CHAPTER 9

The Politics of Multinational Corporations

In late 2013 a Chinese company purchased the American pork-processing giant Smithfield Foods for $4.7 billion. The announcement of the deal sparked political backlash in the United States. Senator Debbie Stabenow, Chair of the Senate Agriculture Committee, declared that “food security is national security.” She noted that she could not “imagine that the American people will feel comfortable if they wake up one day to discover that half of our food processors are owned by China.” She called a special hearing of the Senate Agriculture Committee to look more closely into the Smithfield Foods deal. During that hearing, many Senators voiced concern about how the Chinese acquisition might influence the safety of the American food supply moving forward, while others expressed concern about the long-run implications of the U.S. becoming dependent upon Chinese producers for its food. While the committee lacked the authority to block the deal, the hearing revealed that Chinese acquisitions of American businesses remained a politically sensitive issue.

The sensitivity surrounding the Smithfield Foods deal is hardly unique. MNCs alter the nature of economic decision making in ways that disconnect economic and political geography. Historically, decisions about production have been made by local business owners with reference to local conditions. When MNCs are involved, however, foreign managers make production decisions with reference to global conditions. Yet, whereas the frame of reference for much economic decision making has shifted, the frame of reference for *political* decision making has not. Governments continue to address local concerns in response to the demands of local interest groups. As one prominent scholar of MNCs has written,

> the regime of nation states is built on the principle that the people in any national jurisdiction have a right to try to maximize their well-being, as they define it, within that jurisdiction. The MNC, on the other hand, is bent on maximizing the well-being of its stakeholders from global operations, without accepting any responsibility for the consequences of its actions in individual national jurisdictions.
>
> (Vernon 1998, 28)

The tension inherent in these overlapping decision-making frameworks shapes the domestic and international politics of MNCs. In the domestic arena, most governments have been unwilling to forgo the potential benefits of foreign investment, yet few have been willing to allow foreign firms to operate without restriction. Consequently, most governments have used national regulations and have bargained with individual MNCs to ensure that the operations of foreign firms are consistent with national objectives. Governments' efforts to regulate MNC activities carry over into international politics. Host countries, especially in the developing world, pursue international rules that codify their right to control the activities of foreign firms operating within their borders. Countries that serve as home bases for MNCs—essentially, the advanced industrialized countries—pursue international rules that protect their overseas investments by limiting the ability of host countries to regulate the activity by MNCs.

We examine these dynamics here. We look first at the variety of instruments governments have used to extract as many of the benefits from FDI as they could, while at the same time minimizing the perceived costs arising from allowing foreign firms to control local industries. We then focus on efforts, unsuccessful to date, to negotiate international rules defining the respective rights and obligations of host countries and MNCs.

REGULATING MULTINATIONAL CORPORATIONS

Rather than forgo the potential benefits available from hosting MNC affiliates, most governments have sought to define the terms under which MNCs operate within their borders. Governments have regulated proscriptively and prescriptively—that is, they have prohibited foreign firms from engaging in certain activities, and they have required them to engage in others. All these regulations have been oriented toward the same goal: extracting as many of the benefits from FDI as possible, while simultaneously minimizing the cost associated with ceding decision-

making authority to foreign firms. We look first at how developing countries attempted to regulate MNC activity and then turn our attention to practices common in the advanced industrialized world. As we will see, even though both developed and developing countries regulate MNC activities, developing countries have relied far more heavily on such practices. Thus, we conclude this section by examining why the two groups of countries adopted such different approaches toward MNCs.

Regulating Multinational Corporations in the Developing World

In the early postwar period, most developing-country governments viewed MNCs with considerable unease:

> The association of foreign companies with former colonial powers, their employment of expatriates in senior positions, their past history (real or imagined) of discrimination against local workers, and their embodiment of alien cultural values all contributed to the suspicion with which foreign [MNCs] were regarded in developing countries.
>
> (Jones 1996, 291)

Governments in newly independent developing countries wanted to establish their political and economic autonomy from former colonial powers, and often this entailed taking control of existing foreign investments and managing the terms under which new investments were made.

Concerns about foreign dominance reflected the continuation of historical practice. Most developing countries entered the postwar period as primary-commodity producers and exporters. Yet, MNCs often controlled these sectors and the export revenues they generated. In the aluminum industry, for example, six MNCs controlled 77 percent of the non socialist world’s bauxite output, 87 percent of its alumina output, and 83 percent of its production of aluminum. In agricultural products, the 15 largest agricultural MNCs controlled approximately 80 percent of developing countries’ exports (UNCTAD 1983). And although foreign direct investment (FDI) shifted toward manufacturing activity during the 1960s, MNC affiliates also played an important role in these sectors. In Singapore, MNC affiliates currently account for 52 percent of all manufacturing employment, 75 percent of all sales, and approximately 61 percent of all exports. In Malaysia, the figures are comparable: 44 percent of manufacturing employment, 53 percent of sales, and 51 percent of

exports (UNCTAD 2001). Although Singapore and Malaysia sit at the high end of the spectrum, MNCs also control large segments of manufacturing activity in other developing countries.

Allowing foreign corporations to control critical sectors raised political and economic concerns. The central political concern was that foreign ownership of critical natural-resource industries compromised the hard-won national autonomy achieved in the struggle for independence. It seemed incongruent to achieve political independence from colonial powers and yet continue to struggle under the economic dominance of the colonial power's multinational firms. Economic concerns arose as governments adopted import substitution industrialization (ISI) strategies. If MNCs were allowed to control export earnings, governments would be unable to use these resources to promote their development objectives. Moreover, if MNCs were allowed to enter the local economy freely, there would be no necessary relationship between the investments they made and the government's development goals. FDIs might remain in the extractive industries, and manufacturing investments might not transfer technology. As a result, economic activities would continue to reflect the interests of foreign actors instead of the government's development objectives.

In general, developing countries responded to these concerns by regulating rather than prohibiting FDI. Rather than shut themselves off completely from the potential benefits FDI promised, governments sought to manage access to their economies to ensure that the benefits were in fact delivered. Governments did block foreign investment in some sectors of the economy. For example, they prohibited MNC ownership of public utilities, iron and steel, retailing, insurance and banking, and extractive industries (Jenkins 1987, 172). When foreign firms already owned enterprises in these sectors, governments nationalized the industries. Through nationalization, the host-country government took control of an affiliate created by an MNC.

Nationalization was common during the late 1960s and the first half of the 1970s (see Figure 9.1). Nationalizations occurred most often in the extractive industries and in public utilities such as power generation and telecommunications. Nationalization served both political and economic objectives. Politically, governments could rally domestic support and silence domestic critics "by taking over the most obvious symbols of 'foreign exploitation'" (Shafer 1983, 94). Nationalization also made "rational economic planning possible for the economy as a whole and enhance[d] the government's financial position sufficiently to make

economic diversification and … balanced economic growth attainable” (Shafer 1983, 93–94).

