political governance structures that investors may employ to mitigate them. We employ the comparative institutional approach outlined by Williamson (1985, 1996), which proposes a 'discriminating alignment' between transactional attributes and governance. The two specific political governance structures that we consider are: (i) 'generalized' governance, wherein the investor (and possibly its broader interest group coalition) relies on existing legislative and legal institutions for maintenance and enforcement;

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and (ii) 'specialized' governance, wherein the investor (and possibly its broader interest group coalition) seeks a specialized regulative structure for maintenance and enforcement. The transactional attributes that determine the relative costs and benefits of these alternative political governance structures include the traditional transaction cost economics determinants of contractual hazards (asset specificity, frequency and uncertainty); the public's expectations about the role of the state in the given transaction (probity); the expected strength and stability of the supporting coalition; the existing level of checks and balances in the national political structure; and the level of 'particularism' in the electoral process, i.e. the extent to which politicians face incentives to cater to narrow interest group preferences rather than broader ones.

Our analysis differs from prior attempts to craft a transaction cost politics framework in three primary ways. First, it examines strategic choices of political governance made by private parties who operate in the shadow of an uncertain policy environment rather than the strategic choices of politicians who operate in the policy environment. Dixit's (1996) analysis considers policy stability and the tradeoff between commitment and flexibility, but it focuses on the implicit contracts between political agents and their multiple principals. Epstein and O'Halloran (1997) focus on an even narrower contracting problem: that between various political actors in government (i.e., the legislative and executive branches). The positive political theory literature considers the more general role of what we term specialized governance as commitment or coordination devices for policy-making (Weingast and Moran, 1983; McCubbins *et al.*, 1987, 1989; Gely and Spiller, 1990; Spiller, 1990; Tsebelis, 1995). Williamson's (1999a) analysis of the role of probity in influencing political actors' choice between privatization, regulation and public bureau as a governance form is also related.

Second, our focal question is how private actors should govern their relationship with the government. North's (1989, 1990) transaction cost approach to the historical development of polities and economies also relates to this issue but is much broader in scope. North examines how the interplay among the preferences of economic actors in a society, the types of economic and political investments that they make and the existing institutional environment influences the further development of the institutional environment. Our approach considers the more immediate implications of a similar set of interdependencies on individual managers, as opposed to the implications for decades or even centuries of economic development. Other studies of governance that take institutional differences seriously tend to consider institutions as a shift parameter that influences the relative costs and benefits of various forms of market governance (Williamson, 1991; Oxley, 1995, 1999). Even more sophisticated analyses of the role of institutions have still limited themselves to the hazard-mitigating role of more or less hierarchical governance for economic activity, whereas we focus on political governance (Henisz and Williamson, 1999; Henisz, 2000b).

The third distinction in our analysis is the origin of the hazard. In standard transaction cost analysis, the hazard originates from the private counterparty. Henisz and Williamson (1999) extend this analysis to consider the possibility that a private

counterparty could use its influence with the government to alter the policy environment in a manner that shifts rents from the foreign investor to the local partner. The current analysis considers a more general class of hazards in which government intervention may result from lobbying by a broader range of local or international actors.

2. The transaction cost politics setup

We will argue that in order to make an informed choice between generalized and specialized political governance mechanisms, investors must ascertain the strength and stability of a coalition of actors that shares their preferences. Such an analysis requires a model of the policy-making process and the interactions among politicians, interest groups and voters.

We assume that individuals are boundedly rational (Simon, 1961). In addition to the limitations this places on their ability to craft complete contracts with each other they also face limitations in their carrying capacity for and understanding of current and likely future political debates (Hilgartner and Bosk, 1988). As a result, they process information selectively, typically relying on pre-existing heuristics and shortcuts to structure the information with which they are presented and assess both their preferences with respect to current policies and the likelihood that those policies may be subject to future change (Lau *et al.*, 1991). Politicians who seek to maximize their probability of obtaining or retaining power recognize these cognitive limitations, as do organizations with strong economic or ideological interests (i.e. interest groups). Political actors therefore intermediate the information flow to individuals so as to provide them with useful heuristics and frameworks that encourage support for the political actors' preferred policies (Olson, 1965; Lowi, 1969; Wilson, 1980).

