THE UNITED NATIONS
LIBRARY ON TRANSNATIONAL
CORPORATIONS

VOLUME 7

Governments and Transnational Corporations

EDITED BY
Theodore H. Moran

GENERAL EDITOR
John H. Dunning

ROUTLEDGE

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London and New York
published for and on behalf of the United Nations,
Transnational Corporations and Management Division,
Department of Economic and Social Development

First published 1993
by Routledge
11 New Fetter Lane, London EC4P 4EE

Simultaneously published in the USA and Canada
by Routledge
29 West 35th Street, New York, NY 10001

Typeset by Leaper & Gard Ltd, Bristol, England
Printed and bound in Great Britain by
Mackays of Chatham PLC, Chatham, Kent

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library.

ISBN 0-415-08540-3 (Vol. 7)
ISBN 0-415-08555-1 (Set B)
ISBN 0-415-08559-4 (All 20 volumes)

Library of Congress Cataloging in Publication Data
has been applied for.

ISBN 0-415-08540-3 (Vol. 7)
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United Nations
Department of Economic and Social Development
Transnational Corporations and Management Division

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Note

The Transnational Corporations and Management Division (formerly the United Nations Centre on Transnational Corporations) of the United Nations Department of Economic and Social Development serves as the focal point within the United Nations Secretariat for all matters related to transnational corporations and acts as secretariat to the Commission on Transnational Corporations, an intergovernmental subsidiary body of the United Nations Economic and Social Council. The objectives of the work programme are to further the understanding of the nature of transnational corporations and of their economic, legal, social and political effects on home and host countries and in international relations, particularly between developed and developing countries; to secure effective international arrangements aimed at enhancing the contribution of transnational corporations to national development goals and world economic growth; and to strengthen the negotiating capacity of host countries, in particular the developing countries, in their dealings with transnational corporations.

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Preface

The importance of transnational corporations and the globalization of production are now well recognized. Transnational corporations have become central actors of the world economy and, in linking foreign direct investment, trade, technology and finance, they are a driving force of economic growth. Their impact on the economic and social welfare of developed and developing countries is both widespread and critical.

It is one of the functions of the Transnational Corporations and Management Division (formerly the United Nations Centre on Transnational Corporations) – the focal point in the United Nations for all issues relating to transnational corporations – to undertake and promote research on transnational corporations to contribute to a better understanding of those firms and their impact. Over the past thirty years, research on this phenomenon has mushroomed, and hundreds of books and reports, as well as thousands of papers, have been published. It is the principal purpose of this twenty-volume *United Nations Library of Transnational Corporations* to distil, summarize and comment on some of the more influential of those writings on the role of transnational corporations in the world economy. In particular, the contributions in the *United Nations Library* deal with four main issues; namely, the determinants of the global activities of transnational corporations, their organizational structures and strategies, their interactions with the economies and legal systems of the countries in which they operate and the policies that governments pursue towards those corporations. The twenty volumes are intended to cover a wide range of topics that embrace economic, organizational and legal issues.

To accomplish that task, the Centre assembled a distinguished group of editors, who were commissioned to select the seminal contributions to their subject areas published over the past twenty to thirty years. They were also asked to prepare comprehensive bibliographies of writings on their subjects for inclusion in the volumes, and state-of-the-art introductions that summarize the development of their subjects, review the most important current issues and speculate about future work. We hope that the result in each case is a volume that provides a succinct, yet comprehensive, overview of the subject to which it is devoted.

The political economy of transnational corporation activity is one of the critical areas of interest to both scholars of the transnational corporation and national policy-makers. And nowhere more dramatically has one seen such a change of perception about the consequences of such activity, and of policies relating to such activity, over the past thirty years. Theodore Moran, Professor and Director of the Karl S. Landegger Program in International Business Diplomacy, School of Foreign Service, Georgetown University, Washington, DC, is one of the most influential teachers and researchers on the interaction between transnational corporations and the nation states of which they are part. In both his introduction and selection of readings, he seeks to guide the reader through those changes, and the reasons for them. In particular, he considers some of the consequences of the more conciliatory attitudes adopted by most countries towards the activities of transnational corporations since the mid-1980s.