Governments also created regulatory regimes to influence MNC activities. Many governments required local affiliates to be majority owned by local shareholders, instead of allowing MNCs to own 100 percent of the affiliate. Local ownership, governments believed, would translate into local control of the affiliate’s decisions. Governments also limited the amount of profits that MNC affiliates could repatriate, as well as how much affiliates were allowed to pay parent firms for technology transfers. Such measures, governments believed, would help ensure that the revenues generated by MNC activity within the country remained in the country and available for local use.

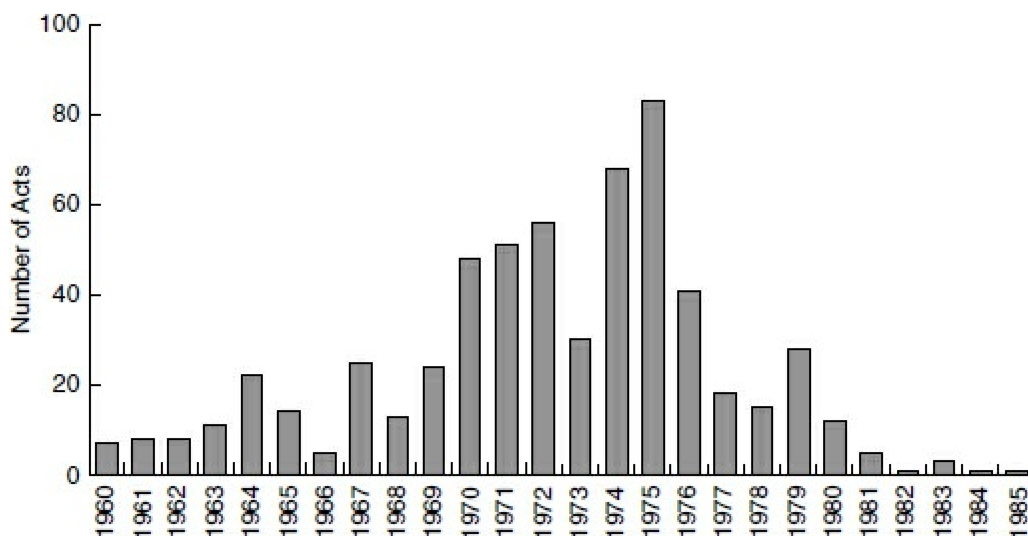

FIGURE 9.1

Expropriation Acts in Developing Countries

Source: Vernon 1998, 6.

Governments also imposed **performance requirements** on local affiliates in order to promote a specific economic objective. If a government was trying to promote backward linkages, for example, it required the affiliate to purchase a certain percentage of its inputs from domestic suppliers. If the government was promoting export industries, it required the affiliate to export a specific percentage of its output. Some governments also required MNCs to conduct research and development inside the host country. Finally, many governments limited the access of MNCs to the local capital market. All these restrictions were aimed at avoiding the downside of MNC involvement, while simultaneously trying to capture the benefits that MNCs could offer.

Of course, not all developing countries adopted identical regimes. Governments that pursued ISI strategies imposed the most restrictive regimes. India, for example, hosted a large stock of foreign investment upon achieving independence. The Indian government was determined, however, to limit the role of MNCs in the Indian economy (Jones 1996, 299). To achieve this goal, the government enacted highly restrictive policies toward new foreign investments and began to "dislodge" existing investments (Encarnation 1989). It forced existing enterprises that owned more than 40 percent of the local subsidiary to either sell equity to Indian firms or leave India. They made exceptions only for MNCs operating in high-priority areas or using sophisticated technologies. As a result, India experienced a net capital outflow during the 1970s when some MNCs, such as Coca-Cola and IBM, left and few new investments arrived.

Other developing countries actively sought FDI in connection with the shift to secondary import substitution, but regulated the terms under which MNCs could invest. Because the Brazilian market was quite large, the Brazilian government could encourage foreign investment on terms that promoted domestic auto production. The government thus banned all auto imports in 1956 and forced foreign auto manufacturers to produce in Brazil in order to sell in Brazil. It imposed high domestic content requirements on MNCs; 35 to 50 percent of cars' parts had to be locally produced in 1956, and the figure was increased to 90–95 percent by the mid-1960s. As a consequence, by the mid-1960s, eight foreign-controlled firms were producing cars in Brazil, and by 1980 over 1 million cars were being produced annually. Thus, even those developing countries that welcomed MNCs sought to ensure that their activities corresponded with the government's development goals.

East Asian governments pursuing export-oriented development strategies were more open to FDI. Singapore and Hong Kong imposed few restrictions; to the contrary, Singapore based its entire development strategy on attracting foreign investment. South Korea and Taiwan were less open to investment than Singapore and Hong Kong: in both countries, the government developed a list of industries that were open to foreign companies, but proposals to invest in these industries were not automatically approved. Each project had to meet requirements concerning local content, the transfer of technologies, the payment of royalties in connection with technology transfers, and the impact on imports (Haggard 1990, 199).

Still, Taiwan and South Korea did more to attract foreign investment than most governments in Latin America or Africa. Beginning in the mid-

1960s and early 1970s, both the Taiwanese and the South Korean government created export-processing zones (EPZs) to attract investment. **Export-processing zones** are industrial areas in which the government provides land, utilities, a transportation infrastructure, and, in some cases, buildings to the investing firms, usually at subsidized rates (Haggard 1990, 201). Foreign firms based in EPZs are allowed to import components free of duty, as long as all their output is exported. Taiwan created the first EPZ in East Asia in 1965, and South Korea created its first in 1970. These assembly and export platforms attracted a lot of investment from American, European, and Japanese MNCs. Finally, both countries further liberalized foreign investment during the mid-1970s in an attempt to attract high-technology firms into the local economies (Haggard and Cheng 1987).

Most developing countries have greatly liberalized FDI since the 1980s. Sectors previously closed to foreign investment, such as telecommunications and natural resources, have been opened. Restrictions on 100-percent foreign ownership have been lifted in most countries. Restrictions on the repatriation of profit have been eased. Two factors have encouraged this liberalization. First, restrictive regimes yielded disappointing results (Jones 1996). FDI fell during the 1970s as nationalizations and regulation led MNCs to seek opportunities elsewhere. MNCs that did operate in developing countries were reluctant to bring in new technologies, and the sectors that governments had nationalized performed well below expectations (Shafer 1983). Second, the decision to liberalize FDI came as part of the broader shift in development strategies. Governments intervened less in all segments of the economy, including FDI, as they shifted to market-based strategies.