This battle for public opinion is not waged in a vacuum. Rather, the formal and informal institutions that 'define the rules of the game in a society' (North, 1990: 3) can introduce a strong *status quo* bias into policy (Levy and Spiller, 1994; Jones *et al.*, 1998). The study of institutions as determinants of policy outcomes has a long history in the field of political economy, from the establishment of a constitution as a check against the absolute powers of the state to the development of a judiciary or multiple legislative and federal entities to check and balance each other; the creation of independent central banks to govern monetary policy ; commitment to international treaties to restrict short-term incentives for protectionism; and the development of independent regulatory agencies to govern investment in politically salient sectors. Other institutional supports for the *status quo* policy include broader legal supports for contracts, procedural rules that require multiple accessions to change existing law or policy and appellate processes within the legislative or judicial branches. In the presence of these institutional commitment devices, policy change requires substantial effort on the part of interest groups or other political entrepreneurs.

This effort has a higher probability of success, however, when political actors can

question the legitimacy of the existing policy regime. Legitimacy, defined as 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions' (Suchman, 1995: 574), becomes a powerful tool that allows political actors to challenge and possibly overturn existing policies or even institutional structures. Thus, while formal institutional structures may enshrine an existing set of policies and those institutions themselves are even more durable (DiMaggio and Powell, 1983), misalignment among underlying societal norms, beliefs and definitions may still lead to policy and institutional change particularly when captured and harnessed by interest groups and political entrepreneurs (Jones *et al.*, 1998; Scott, 2001).

Building on the arguments presented in Henisz and Williamson (1999) using the political context outlined above yields the following observation. According to John R. Commons (1932), 'the ultimate unit of activity . . . must contain in itself the three principles of conflict, mutuality and order. This unit is a transaction.' Transaction cost politics concurs with transaction cost economics that the transaction (here between economic actors and political actors over the set of policies relevant to the former) is the basic unit of analysis. It further asserts that the policy-making process is the means by which order is accomplished in a relation in which potential conflict among political actors threatens to undo or upset opportunities to realize mutual gains.

Like transaction cost economics, transaction cost politics emphasizes the problem of bilateral dependency here between an investor or set of investors and a government. While in the analysis of economic activity in isolation from the policy-making process, contractual incompleteness in the presence of specific investments focuses attention on private ordering, no such escape from poorly defined or enforced property rights is available when risk emanates from the government itself. Unlike the transaction cost economics prescription of internalization as a means to overcome contractual hazards in exchange and align the incentives of counterparties, investors facing political hazards are unable to fully internalize their transactions with governments. Even where a joint venture with a public enterprise is feasible, the various interest groups that together define government policy towards that joint venture are still absent from the initial phase of contract negotiation and continue to pose *ex post* political hazards. We therefore shift attention from the question of comparative economic organization to that of comparative political organization.

3. Governance

Challenges of political governance supplement the traditional managerial challenge of economic governance. Business activities that have low 'political salience'—i.e. that are unlikely to become the focus of lobbying efforts by interest group coalitions seeking redistribution—may be organized without regard to political governance. That is, standard transaction cost analysis, which emphasizes the crafting of discriminating governance alignments that mitigate contractual hazards, applies without modification.

As the political salience of an activity increases, however, the political hazards that the investor faces grow and so too does the need to augment the consideration of economic governance with a symmetric consideration of political governance as a means to mitigate this new class of hazards.

Generalized political governance is akin to hybrid organization in transaction cost economics. When contractual hazards are sufficiently low, economic actors turn to spot markets, where neither contracting party has an interest in maintaining an association, but rather exchanges goods or services for immediate payment without the development of a specialized governance structure. Similarly, where political hazards are sufficiently low, economic actors interact with each other under the shadow of the policy-making process but without specific regard to the influence of current or future laws or legislation on their activity. That is, economic actors assume that the future policy-making process will not interfere with their ability to engage in future economic exchange. As political hazards increase, however, economic actors begin to incorporate into their calculations an analysis of current policy and the policy-making process that generates future policy. As a result of this analysis, they may devote resources to the policy-making process to enhance the probability of the continuance of desired policies, the adoption of favorable policies and the blockage of unfavorable policies. Specific mechanisms of influence will differ according to the structure of the political institutions and the preferences of the actors that inhabit them (Weingast and Moran, 1983; McCubbins *et al.*, 1987, 1989; Gely and Spiller, 1990; Spiller, 1990; Tsebelis, 1995; Holburn and Vanden Bergh, 2002), but typically include lobbying political actors directly or indirectly and making financial contributions to political actors.