Among other things, Moran points out that the political economy of transnational corporation activity varies according to the goals of the political systems, cultures and ideologies of both home and host countries, and also according to the characteristics of transnational corporations – including the motives for their investment and their size, age and degree of experience in the countries concerned. Moran not only surveys the likely causes of conflict between transnational corporations and Governments, but also offers useful practical advice as to how those conflicts might be resolved.

While the subject matter of the present volume is very controversial, the author presents a carefully balanced (yet critical) view of the main schools of thought about the costs and benefits of transnational corporation activity to nation states wishing to protect and preserve their cultural identity, political autonomy and strategic interests. Many of those concerns – which go well beyond the purely economic – are of no less relevance to developed, as well as to developing, countries. Indeed, issues like the environment, strategically sensitive areas and political sovereignty are increasingly being raised in the United States, Canada, the European Community and Japan, as global firms and regional economic integration are tending to erode their economic sovereignty. Accordingly, they are high on the political agendas of those countries and of the transnational corporations that are most likely to be affected by decisions taken by those authorities.

New York, June 1992

Karl P. Sauvant
Chief, Research
and Policy Analysis Branch
Transnational Corporations and
Management Division

John H. Dunning
General Editor of
United Nations Library on
Transnational Corporations

Acknowledgements

The editors and publishers would like to thank the following publishers and other organizations for permission to reprint copyright material: Columbia University Press; Edward Elgar Publishing; *Foreign Affairs*, Council on Foreign Relations; *International Organization*, MIT Press Journals; *Journal of Common Market Studies*, Basil Blackwell Publishers; Institute for International Economics; Rutgers – the State University of New Jersey; John Wiley & Sons.

Acknowledgement is also due to: Professor Tom L. Beauchamp; Macmillan Publishers; and Prentice Hall International.

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Introduction: Governments and Transnational Corporations*

Theodore H. Moran

Introduction: Transnational Corporations and the Great Analytical Paradigms

In the neo-classical world of perfect competition, the political dimension of government–firm relations does not loom large. Other than profit-maximization, firms can hardly be said to follow a strategy of their own; they merely respond to exogenous market signals which, with few exceptions, reconcile individual and common interests, producing the greatest good for the greatest number. The nationality of their owners or managers has little significance. Except for clearly defined circumstances in which externalities are present (as in environmental pollution or optimum tariff cases), governments are best advised to stand back and let the firms operate on their own.

When one relaxes neo-classical assumptions and enters a setting of oligopoly or monopoly, however, the question of governmental intervention and political control becomes much more prominent. Firms have a measure of choice about where and how to conduct their operations, and they have rents (as well as promises and threats) to use to influence the environment around themselves. Once they move across borders, the question of how they balance the directives placed upon them (by home governments, host governments, their own needs) acquires importance. The nationality of owners or managers becomes potentially significant. Not only do governments have to worry about economic distortion as a result of the behaviour of transnational corporations (TNCs), but they confront legitimate concerns about the impact of TNCs on national power and national autonomy, in particular in small and medium-sized countries.

It was in the latter context, when the activities of TNCs first became unambiguously identified with imperfect competition via the writings of Stephen Hymer, Charles Kindleberger, Raymond Vernon and others (see the volume in this series edited by John Dunning), that the early frameworks for TNC-government relations emerged. In attempting to characterize the TNC-government relationship, the authors drew on the great historical paradigms: liberalism, neo-mercantilism and neo-imperialism.[1] The liberal tradition condoned government intervention only to enhance competition and correct for market failures; it tended to be agnostic about the nationality of firms and the source of capital or technology (or products) and was inclined to pursue cooperative economic solutions that promoted global welfare. The neo-mercantilist tradition showed a preference for government intervention to promote a nation's own firms as a way of meeting national needs, stressed the need to avoid dependence on outsiders and was prone to seek relative advantage over other nations. The neo-imperialist tradition exhibited a propensity for direct public sector participation in economic activity, displayed a concern about class (as well as national) roots of ownership, and sought to prevent an exploitative distribution of benefits within, as well as among, nations. The tension between these three intellectual traditions has persisted throughout the attempts to conceptualize TNC–government relationships.