Developing countries' governments have not abandoned efforts to control MNC activity. Although they have become more open to FDI, they

> continue to look on multinational enterprises from the vantage point of their past experiences. Much as they welcome the contribution of foreign-owned enterprises … these countries will have grave doubts from time to time about the long-term contribution of such enterprises, especially as they observe that the grand strategy of the enterprise is built on the pursuit of global sources and global markets.
>
> (Vernon 1998, 108)

Regulating Multinational Corporations in the Advanced Industrialized Countries

The typical advanced industrialized country has been more open to FDI and less inclined to regulate the activities of MNCs than the typical developing country. Only Japan and France required explicit government approval for manufacturing investments by foreign firms (Safarian 1993). Most governments have excluded foreign firms from owning industries deemed "critical," but they have not drawn the lists of sectors from which foreign firms are excluded so broadly as to discourage MNC investment (Safarian 1993). In the United States, for example, foreign firms cannot own radio and television broadcasting stations, cannot own a domestic airline, and are prohibited from participating in defense-related industries. Nor are American restrictions unique, as most advanced industrialized countries prohibit foreign ownership in many of these same sectors.

Japan was the clearest exception to this tendency throughout much of the postwar period. Until 1970, Japan tightly regulated inward FDI (see Safarian 1993; Mason 1992). Japanese government ministries reviewed each proposed foreign investment and approved very few. Proposals that were approved usually limited foreign ownership to less than 50 percent of the local subsidiary. Such restrictions were motivated by the Japanese government's economic development objectives. Government officials feared that Japanese firms would be unable to compete with MNCs if FDI was fully liberalized. In particular, the Japanese government feared that unrestricted FDI would prevent the development of domestic industries capable of producing the technologies deemed critical to the country's economic success (Mason 1992, 152–153). Regulations on inward investment thus comprised an important component of Japan's industrial policy.

A Closer Look

Sovereign Wealth Funds

Foreign ownership of local industry has recently generated renewed concern and political activity in the United States and the EU. The trigger has been the visible activities of sovereign wealth funds. **Sovereign wealth funds** (SWFs) are government-owned funds that purchase private assets in foreign markets. Many SWFs, so-called commodity SWFs, are funded with revenues generated by state-owned oil companies in the Gulf states and in Norway. And although commodity SWFs have been around for 50 years (Kuwait established the first in 1953), the recent sharp rise in oil and natural gas prices has stimulated their rapid growth. Non-commodity SWFs are funded via

the foreign exchange reserves generated by persistent balance-of-payments surpluses. China's SWF, the China Investment Corporation, for example, was established using some of the foreign exchange reserves the Chinese government has accumulated. Continued growth of these funds is thus directly linked to balance-of-payments positions.

More than 20 governments currently have SWFs, and perhaps six others may be about to create them. The single largest fund, Norway's Government Pension Fund, controls approximately $1 trillion as of September 2017. The second largest, United Arab Emirate's Abu Dhabi Investment Authority, controls approximately $830 billion. As a group, the 20 active SWFs control approximately $6.3 trillion. And though many predicted that the rapid growth seen in the early 2000s would continue, the sharp decline of energy prices after 2009 hit the SWFs hard. To put the size of SWFs in perspective, consider that U.S. gross domestic product (GDP) is more than $17 trillion, and the total market capitalization of the world's 60 largest stock markets is about $69 trillion. SWFs are thus large, but as 10 percent of total global equities, they are not dominant players in global finance.

The recent growth of SWF activity has worried some American and European policymakers. Some fear that governments intend to use their SWFs to achieve political rather than economic objectives. Gal Luft, the Executive Director of the Institute for the Analysis of Global Security, expressed such concerns in testimony to the U.S. House Committee on Foreign Affairs in May of 2008. "Governments," he argued, "have a broader agenda [than private investors]—to maximize their geo-political influence and sometimes to promote ideologies that are in essence anti-Western" (Luft 2008). Luft found particularly worrying the fact that many of the largest SWFs are owned by Gulf states. Persistent high oil prices, he argued, could dramatically increase the size of SWFs and enable them to purchase large segments of the U.S. economy. "At $200 oil," he argued, "OPEC could potentially buy Bank of America in one month worth of production, Apple Computers in a week, and General Motors in just 3 days. It would take less than 2 years of production for OPEC to own a 20 percent stake (which essentially ensures a voting block in most corporations) in every S&P 500 company" (Luft 2008, 4).

Few observers are as worried as Luft about the national security implications of SWFs. But even those who are more sanguine about the security implications of SWFs do raise concerns about SWFs' impact on financial markets (see, for example, Kimmitt 2008). Many

of these concerns reflect the lack of transparency in SWF operations and the absence of a common regulatory framework. Few SWFs are open about the strategies that motivate their investment decisions or about the assets that they own. As they grow in size, their investment decisions increasingly will affect markets. In the absence of better information about what they own and what motivates their purchases, other market participants will wind up guessing. Such dynamics could give rise to disruptive and potentially destabilizing trading activity.

American and European policymakers have responded to SWF activity in three ways. One strong impulse has been to welcome SWF investment in the midst of the extended difficulties in the American financial system. SWFs from Gulf states and China have purchased significant stakes in American financial institutions such as Citigroup, Blackstone Private Equity Group, and Merrill Lynch since August of 2007. These investments and others like them (estimated at as much as $69 billion) have helped recapitalize American banks. In this context, then, SWFs have played an important stabilizing role in the global financial system.

Simultaneously, however, policymakers have become a bit more protectionist regarding foreign investment. The German government is currently considering a law, for example, that would review purchases of more than 25 percent of German companies by groups outside the EU. The government also recently blocked a Russian effort to invest in Deutsche Telekom AG and European Aeronautic Defence and Space Company NV (the parent firm for Airbus; Braude 2008). Such moves reflect heightened German concern about foreign government investment in the German economy. In the United States, Congress recently strengthened the scrutiny applied to proposed foreign investments that involve direct control by a government entity.

Finally, American and European policymakers have sought to reconcile these two conflicting tendencies—sometimes welcoming and sometimes blocking investments by foreign governments—by trying to develop international rules, or codes of best practices, to govern SWF activities. Then U.S. Treasury Secretary, Henry Paulson, convened a dinner in October of 2007 that drew together finance ministers from the Group of Seven (G-7); top officials from the International Monetary Fund (IMF), the World Bank, and the Organization for Economic Co-operation and Development (OECD); as well as finance ministers and heads of SWFs from many states with large SWFs. The discussions culminated in the articulation of the

Santiago Principles and the creation of the International Forum of Sovereign Wealth Funds (IFSWF) in 2009. The Santiago Principles are designed to promote "good governance, accountability, transparency and prudent investment practices" by SWFs. The IFSWF is intended to help SWFs implement the Santiago Principles as well as provide other services to its SWF members.