Laws and policies always exhibit some degree of survival bias as a result of the legislative effort required to overturn them and are therefore not as 'frictionless' as the market itself. Nevertheless, reliance on the normal policy-making process itself in order to sustain the initial terms of investment enshrined in a law or policy still leaves the investor susceptible to policy shifts resulting from the ongoing efforts of various interest groups to influence politicians to redistribute returns toward them *ex post*. To be sure, the investor is not without any recourse: it, too, may conduct ongoing lobbying or influence efforts of its own in order to maintain favorable policies. These efforts are most successful when the investor belongs to a broad, stable coalition of interest groups that can bring its aggregate weight to bear on politicians.

As political hazards increase, so too do the relative benefits of specialized political governance, which is akin to hierarchical organization in transaction cost economics. When political hazards are sufficiently high, economic actors may lobby or otherwise influence the policy-making process to generate a specialized political governance structure with jurisdiction over policies of particular interest to them. Such specialized structures may take the form of a newly formed dedicated regulatory agency, administrative oversight by an existing regulatory agency or a less formal public–private partnership. In all of these cases, the distinguishing factor of specialized political

governance is the development of specific safeguards that limit the discretion of current and future policymakers by specifying a process for altering the *status quo* policy that is typically more challenging than it would be under generalized political governance.

The main protective benefit of adopting a specialized political governance structure for a given policy lies in the stronger *status quo* bias that it creates relative to generalized governance. However, just as hierarchical governance in transaction cost economics confronts the parties with added bureaucratic costs that impede their ability to adapt efficiently and efficaciously to external 'disturbances' such as changes in demand or cost conditions, the cost of the increased policy commitment created by specialized political governance reduces the flexibility of policy and thus the investor's ability to adapt to such disturbances.

All legislative enactments are characterized by a baseline level of *status quo* bias as a result of the legislative effort required to overturn them. The increased *status quo* bias of the specialized political governance structure—and thus the protective benefits and adaptive costs that it creates for the private investor—derives from the benefits that it provides to interests other than the investor itself.

One possible set of interests includes organized consumers, suppliers or ideological groups that, along with the investor, may have formed a coalition to lobby for the creation of the specialized structure. The support of such a coalition increases the investor's probability of obtaining a specialized structure in the first place and the politicians' incentives to maintain the structure in the face of opposition. However, the interests of the coalitions members may diverge over time in response to external disturbances. Members benefiting from the *status quo* can be expected to impede changes in rules, policies and the like within the structure itself, constraining the ability of the private investor to adapt autonomously when it could benefit by doing so.

In addition to interest groups that may be part of a coalition, other external and internal interest groups may also develop an interest in the regulative structure over time, further increasing the *status quo* bias. Rodrik's (1994) analysis of the institutions that govern trade policy and the entrenched business interests that position themselves to benefit from the current policy-making structure is demonstrative of the former. Downs' (1966) analysis of the tendency for bureaucratic and other political actors in an institutional body to promote the survival of the body—presumably because of the vested interest that they develop in the body itself—illustrates the latter. Specific efforts include the hiring of likeminded individuals, mounting campaigns for autonomy from political oversight and providing increased voice for interest groups benefiting from the body, all of which increase the body's resistance to change.

Politicians themselves may come to develop an interest in the survival of the specialized structure. Such a structure typically affords the state enhanced monitoring and control of investor operations. Thus, even though the business remains in private hands, politicians have a direct channel through which to tilt operations toward 'public' objectives that the investor would not pursue on a purely economic basis. The political

benefits of this arrangement to politicians are especially large when attainment of the objectives is crucial for maintaining widespread public support and the costs of attainment through other means are high. The regulative structure's resistance to change is especially high in this case; so too are the constraints on adaptation even within the confines of the structure.