"Suddenly, it seems, the sovereign states are feeling naked", wrote Vernon in introducing his analysis of TNC–government relations.[2] *Sovereignty at Bay* was the name he gave to the book that incorporated his early research. The title captured one of his arguments, namely that TNCs are able to conduct their operations with a scope and flexibility which sometimes renders governmental efforts to control them impotent. But a characterization of Vernon's position based on this title alone would fail to appreciate the dialectical nature of his argument (as the first selection in the present volume demonstrates). Along with the expansion of TNC activities, Vernon also detected signs that public authorities in home and host countries were girding themselves to reassert their own sovereign authority over TNC operations within their jurisdictions. The inevitable outcome, Vernon suggested, would be jurisdictional overlap and jurisdictional conflict. In the end, therefore, Vernon predicted, multilateral efforts in which home and host states pooled their own sovereignty might be needed to restore public accountability on the part of TNCs.

Jean-Jacques Servan-Schreiber looked at the same phenomenon as Vernon, i.e., the growing presence and expanding power of transnational investors (in Servan-Schreiber's case, in the postwar European economic recovery), and drew conclusions that in part resembled Vernon's. Transnational corporations from the United States, observed Servan-Schreiber in the second selection in the present volume,[3] were the only firms that looked upon the new Europe as a single market and rationalized their operations accordingly, without regard for traditional national boundaries. European companies, in contrast, remained wedded more parochially to their home markets. "Fifteen years from now", asserted Servan-Schreiber, "it is quite possible that the world's third greatest industrial power, just after the United States and Russia, will not be Europe, but *American*

Industry in Europe" (Servan-Schreiber, 1968, p. 3).

There was a subtle difference between the Vernon and the Servan-Schreiber perspectives, however. Whereas Vernon hinted that TNCs might be becoming more a-national ("stateless") in their perspective, Servan-Schreiber revived the neo-mercantilistic postulation that home-country firms could be counted on to serve home-country needs better than foreigners. If the European Community did not create its own national champions as an alternative to reliance on firms from the United States, Europe might become, via TNC investment, he argued, a political appendage of the United States.

As shown in the third selection, Osvaldo Sunkel, like Fernando Henrique Cardoso and other third world writers, introduced a neo-imperialist critique (using the term *dependencia*) into the conceptualization of TNC–government relations in the developing countries.[4] Sunkel viewed the spread of TNCs into the countries of the "periphery" with even more apprehension than Servan-Schreiber did with regard to Europe. As the "commanding heights" of third world countries were captured by foreign investors, the political economy of development itself, he feared, was being undermined. The growth of domestic economies in developing countries, which had remained largely in local hands from 1930 to the mid-1950s, was being "taken over to a large extent by foreign subsidiaries, with the result that much of the benefit expected from industrialization has gone abroad in payment for capital equipment and in transfer of profits, royalties, and other financial payments" (Sunkel, 1972, p. 518). The local entrepreneurial class was undergoing a process of erosion, he argued, and traditional labour-intensive activities were being disrupted, leading to a marginalization of workers. Development and underdevelopment, he concluded in his statement of the *dependencia* view, "are simultaneous processes: the two faces of the historical evolution of the capitalist system" (Sunkel, 1972, p. 520).

A reaction to the uncontrolled spread of TNCs in the third world was politically inevitable. "What we are seeing", concluded Sunkel, "is the assertion of the national interest of our countries in their international economic relations. The aim is greater autonomy, in order to achieve development without *dependencia* and without marginalization" (Sunkel, 1972, p. 531).

The three pieces in the first part of the present volume, by Vernon, Servan-Schreiber and Sunkel, thus serve to lay out the major themes that have dominated the literature on TNCs and governments: the question of political control and political autonomy *vis-à-vis* TNCs; the question of government intervention to alter TNC activities and change the distribution of costs and benefits; and the question of creating national alternatives to reliance on foreign investors. The next two parts of the present volume examine these issues in more detail, first with regard to the developing countries and then with regard to the industrial states. The final part offers visions of how TNC–government relations might evolve in the future.

Relationships between Transnational Corporations and Governments in Developing Countries

The deviation from the neo-classical model of perfect competition is particularly pronounced in the activities of TNCs in developing countries. More than 80 per cent of the inflows of foreign direct investment typically take place in industries where the four-firm concentration ratio is higher than 50 per cent (see the volume in this series edited by Richard Newfarmer and Claudio Frischtak).[5] There has consequently been an ongoing tension between the idea of allowing markets to work without government interference and the requirement for public sector intervention to prevent distortion and exploitation. (The following analysis should be read in conjunction with the volumes in this series by Sanjaya Lall and Daniel Chudnovsky which treat the economic impact of TNCs on development more directly.)