Japanese restrictions on inward direct investment were designed to encourage technology transfers (Mason 1992, 151). Japanese officials first pressured foreign firms to license their technologies to Japanese firms. If this strategy proved unsuccessful, the Japanese government would consider a direct investment, but it often attempted to force the foreign firm to create a joint venture with a Japanese firm in order to transfer technology to Japanese firms working in the same industry. Only if a firm was unwilling to license its technology or to form a joint venture—and then, only if that firm controlled technologies that were not available elsewhere—did the Japanese government permit the creation of a wholly owned foreign subsidiary in Japan, and even then the government often attached conditions to the investment. IBM, for example, was forced to license critical technologies to seven Japanese competitors in exchange for being allowed to produce computers in Japan.

Japanese investment restrictions have been greatly liberalized since the late 1960s. In 1967, Japan increased the number of industries open to foreign investment and began to allow 100 percent ownership in some sectors. Additional measures taken in the 1970s and early 1980s further liberalized inward FDI, so that Japan now has no formal barriers to such investments. In spite of this liberalization, however, Japan continues to attract only a small share of the world's foreign investment (see Table 8.2).

Despite the general tendency toward greater openness, governments in the advanced industrialized countries have been sensitive to foreign control of critical sectors. Two instances illustrate such concerns. The China National Offshore Oil Corporation (CNOOC) sought to purchase Unocal in the summer of 2005. In early 2006 the United Arab Emirates-owned Dubai Ports World sought to acquire a British firm that operated American seaports. Both transactions prompted strenuous congressional opposition, and this opposition led both firms to withdraw their offers. Lenovo's acquisition of IBM's personal computer unit was closely scrutinized but ultimately was approved in 2005. These recent cases indicate that American policymakers remain highly sensitive to foreign

ownership of critical industries.

In summary, even though the advanced industrialized countries have been more open to FDI than developing countries, they have attempted to manage the terms under which MNCs invest in their countries. Governments that used industrial policies have attempted to protect national firms from competition by restricting foreign investment. Even governments that refrained from promoting active industrial policies restricted foreign ownership of sensitive industries, such as those at the forefront of high-technology sectors as well as industries closely connected to national security.

Bargaining with Multinational Corporations

Many host countries try to restrict MNC activities, but few can dictate the terms under which MNCs invest. Instead, host countries and MNCs often bargain over the terms under which investment takes place. We can think of this bargaining as oriented toward reaching agreement on how the income generated by an investment will be distributed between the MNC parent and the host country. The precise distribution will be determined by each side’s relative bargaining power.

Bargaining power arises from the extent to which each side exerts monopolistic control over things valued by the other. To what extent does the host country have monopolistic control over things vitally important to the MNC? Does the host country control natural resources that are not available in other parts of the world? Does the host country control access to a large domestic market? Does the host country control access to factors of production that yield efficiency gains that cannot be achieved in other countries? The more the host country has exclusive control over things of value to the MNC, the more bargaining power it has. Equally critical is the extent to which the MNC exerts monopolistic control over things of value to the host country. Does the MNC control technology that cannot be acquired elsewhere? More broadly, are there other MNCs capable of making, and willing to make, the contemplated investment? The more the MNC has exclusive control over things the host country values, the more bargaining power the MNC has. Bargaining power, therefore, is a function of monopolistic control.

Host countries have the greatest bargaining power when they enjoy a monopoly and the MNC does not. In such cases, the host country should capture most of the gains from investment. In contrast, an MNC has its greatest advantage when it enjoys a monopoly and the host country does

not. In these cases, the MNC should capture the largest share of the gains from investment. Bargaining power is approximately equal when both sides have a monopoly. In such cases, each should capture an equal share of the gains from the investment. The gains also should be evenly distributed when neither side has a monopoly on things the other values. In these cases, neither side has much bargaining power, and they should divide the gains relatively equally. The distribution of the gains from any investment, therefore, will be determined by the relative bargaining power of the host country and the MNC.

We can apply the logic of this kind of bargaining analysis to investments in natural-resource industries and in low-skilled labor-intensive manufacturing industries. In natural-resource investments, bargaining power initially favors the MNC. Few countries enjoy a monopoly over any natural resource; thus, MNCs can choose where to invest. Also, because an MNC often does have a monopoly over the capital, the techniques, and the technology required to extract and refine the natural resources, and because the return on the investment is initially uncertain, the MNC bears all of the risk. The MNC can exploit this power asymmetry to initially capture the larger share of the gains from the investment.

Over time, however, bargaining power shifts to the host country in a dynamic that has been called the **obsolescing bargain** (Moran 1974). The MNC cannot easily remove its fixed investment from the country, so the investment becomes a hostage. In addition, the MNC's monopoly over technology diminishes as the technology is gradually transferred to the host country and indigenous workers are trained. If the investment proves successful, uncertainty about the return on the investment diminishes. Unable to threaten to leave the country without suffering substantial costs, and no longer controlling technology needed by the host country, the MNC sees its earlier bargaining power weaken while the host country's power strengthens. The host country can exploit this power shift to renegotiate the initial agreement and extract a larger share of the gains from the project. Indeed, one might suggest that the widespread nationalizations during the 1960s and 1970s reflected precisely this shift of bargaining power to host countries.

MNCs enjoy more bargaining power than host countries in low-skilled labor-intensive manufacturing investments. On the one hand, no host country enjoys a monopoly on low-skilled labor; thus, MNCs can pick and choose between many potential host countries. Nor are such investments very susceptible to the obsolescent bargain. Often, investments in low-

skilled manufacturing entail a relatively small amount of fixed capital that can be readily moved out of a particular country. In addition, technology in many manufacturing industries changes rapidly and therefore is not easily transferred to the host country. Consequently, unlike natural-resource investments, manufacturing investments do not become hostages, and host countries do not gain power once the investment has been made (Kobrin 1987).

Evidence that MNCs enjoy greater bargaining power than do host countries when it comes to manufacturing investment can be seen in the growing competition between host countries to attract such investment. This competition has emerged in the form of **locational incentives**—packages host countries offer to MNCs that either increase the return of a particular investment or reduce the cost or risk of that investment (UNCTAD 1995, 288–289). Host countries offer two types of incentives to MNCs. Most offer tax incentives. In one such incentive, MNCs are granted a reduced corporate income tax rate. Many governments also provide "tax holidays," usually a period of 5 years during which the firm pays no tax. MNCs also are exempted from import duties, are permitted to depreciate their investments at accelerated rates, and are allowed substantial deductions from their gross incomes. Many advanced industrialized countries also offer MNCs direct financial incentives. In some instances, these are provided as a grant from the government to the MNC, in some as a subsidized loan (Moran 1999, 95).

The willingness of governments to offer locational incentives and the size of the typical package have both increased rapidly during the last 20 years. Across the entire OECD, 285 incentive programs offering a total of $11 billion were provided to MNCs in 1989. By 1993—the last year for which comprehensive data are available—362 programs offering incentives totaling $18 billion were provided. Within the United States, the typical package averaged between $50 million and $70 million, but the value of that package has been increasing (Moran 1999). Alabama provided Honda with more than $158 million in the 1990s to attract this auto producer's new plant. In 2005, North Carolina provided incentives totaling $242 million to induce Dell, the personal computer manufacturer, to build a facility in the state. The North Carolina package for Dell, for example, amounted to slightly more than $161,333 per job (Kane, Curliss and Martinez 2004). The growing use of locational incentives suggests that host countries are at a disadvantage when bargaining with MNCs over manufacturing investments.