Perhaps the greatest *status quo* bias obtains when the polity comes to embrace the specialized regulative structure as an end itself rather than as a means to specific public objectives through the social process of institutionalization. Berger and Luckman (1967) point to an institution's ability to possess 'a reality of [its] own, a reality that confronts the individual as an external and coercive fact' (Berger and Luckman, 1967). Eventually, the institution enters a mature phase in which it is 'retrojected into consciousness in the course of socialization' (Berger and Luckman, 1967: 60–61). At this point, 'institutions do not just constrain options: they establish the very criteria by which people discover their preferences' (Powell and Dimaggio, 1991: 11).

Thus, policies enacted through a specialized structure are likely to be characterized by a *status quo* bias beyond that of a simple law or decree. This bias creates protective benefits for the investor but also imposes costs in the form of reduced adaptive ability. When the political hazards that the investor confronts are great enough, the protective benefits of the specialized structure exceed its costs. When hazards are low, however, the cost of the investor's reduced adaptive ability exceeds the value of any protective benefits.

4. Hazards

Specific transactional attributes affect the level of political hazard that an investor faces and may increase the appeal of specialized relative to generalized mechanisms of political governance. These attributes include the standard complement of transactional characteristics (i.e. asset specificity, frequency and uncertainty) that give rise to contractual hazards in economic exchange. Investments that have limited mobility outside of the territory of a given nation-state have long been highlighted as subject to the risk of opportunistic political or regulatory policy (Vernon, 1977; Kobrin, 1987). Similarly, exceptionally rare transactions also face enhanced political hazards as the investor has little in the way of precedent to consider regarding the likely roll of various interest groups and the shape of potential supporting and opposing political coalitions over time. Finally, in the face of uncertainty deriving from the inability to forecast future technological trends, market-based factors or government policy, political hazards may similarly loom large due to the uncertainty surrounding future political coalitions and even the relevant set of political and economic actors that might have an interest in the policy outcome.

Another type of hazard that is unique to the political context derives from the polity's expectations regarding the role of the state. In some sectors of an economy, because of concerns regarding the public nature of outputs or inputs or concerns

regarding profiteering at the expense of consumers—particularly those that are perceived as disadvantaged or deserving—the public has expectations that the government will directly intervene in the operation of the sector.

At one level, such expectations affect all firms in an economy. Regulations restricting the use of child labor or the discharge of toxic waste restrict the domain of business practices in many societies. In some sectors, however, the level of government scrutiny extends beyond ensuring compliance with the law to ensuring compliance with vaguer perceptions of fairness or appropriateness. Williamson (1999a) refers to this sort of transactional characteristic as 'probity'. The hazard that it creates for investors derives from the need to comply with implicit expectations to reduce the probability of political opposition and not just those written into laws or contracts.[1]

5. Shift parameters

Investors engaged in a similar business activity in different countries may make different choices regarding the political governance of that activity as a result of differences in the institutional environment that affect the 'baseline' level of *status quo* bias in policies. Two key attributes of the institutional environment in this regard are the level of checks and balances in the policy-making process and the level of particularism (i.e. the strength of politicians' incentives to cater to narrow as opposed to broad national interest groups) in the electoral process.

Checks and balances in the policy-making process create a *status quo* bias by increasing the probability that multiple interest groups will participate (through their control or influence over at least one of the veto points), requiring broader agreement o change a given policy and thus increasing the difficulty of doing so. Prior research has demonstrated that nations with stronger checks and balances better attract investment, especially long-lived investment that may be a crucial input to broad-based economic growth (Levy and Spiller, 1994; Borner *et al.*, 1995; Knack and Keefer, 1995; Mauro, 1995; Barro, 1996; Campos and Root, 1996; Henisz, 2000a; Stasavage, 2002; Klein and Luu, 2003).

Just as the presence of stronger property rights increases the range of economic transactions governed by market and hybrid forms of market organization (Williamson, 1991), the presence of greater checks and balances expands the range of business activities for which investors disregard political hazards or rely on generalized political governance to mitigate them. When the baseline level of protection against policy change is stronger, investors less frequently require the added protective benefits of a specialized structure.