In a setting of highly imperfect competition, Edith Penrose first proposed that, to understand TNC-government relations in the third world, one needed a framework of bilateral monopoly, with the firm controlling sector-specific capabilities and the host country controlling the conditions of access.[6] Within that framework, Penrose suggested there was an objective measure of the appropriate return for the foreign investor: TNCs should get no more than the bare minimum to attract them to invest; anything more would constitute "exploitation". Using the same bilateral monopoly model, Kindleberger countered that TNCs are entitled to the scarcity value of their activities (i.e., as much as a third world host country would lose if it had to do without the TNC's operations).[7] According to Kindleberger, there was no justifiable way to claim exploitation as long as TNCs were only appropriating the scarcity value of their services.

The early writings that attempted to understand the TNC–government relationship in the third world by applying the bilateral monopoly model to bargaining outcomes in individual investment cases encountered the following two questions:[8] first, where between the two Penrose–Kindleberger extremes might the equilibrium in the distribution of returns between TNC and host government fall? And, second, how could host governments use what bargaining power they had to pursue objectives other than merely capturing a larger share of the foreigners' economic rents for themselves?

To discover the answer, Vernon suggested that it was necessary to move beyond the static conceptualizations of Penrose and Kindleberger. What gives dynamism to the bargaining process, Vernon argued, is the evolution of risk and uncertainty over the life of a (successful) TNC investment.[9] This produces a dynamic phenomenon which he named the "obsolescing bargain", whereby investment contracts that are initially favourable to the foreign firm (reflecting early risk and uncertainty) may be renegotiated on terms more favourable to the host country, as risk and uncertainty dissipate.

The obsolescing bargain model (later called the "bargaining school", as the chapter by Joseph Grieco indicates) was first tested in the natural resource sector.[10] It could be shown that, for example, tax rates rose from 38 per cent to 68 per cent in copper cases and 50 per cent to 92 per cent in petroleum cases. The time interval between negotiation and renegotiation shortened, and the placement of nationals in supervisory and management positions expanded, as host-country authorities moved up a learning curve in dealing with TNC operations.

That might be interpreted as a vindication of the obsolescing bargain model as a guide to understanding TNC–government relations. But, the case studies revealed unanticipated difficulties as governments in the third world sought majority ownership of the projects, or moved all the way to nationalization. In the mining industries of Zambia and Zaire, for example, Michael Shafer discovered that nationalization brought what he called "loss of insulation".[11] As long as the foreign TNCs held a majority equity position in mineral production, they acted as a buffer against, for instance, excessive wage demands, lower efficiency in production and favouritism in procurement practices. Nationalization eliminated this insulation, pitting host authorities directly against local labour groups, procurement interests and rival ministries which sought the funds needed for reinvestment in the industry.[12]

Thus, as shown in the volume edited by Bruce McKern on natural resources in this series, more recent TNC–government negotiations have channelled host-country demands towards the expansion of domestic processing and the training of indigenous management, with less emphasis on high tax rates or majority local ownership (ownership and control tend to be treated separately in contemporary negotiations, with appointment of a ministry representative to the local project board and requirement of unanimous approval for annual operational plans, for example, replacing the demand for majority ownership by the host).[13]

The obsolescing bargain model did constitute a breakthrough of sorts in the conceptualization of TNC–host government relations in the third world. Hitherto, the sources of economic nationalism in the treatment of foreign investors were associated with the politics of emotion, xenophobia or ideology, propelled by some version of what Harry Johnson characterized as "psychic gratification".[14] The obsolescing bargain model, in contrast, offered the beginnings of a theory of economic nationalism based on rational self-interest.[15]

But could a similar analysis of TNC–government relations be extended to manufacturing or other sectors?[16] And could the evaluation of outcomes be broadened to include a greater array of host-country objectives than the capture of rents?