In sum, few governments have allowed foreign firms to operate without

any restrictions, and many have actively managed the terms of their activities, in part by using national regulations and in part by bargaining with MNCs. As we have seen, the typical advanced industrialized country has been less inclined to try to restrict the activities of foreign firms than has the typical developing country. We conclude this section, therefore, by considering a few factors that account for this difference.

Three such factors are probably most important. First of all, developing countries have been more vulnerable to foreign domination than advanced industrialized countries have been. The advanced industrialized countries have larger and more diversified economies than the developing countries; consequently, a foreign affiliate is more likely to face competition from domestic firms in an advanced industrialized country than in a developing country. The lack of diversification is compounded by the fact that, in the early postwar period, most FDI in the developing world was concentrated in politically sensitive natural-resource industries. In contrast, most FDI in the advanced industrialized countries flowed into manufacturing industries. As a result, foreign firms were much more likely to dominate a developing country than an advanced industrialized country, and the advanced industrialized countries have felt less compelled to regulate MNC activity.

There also appears to be a strong correlation between a country's role as a home for MNCs and its policies toward inward FDI. The two largest foreign investors during the last 140 years—the United States and the United Kingdom—have also been the most open to inward foreign investment. Japan began to open itself to inward investment as Japanese firms started to invest heavily in other countries. When countries both host foreign firms and are home base to MNC parents, they are unlikely to adopt policies that reflect purely host-country concerns. Attempts by the United States or Great Britain to regulate inward FDI would invite retaliation that would make it harder for their own firms to invest abroad. Because developing countries have historically hosted foreign investment but rarely have been home bases for MNCs, their concerns are more narrowly based on host-country issues untempered by the fear of retaliation.

A Closer Look

Luring German and Asian Car Producers to the U.S. South

In 1990, no Deep South State manufactured cars. Today, Alabama, Georgia, Mississippi, and South Carolina produce more than 2 million

cars per year. This rather extraordinary transformation was achieved through heavy use of investment incentives by state-level governments. In the early 1990s, the German automaker BMW decided to create a new assembly plant outside Germany. Such a move represented a real shift for BMW, which had never previously assembled cars outside of Bavaria. The firm's decision to begin assembling cars outside Germany was motivated by a determination to reduce its costs. German automakers were earning about $28 an hour, far greater than the average of $16 an hour that unionized autoworkers make in the United States. In addition, the persistent strengthening of the German mark against the dollar during the late 1980s had further eroded the ability of BMW to compete in the American market. BMW spent 3 years and looked at 250 different sites in ten countries before deciding in 1992 to build the plant in Spartanburg, South Carolina. In late September 1992, BMW began construction of the $400 million assembly plant that would employ some 2,000 people and produce as many as 90,000 cars a year. In 1998, BMW expanded this production facility from 1.2 million square feet to 2.1 million square feet. The facility remains BMW's only American production site (www.BMW.com).

Why did BMW choose Spartanburg over other potential sites? A range of considerations, including financial incentives offered by the State of South Carolina, shaped BMW's decision to base production in Spartanburg. First, the city had some advantages arising from its location; it is close to Charleston, South Carolina, a deep-water seaport, and is connected to this port by a good interstate highway. This transportation network would allow BMW to transport the cars destined for overseas markets easily. In addition, labor in South Carolina was relatively cheap—averaging about $10 to $15 an hour—and non-unionized. In addition, the state and local government in South Carolina put together a financial package that offset a substantial share of BMW's investment. Officials advanced about $40 million to purchase the 900 acres of land upon which the plant would be built, and they agreed to lease the site to BMW for only $1 per year. In addition, about $23 million was spent preparing the site and improving the infrastructure, including such things as water, sewer, and roads. Another $71 million of tax breaks were offered over a 20-year period. Finally, state, local, and federal money was provided to improve the airport in nearby Greenville (Harrison 1992). Altogether, the incentives offered by South Carolina to BMW totaled about $135

million, an amount equal to $67,500 for each job BMW would create.

The use of financial incentives to attract an investment from a German automaker reached new heights in Alabama's courtship of Mercedes-Benz in the mid-1990s. For reasons identical to those that motivated BMW, Mercedes-Benz decided to build an assembly plant outside of Germany (Myerson 1996). The firm eventually constructed a $300 million plant in Vance, Alabama, employing about 1,200 workers to produce 65,000 sport utility vehicles each year. In its initial search for suitable sites, Mercedes-Benz focused on 62 possibilities, none of which were in Alabama. As Andreas Renschler, who led the search for the site, remarked, "Alabama was totally unknown" (quoted in Myerson 1996). Government officials in Alabama were determined to attract Mercedes to their state, however. The governor, James E. Folsom Jr., flew to Mercedes-Benz headquarters in Stuttgart three times and, working with other state politicians, put together a financial package to attract the German firm to Alabama. The package included $92.2 million to purchase and prepare the site for construction; $75.5 million in infrastructure improvements for water, sewage, and other utilities; $5 million each year to pay for employee training; and tax breaks. In addition, at a cost of about $75 million, the state of Alabama agreed to purchase 2,500 of the sport-utility vehicles that Mercedes-Benz intended to build in the factory. The total package was estimated at between $253 million and $300 million, an amount equal to $200,000 to $250,000 for each job Mercedes-Benz intended to create (Waters 1996).

The state of Alabama built on the lessons it learned during its courtship of Mercedes-Benz to attract other car makers to Alabama. The state offered Toyota Motor Corp. $29 million in 2001 to secure a plant that produced V8 engines. In 2002, Alabama offered Hyundai Motors $234 million to secure a manufacturing plant. And in late 2017, Alabama was competing with (at least) ten other states to attract a new $1.6 billion manufacturing facility that is being planned by Toyota-Mazda as well as a huge $3.1 billion investment by Hyundai-Kia. The state of Mississippi looked at the success Alabama enjoyed in attracting MB, and in the early 2000s offered Nissan almost $300 million to base a manufacturing plant in Canton that opened in 2003. A couple of years later, Mississippi offered Toyota roughly the same amount to build a plant that opened in 2011. Georgia secured a Kia factory with an incentives package worth somewhere in the neighborhood of $400 million. As a consequence of its successful

incentives initiatives, Alabama is now the fifth largest producer of cars in the United States. Together, Alabama, Georgia, Mississippi, and South Carolina now produce more than 2 million cars, sport utility vehicles, and light trucks per year.