In addition to considering the feasibility of policy change as defined by the structure

[1]The government itself clearly has an interest in the enhanced monitoring and direction that a specialized structure creates in this case (Williamson, 1999a). Investors too may enjoy enhanced protective benefits.

of interaction among the politicians and bureaucrats in government, investors should also consider the incentives of the politicians in office to seek policy change. Assuming that politicians' goals are to stay in office, one crucial determinant of these incentives is the process by which they reach office. To the extent that their retention of office depends upon catering to narrow interest group preferences as opposed to broader national interests, the problem of coalition instability is enhanced. The more possible majority coalitions that exist the more likely preferences are to cycle and threaten any existing policy regime. As a result, investors must worry more about defection from the coalition of actors that supports their interests and the construction of a new coalition of actors that may seek inimical policy change. By contrast, in countries with electoral systems that mute the power of small fractionalized interest groups and create more cohesive national parties, policy volatility is reduced and the likelihood of defection among an investor's interest group coalition, although still positive, is muted.

A broad body of literature compares various facets of electoral systems that generate broad-based national interests or smaller concentrated interest groups (Ordershook and Shvetsova, 1994; Carey and Shugart, 1995; Blais and Massicotte, 1997; Neto and Cox, 1997; Boix, 1999; Cox and McCubbins, 2001; Franzese and Nooruddin, 2004; Shugart, 1999; Panizza, 2001; Persson *et al.*, 2001; Milesi-Ferretti *et al.*, 2002; Kunicova and Rose-Ackerman, 2003; Wallack, 2003). A simple example is the difference between constituencies that span the entire nation, which are more likely to generate politicians that support broad-based interests, and small geographic voting districts which give rise to more particularistic politics.

Now consider the implications for the costs and benefits of specialized versus generalized governance of changing the level of checks and balances for countries with various levels of particularism. As the level of checks and balances in the broader political system increases, the *status quo* bias in the policy regime increases as well. The increased *status quo* bias implies a decreased likelihood that investors can craft a majority coalition for the design of a new specialized governance mechanism. Despite this enhanced difficulty in crafting specialized political governance mechanisms, the benefits of such efforts may be substantial, depending on the extent of particularism. In a particularistic electoral system that is more prone to cycling and policy instability, future coalitions may seek to undermine the existing policy regime, thus enhancing the benefits of specialized governance (Alt and Shepsle, 1990; Laver and Shepsle, 1990; Ordershook, 1992; Soskice *et al.*, 1992; Shepsle and Weingast, 1994). The same change in the system of national checks and balances in a country characterized by an electoral system that moderates interest groups pressures or deflects them offers lower benefits to specialized governance. Here, the likelihood that a future interest group coalition will be able to secure policy change is diminished somewhat by the electoral system; therefore, specialized political governance structures are less likely to merit the fixed cost of creating them and the bureaucratic costs of operating under them. We therefore predict that the impact of increasing the strength of national checks and balances on the probability of lobbying for the development of a specialized political governance

mechanism is more likely to be positive the more particularistic is a country's electoral systems.

Now consider the impact of altering the level of particularism for a given level of national checks and balances. Increasing the particularism of the electoral system enhances the feasibility of future change in the policy regime, making specialized governance mechanisms more attractive. Where the national structure of checks and balances allows for highly concentrated power by those in office, the costs of introducing such a new regulative institutional structure to govern investors' transactions is low, as are the associated bureaucratic costs over time. Where the national structure of checks and balances is stronger, the fixed and bureaucratic costs are higher. We therefore predict that the impact of increasing particularism on the probability of lobbying for institutional development is more likely to be positive in countries with national political systems characterized by concentrated power.

6. Sample applications

As an illustration, consider the political governance choice of an international investor contemplating an investment in infrastructure (e.g., electricity generation, telecommunication services, toll roads, ports, damns, water, sewerage). Not only might organized interest groups such as labor unions exert pressure for future policy change to redistribute the returns of the investment, but the broader polity is also likely to regard the reliability and pricing infrastructure services as politically salient. Infrastructure investment is thus characterized by a high degree of probity and investors face substantial political hazards.