In manufacturing, the analysis becomes much more complex, with the success of the obsolescing bargain depending upon more diverse characteristics of the project itself (such as the size of the fixed investment, the stability of the technology, the extent of product differentiation and the degree of competition in the industry) which strengthen the hand of one side or the other in negotiating over the life-cycle of the investment. The selection on the computer industry in India by Grieco demonstrates the subtlety required for analysing the evolution of host-government–TNC negotiations in the manufacturing industry.[17] India's initial attempts to control foreign TNCs by demanding joint ownership did not prove efficient, nor did subsequent efforts to build a national champion computer company by excluding foreign competition. Ultimately, however, a host strategy which allowed indigenous computer companies to shop around among alternative foreign suppliers as they expanded their own operations, both lowered the cost per bit of memory and shortened the time lag between the introduction of innovation outside the country and the adoption of the innovation internally. Grieco concluded from the Indian experience that third world policies that take advantage of competition among foreign TNCs can strengthen the bargaining position of the host country even in industries in which TNC domination of technology might otherwise be decisive.[18]

Because host-country objectives in manufacturing have expanded in the past two decades from a predominant focus on tax revenues and joint ownership to local value-added, domestic research and development, job creation and exports, studies of TNC–host government negotiations that highlight local ownership as a proxy for successful bargaining tend to miss much of what the more recent struggles have been about. The examination of the Mexican automobile industry by Douglas Bennett and Kenneth Sharpe, as well as research by Barbara Samuels, for example, documents a long and exhausting struggle to harness international manufacturing investors for local industrial development.[19] The progressive imposition of performance requirements (domestic content and export requirements) on GM, Ford, Volkswagen, Nissan and Chrysler, with the goal of inducing them to establish world-scale production facilities (and supplier industries), were estimated to have created more than 100,000 jobs and exports of $5 billion per year. None of these accomplishments are recorded by those analysts who focus exclusively on the tax revenue and ownership parameters.[20] The work of Stephen Guisinger has led the way in documenting the shift of host-country demands in the direction of performance requirements coupled with investment incentives.[21]

Looking to the future of government–TNC bargaining, the more typical case may resemble the IBM–Mexico computer negotiations of 1985–86 in which savvy domestic authorities played the role of discriminating monopolist, trading concessions in an area of high relative importance to the investor (100 per cent ownership for IBM) for concessions in areas of high relative importance for the country (becoming the centre for hemispheric exports for a particular product).[22]

But, as *dependencia* writers like Sunkel have pointed out, the political economy of TNC–government relations in the third world requires a further dimension of analysis. Whereas the bargaining framework based on project variables can help elucidate the *potential* path for government–TNC interactions, the task of converting that potential into reality requires an exercise of host-country autonomy that may not be possible because of political constraints. After all, Cardoso and Faletto have suggested, the integration of TNCs into the development process may come "at the expense of the autonomy of the national economic system and of policy decisions for development."[23]

There are two principal avenues of investigation that pursue the question of national autonomy *vis-à-vis* foreign investors. The first centres on the domestic politics of policy towards TNCs, and especially the role of indigenous business groups (the "national bourgeoisie") in shaping host policies towards TNCs. The second focuses on the extent of outside intervention by home-country governments on behalf of their own TNCs whenever the latter try to resist host-country demands.

With regard to the domestic politics of policy formation towards TNCs, there is quite a broad spectrum of evidence, from cases in which indigenous economic groups are displaced or converted into "comprador elites" whose (imputed) parasitical behaviour attenuates effective national policy, to cases in which the same indigenous economic groups play a central role in guiding the regulation of TNC behaviour.[24] Despite the diversity of results, however, there has been a striking transformation (at least in the case of the newly industrializing countries) in appraising the potential capability of local business groups to acquire technology and play TNCs off against each other. The shift has led the analysis of the political impact of TNCs, as Peter Evans and Paulo Bastos Tigre described it, from a primarily *defensive* perspective ("founded in large part on the conviction that local firms will be destroyed if forced to compete with foreign firms or dominated if allowed to form alliances with them") to a more *supportive* perspective ("international ties could be considered potential instruments to be manipulated for nationalist ends rather than as threats to nationalist goals").[25]

Given the disparity of findings and the continuing need to examine the impact of TNCs on the domestic political configuration on a case-by-case basis, the formulation of generalizations is difficult. But two divergent