Although the manufacturers typically deny that the incentive packages they receive play an important role in their decisions to invest in one community rather than another, respectively, it is hard to escape the conclusion that these packages do matter. Because incentive packages do shape the investment decisions that firms make, governments cannot easily opt out of the incentive game. As Harlan Boyles, former treasurer of North Carolina, commented following the Mercedes-Benz–Alabama deal, “All the competition [for investment] has been forced upon the states” by the MNCs. “Until there is meaningful reform and an agreement between states not to participate, very little will change” (quoted in McEntee 1995). Of course, although Boyles’s comment was directed at competition for investment among states within the United States, its logic applies equally well to competition among national governments in the international economy.

Finally, there have been fundamental differences in how governments approach state intervention in the national economy. Although many developing countries pursued ISI strategies that required state intervention, most advanced industrialized countries have been more willing to allow the market to drive economic activity. Different attitudes about the government’s role in the national economy translated into different approaches to FDI. Even the exceptions to the non-intervention tendency in the advanced industrialized countries are consistent with this factor: the two governments that were most restrictive toward FDI, Japan and France, were also the two governments that relied most heavily on industrial policies to promote domestic economic activity. Thus, attempts to regulate MNC activity were most likely in countries where governments played a large role in the economy.

All these factors suggest that we are unlikely to see an abrupt shift away from the more liberal attitude toward FDI that has prevailed in the developing world since the late 1990s back to the more restrictive practices that characterized much of the postwar period. Developing countries have become more diversified and now are attracting more foreign investment in manufacturing than in natural resources. As a

consequence, some, though certainly not all, of these countries are less vulnerable to foreign domination today than they were in the mid-twentieth century. In addition, some developing countries are gradually moving away from only hosting foreign investment to being a home base for MNC parents as well. This trend, although involving only a small number of East Asian and Latin American countries, will gradually make these governments increasingly reluctant to restrict the activities of foreign firms they host. Finally, there is no evidence of an impending shift back toward interventionist strategies. As long as developing countries continue to pursue liberal strategies, they will continue to make it easier, rather than harder, for foreign firms to participate in the local economy.

THE INTERNATIONAL REGULATION OF MULTINATIONAL CORPORATIONS

There is no multilateral regime governing FDI and the activities of MNCs. Governments have tried to create a multilateral regime on multiple occasions since 1945. But these efforts have yielded little because conflict between the capital-exporting countries and the capital-importing countries has prevented agreement on such rules. Developing countries have advocated international rules that codify their right to control foreign firms operating within their borders. Advanced industrialized countries have pursued rules that protect foreign investment by limiting how host countries can regulate MNC affiliates operating in their economies. Given these divergent goals, agreement on a multilateral investment regime has proved impossible. Because of the impasse on multilateral rules, capital-exporting states have protected their firms' overseas investments by negotiating thousands of bilateral investment treaties (BITs) with host governments. This BIT-based approach has generated a global FDI regime that is not only decentralized but also highly asymmetric, that is, biased toward the interests of capital-exporting economies.

Historically, international rules governing FDI have been based on four legal principles. First, foreign investments are private property to be treated at least as favorably as domestic private property. Second, governments have a right to expropriate foreign investments, but only for a public purpose. Third, when a government does expropriate a foreign investment, it must compensate the owner for the full value of the expropriated property, or, in legal terminology, compensation must be "adequate, effective, and prompt" (Akehurst 1984, 91–92). Finally, foreign investors have the right to appeal to their home country in the event of a

dispute with the host country. Although such principles are designed to protect the property of foreign investors and therefore clearly reflect the interests of the capital-exporting countries, capital-exporting and capital-importing countries alike accepted them throughout the nineteenth century (Lipson 1985). The one exception came from Latin American governments' challenge to the right of foreign governments to intervene in host countries in support of their firms. By the late nineteenth century, Latin American governments were invoking the **Calvo doctrine** (named after the Argentinean legal scholar Carlos Calvo, who first stated it in 1868), which argues that no government has the right to intervene in another country to enforce its citizens' private claims (Lipson 1985, 19).

The capital-importing countries began to challenge these legal principles more intensively following World War I (Lipson 1985). The first challenge came in the Soviet Union, where the 1917 revolution brought to power a Marxist–Leninist government that rejected the idea of private property. The comprehensive nationalization of industry that followed "constituted the most significant attack ever waged on foreign capital" and radically redefined the role of the government in the economy (Lipson 1985, 67). Some Latin American governments also began to expropriate foreign investments during this period, particularly in the extractive industries and public utilities. These acts broadened the notion of "public purpose" that stood behind the internationally recognized right of expropriation, extending it from its traditional association with eminent domain to a much wider association with the state's role in the process of economic development. In addition, such widespread nationalizations posed a challenge to the principle of compensation. The Soviet government linked compensation of foreign investors, for example, to claims on Western governments for damages caused by their militaries during the civil war that followed the revolution (Lipson 1985, 67).

The United States attempted to re-establish the traditional legal basis for investment protection following World War II. As the largest and, in the immediate postwar period, only capital-exporting country, the United States had a clear interest in establishing multilateral rules that secured American overseas investments. But U.S. efforts to achieve this goal by incorporating the historical legal principles into the International Trade Organization (ITO) ran into opposition from the capital-importing countries. Governments from Latin America, India, and Australia were able to create a final set of articles that elaborated the right of host countries to regulate foreign investments within their borders but provided little of the security that American business was seeking (Brown 1950;

Lipson 1985, 87). Consequently, American business strongly opposed the ITO's investment components. As the U.S. National Foreign Trade Council commented, "[The investment] article not only affords no protection for foreign investments of the United States but it would leave them with less protection than they now enjoy" (Diebold 1952, 18). Opposition to the investment articles from American business proved a major reason for the ITO's failure to gain congressional support.

The ITO experience is important for two reasons. First, the failure of the ITO meant that there would be no multilateral regime governing FDI. Second, and more broadly, the failure of the ITO reflected a basic conflict that has dominated international discussions about rules regulating FDI to this day. Capital-exporting countries have pursued rules that regulate host-country behavior in order to protect the interests of their MNCs. Capital-importing countries have pursued rules that regulate the behavior of MNCs so that they can maintain control over their national economies. This basic conflict has prevailed for more than 70 years of discussions about international investment rules.

During the 1960s and 1970s, developing countries largely set the agenda for international discussions about FDI. Working through the United Nations (UN), the developing countries sought to create international investment rules that reflected their interests as capital importers. The effort to regulate MNCs became a central element of the New International Economic Order (NIEO), under which developing countries sought two broad objectives that were designed to "maximize the contributions of MNCs to the economic and social development of the countries in which they operate" (Sauvant and Aranda 1994, 99). To this end, states passed the **United Nations Resolution on Permanent Sovereignty over Natural Resources** in 1962. This resolution recognized the right of host countries to exercise full control over their natural resources and over the foreign firms operating within their borders extracting those resources. The resolution affirmed the right of host-country governments to expropriate foreign investments and to determine the appropriate compensation (de Rivero 1980, 92–93; Akehurst 1984, 93). Developing countries also sought to write a code of conduct that would ensure that MNC activities "were compatible with the medium and long-term needs which the governments in the capital importing countries had identified in their development plans" (de Rivero 1980, 96).