While the benefits to the investor of a specialized political governance structure are clearly large in this case, we still observe substantial heterogeneity across countries and sectors in the level of *ex ante* institutional development. To what should we ascribe this variation?

First, the extent to which infrastructure services are popularly perceived as inalienable rights or government obligations varies across countries. The extent to which other sectors of the economy—especially other infrastructure sectors—operate according to market principles is partly determinative. More generally, widely held values and norms that have developed over time dictate the extent to which a society recognizes private participation as 'legitimate' and determine the level of probity associated with infrastructure. These factors influence the relative attractiveness of specialized structures to investors. Thus, in 'market-oriented' countries such as Chile, New Zealand and Estonia, later stage reforms have been governed by generalized structures such as antitrust policy, whereas specialized structures have been necessary in countries with more limited reference points for private market activity in politically salient sectors. Examples of such countries include Argentina, Brazil, Malaysia and China.

Even in sectors where private investment is widely accepted at one point in time, the

evolution of private activity in the sector may shape the future preferences of various interest groups. For example, in the case of cellular services, rapid technological growth facilitates the introduction of new services and reductions in cost that help to maintain a coalition of supporters in favor of private sector activity, reducing the relative benefits of specialized governance. In contrast, in sectors where private sector involvement is needed mainly to solve a short-term crisis—such as electricity in many cases in the early 1990s—groups that are opposed to private involvement may initially acquiesce, but later militate for redistribution or expropriation as the crisis fades, increasing the desirability of a specialized political governance structure.

Specialized governance holds less appeal in countries with underdeveloped national checks and balances and electoral systems that are not particularistic. Investors in these countries are more likely to strike 'side deals' with a coalition of powerful interest groups rather than rely on a formal regulative structure. Cellular service licenses across most of Sub-Saharan Africa or infrastructure investment of any kind in Suharto's Indonesia are clear examples of investor choices to rely on coalition support under generalized governance rather than formal institutional commitment devices.

As discussed in the previous section, variation in formal checks and balances or electoral particularism may also influence the choice of political governance structure. Consider Chile and Argentina, both countries in which formal policy-making institutions creates strong checks and balances and should therefore reduce the overall need for specialized governance structures. However, as Persson *et al.* (2001) observe, Argentina's electoral system employs closed party lists, giving rise to substantially greater party-centered particularism than does Chile's system, which uses open list proportional representation in two-member electoral districts. As a result, investors in Argentina to demand greater *ex ante* institutional safeguards—such as a specialized governance structures—than do investors in Chile.

Intertemporal changes in Chile illustrate the effect of variation in checks and balances. Since 1989, Chile has employed the same electoral rule, but its formal institutions have developed substantial strength and independence from the executive during this period. According to our arguments, that increase in the strength of checks and balances should diminish the need for specialized governance structures as compared to the case of Chile in 1989.

7. Conclusion

Comparative institutional analysis informs the organization of political activity. Analysis may be pursued by comparing transactions with different levels of political hazards across institutional environments with different levels of national checks and balances and particularism. The two crucial insights that distinguish transaction cost politics from transaction cost economics are the inability in the former case to rely upon private ordering and also the recognition in this case of an *ex post* hazard stemming from the broader polity that is not represented in the initial contract

negotiations. This extension of transaction cost analysis leads us to include in our determinants of political governance the expectations of the polity with respect to the government's role in the sector, the national structure of checks and balances and the efficacy with which the preferences of the polity are represented in the political arena.

A firm's ability to economize in both economic and political governance could be an important source of strategic advantage over its competitors (Williamson, 1999b). Managers who can better identify pivotal actors in the policy-making process (Holburn and Vanden Bergh, 2002) and deliver to those actors the messages most likely to generate favorable policy outcomes may generate super-normal returns for their firms (Henisz and Delios, 2002; Henisz and Zelner, 2003, 2005). While the sort of discriminating alignment that mitigates contractual hazards is relatively well established, we provide some initial insights into the analogous relationships for political transactions. Subsequent research should seek opportunities to test empirically the proposed alignments developed here as well as to theoretically and empirically explore the relationships between a firm's ability to produce goods and services and to economize on economic and political governance mechanisms.

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