The developing countries' efforts to write a code of conduct for MNCs met opposition from the advanced industrialized countries. Although the developing countries wanted the code to be binding, the advanced

industrialized countries pushed for a voluntary code; in addition, although the developing countries wanted to regulate only MNCs, the capital-exporting governments insisted that any code that regulated MNC behavior be accompanied by a code that regulated the behavior of host countries (Sauvant and Aranda 1994, 99). Governments worked on both codes throughout the late 1970s and early 1980s, completing drafts of both by 1982. The codes remained in limbo for 10 years until finally in 1992 a UN committee recommended that governments seek an alternative approach (Graham 1996, 78–79).

In the early 1980s, bargaining power in international negotiations shifted back toward the advanced industrialized countries. The capital-exporting countries used this advantage to shift the agenda back toward regulating host-country behavior. Some initial steps were taken during the Uruguay Round. Under pressure from the United States, trade-related investment measures (TRIMs) were placed on the agenda. **A trade-related investment measure** is a government policy toward FDI or MNCs that has an impact on the country's imports or exports. For example, domestic-content or trade-balancing requirements force firms to import fewer inputs or export more output than they would without such government-imposed requirements. Consequently, such requirements distort international trade. In placing TRIMs on the GATT agenda, the United States sought to limit the ability of host countries to use such measures (Croome 1995). Developing countries were reluctant to incorporate TRIMs into the GATT, arguing that "development considerations outweighed whatever adverse trade effects TRIMs might have" (Croome 1995, 258). Not surprisingly, these differing views made it difficult to reach agreement on TRIMs within the GATT.

Failure in the GATT led the principal capital-exporting countries to pursue a **Multilateral Agreement on Investment** (MAI) among OECD members. The OECD appeared to offer at least three advantages. Because the OECD was composed primarily of advanced industrialized countries, all of which shared a commitment in principle to liberal investment rules, negotiations in the OECD seemed more likely to produce agreement. Moreover, because most FDI takes place between advanced industrialized countries, an agreement among OECD members would regulate the majority of international investment. Finally, an OECD-based agreement would not preclude participation by developing countries. Non-OECD governments could accede if they desired.

Governments intended the MAI to liberalize FDI and to provide greater security to MNCs. Liberalization was to be achieved by basing the

agreement on national treatment and MFN. National treatment would require states to treat foreign-owned firms operating in their economy no differently than domestic firms. The MFN clause would oblige states to treat the foreign firms from each party to the agreement on the same terms it accorded to firms from all other parties to the agreement. To provide greater security to foreign investors, the agreement incorporated the historical standard of prompt, effective, and adequate compensation in cases of expropriation. In addition, the draft agreement restricted the ability of governments to limit the ability of firms to remit profits, dividends, and proceeds from the sale of assets. The agreement was also to provide for a dispute-settlement mechanism patterned on NAFTA, which would allow for both state-to-state claims and firm-to-state claims.

Governments failed to reach a final agreement on the MAI, however, due to disagreements among OECD governments and to strong and vocal opposition from groups outside the process. By 1997, OECD governments had attached several hundred pages of exceptions to the general obligations they had established. The United States pressed to include labor and environmental standards. Outside the negotiations,

> a coalition of strange bedfellows arose in opposition to the treaty, including the AFL–CIO, Amnesty International, Australian Conservation Foundation, Friends of the Earth, Public Citizen, Sierra Club, Third World Network, United Steelworkers of America, Western Governors' Association, and World Development Movement.
>
> (Kobrin 1998, 98)

In all, some 600 organizations in almost 70 countries spoke out against the proposed treaty (Kobrin 1998, 97). The combination of conflict among OECD governments about the specific content of the treaty and public opposition proved fatal. Negotiations ceased in December 1998 without a final agreement.

In the absence of a broader multilateral framework, states have come to rely heavily on **Bilateral Investment Treaties** (BITs). A BIT is a legally binding agreement between two states that establishes the terms that govern private investment by residents of one state in the national jurisdiction of the other. The typical BIT requires fair and equal treatment, limits expropriation, and protects the repatriation of earnings and assets. In addition, a large number of BITs include arbitration clauses that commit the parties to adjudicate disputes in international forums such as the International Center for the Settlement of Investment Disputes. Though BITs have been part of the global economy since 1959, they emerged as

the predominant approach to governing FDI beginning in the late 1980s. In the early 1980s, states had signed fewer than 500 BITs. UNCTAD estimates that in mid-2017 there were 2,360 BITs in force as well as 307 bilateral and plurilateral treaties—such as regional trade agreements—that contain investment provisions quite similar and in some instances identical to those found in the typical BIT. In the absence of a single multilateral regime, therefore, states have created a very decentralized system by negotiating separate agreements with their investment partners.

This system is also highly asymmetric as the typical BIT offers strong protection to MNCs while doing little to expand the rights of host countries. The standard BIT includes a commitment to remain open to FDI from the partner and to adhere to the principles of National Treatment and MFN. In addition, BITs typically restrict the right of states to expropriate foreign investments to a legitimate public purpose and relies upon the historical standard of prompt, effective, and adequate compensation when expropriation does occur. In addition, BITs contain dispute resolution obligations, and many of the treaties obligate the parties to accept binding third-party arbitration within the International Center for the Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL). Indeed, a typical BIT thus reveals the asymmetry inherent in the current FDI regime, as the terms reflect the legal conceptions of capital-exporting states as they have developed during the last 100 years and make little to no effort to protect a conception of host country interests.

The asymmetry is evident also in the distinctive nature of BITs dispute settlement provisions. In practically all other international treaties, states and only states have standing in dispute-resolution proceedings. Under the WTO dispute-settlement mechanism, for instance, states initiate disputes against other states. States might pursue trade disputes in response to pressure from firms, but it is the state and not the firm that has the legal right to file a claim and be heard. Moreover, in the WTO, states are punished for violations; Brazil could remove concessions on American imports until the U.S. government came into compliance with WTO rules on agriculture. In BITs, private firms have standing: a firm based in one country has the right to sue the state of a foreign country in which it has made an investment. Moreover, the firm has the right for that suit to be heard by a third-party arbitrator rather than being required to work through the host-country court system. Finally, when firms are successful in their suits under BITs, they are awarded monetary compensation. BITs thus create a fairly onerous set of obligations for host states, and create an

intrusive dispute-resolution system that kicks in when violations of treaty obligations occur. These characteristics lead many to consider the BIT regime asymmetric.

Why do host countries enter into BITs if they are so asymmetric? The standard explanation focuses on the inability of a sovereign state to pre-commit itself to investor-friendly policies. The core logic of this argument harkens back to the obsolescing bargain model: states can have an incentive to renege on the initial agreement once an investment has been made. Moreover, because developing countries are typically host to foreign investments and much less frequently the home of MNC parent firms, developing countries may be less concerned about reciprocity of treatment than they are about trade. In the absence of mechanisms that prevent or at least limit *ex post* opportunism, states will attract less foreign investment than they desire. The challenge of attracting investment without signing BITs is magnified in a world in which all the states with which you are competing to attract investment do sign BITs (see Elkins et al. 2006).

Within this strategic context, BITs can provide a mechanism that helps states commit to investor-friendly policies. BITs provide a stable policy environment by locking states into a set of enforceable international obligations:

> They lock countries in to agreements that offer national or non-discriminatory treatment to foreign investors, allow firms access to dispute-settlement procedures, and promise third-party arbitration of disputes. [And] violating these provisions does seem to be costly … and hence there is evidence of credible commitments."
>
> (Milner 2014, 4)

Thus, states sign BITs because they believe that on balance the benefits they realize from doing so—benefits that arise from increased FDI inflows —outweigh the costs associated with accepting restraints on their policy choices in the future.

It is growing less clear that the benefits BITs provide do in fact outweigh the costs they carry. On the one hand, it has proven remarkably difficult to find robust evidence to support the proposition that states that sign BITs attract substantially more FDI than states which do not. On the other hand, the frequency of disputes (and thus the cost of litigation for developing countries) has risen dramatically. In 2016 alone the ICSID heard 74 new disputes, with firms from the developed world responsible for 62 of these claims. During the last 6 years, the ICSID has seen 64 new

disputes each year on average, up sharply from between 25 and 40 new disputes per year during the first decade of the twenty-first century and fewer than 10 new disputes per year during the 1990s. Since 1990, more than 90 states have been sued under BITS and other IIAs, with more than half of all cases involving a firm from the developed world suing a developing country. And of the 471 ICSID concluded disputes for which we have information, firms win about 27 percent of the time, while states prevail about 36 percent of the time (the remaining suits are either discontinued, settled, or resolved without either party winning). When firms do prevail, the median monetary compensation is about $20 million.

Developing countries, and a few advanced industrialized countries, are beginning to push back against the BIT regime. Bolivia, Ecuador, and Venezuela have opted out of BIT dispute resolution. In 2016, the Indian government withdrew from 57 BITs that it had ratified and was making plans to negotiate new agreements based on its own template—one more favorable to host-country interests. Other states, Indonesia as one prominent example, are renegotiating their BITs as they expire. The UNCTAD reports that more than 350 BITs will be up for renewal between 2014 and 2018, and it will be interesting to observe how much these treaties are restructured in light of the experience with binding arbitration. It does seem that the pendulum is likely to begin to shift back toward the interests of capital-importing countries.

Policy Analysis and Debate

The Race to the Bottom

Question

How should governments respond to the threat of a “race to the bottom” dynamic that weakens public-interest regulation?

Overview

Some scholars have argued that the growth of MNC activity has given rise to a “race to the bottom” dynamic in government regulation. The world’s governments maintain different regulatory standards. Some enact stringent regulations concerning how firms can treat workers, how they must handle their toxic waste and other pollutants, and how they must conduct their other business activities. Others maintain less stringent regulatory environments, allowing firms to engage in

activities that are illegal in other countries.

Many of these regulations affect production costs. It is more expensive, for example, for a firm to treat chemical waste before it is disposed than simply to dump the raw waste in a landfill. Hence, national regulations that require firms to treat their chemical waste raise production costs. Consequently, even if all other production costs in two countries are the same, different regulatory standards can make it less costly to produce in the country with the lower standard.

MNCs might therefore engage in regulatory arbitrage. That is, they might shift their activities out of countries with stringent regulatory standards and into countries with lax regulatory standards. Governments in high-standard countries will then feel pressure to relax their standards in order to encourage firms to keep production at home. As a consequence, national regulation will increasingly converge on the regulatory practices of the least restrictive country. Governments that refuse to engage in this competition for investment will be left behind, enjoying the benefits of strict regulations but suffering the cost of substantially less investment. How should governments respond to the threat of this race to the bottom?

Policy Options

- Negotiate international rules that harmonize regulations throughout the world. Creating common regulations will prevent regulatory arbitrage and the race to the bottom.
- Restrict foreign direct investment and the activities of MNCs. Such restrictions would limit corporations' mobility, thus enabling governments to maintain distinct national regulations.

Policy Analysis

- Is regulatory arbitrage necessarily a bad thing from the perspective of economic efficiency? Why or why not?
- How easy or difficult will it be for governments to reach agreement about common regulatory standards? How should we weigh these costs?

Take A Position

- Which option do you prefer? Justify your choice.
- What criticisms of your position should you anticipate? How would you defend your recommendation against these criticisms?

Resources

Online: Search for “Race to the Bottom” MNCs. This search will yield more information than you can possibly digest, much of it highly critical of globalization. Miles Kahler’s paper, “Modeling Races to the Bottom,” surveys many of the issues concerned.

In Print: David Vogel and Robert Kagan, eds., *The Dynamics of Regulatory Change: How Globalization Affects National Regulatory Policies* (Berkeley: University of California Press, 2004); Daniel Drezner, “Bottom Feeders,” *Foreign Policy* 121 (November/December 2000): 64–70; Debora Spar and David Yoffie, “Multinational Enterprises and the Prospects for Justice,” *Journal of International Affairs* 52 (Spring 1999): 557–581.

Although governments have spent almost 30 years negotiating rules to regulate foreign direct investment—within the UN, within the GATT, and within the OECD—they have yet to agree on a regulatory framework. Conflict between capital-exporting countries and capital-importing countries over the basic purpose of such a regime is the primary reason for this lack of success. Governments have been unable to agree whether such rules should regulate host countries or MNCs. The obvious compromise—that international rules might usefully regulate both—has yet to materialize in a meaningful way.

CONCLUSION

The politics of MNCs emerge from the competing interests of host countries, home countries of the MNCs, and the MNCs themselves. Each group has distinctive interests regarding FDI. MNCs want to operate freely across the globe, with few government-imposed restrictions on their activities. Host countries want to ensure that the MNCs operating within their borders provide benefits to the local economy that offset the loss of decision-making authority that is inherent in foreign ownership. The home countries of the MNCs want to ensure that their firms’ overseas investments are secure. The politics of MNCs emerge when these distinct interests come into conflict with each other.

As we have seen, almost all governments impose some restrictions on the activities of foreign firms that operate inside their countries. Many governments, especially in the developing world, have tried to harness multinationals to their development objectives, but even the advanced industrialized countries have been unwilling to allow foreign firms to control critical sectors of the national economy. Similarities arise from the common concern about the local impact of foreign decision making. Differences arise from the fact that most developing countries are only hosts to MNC activities, whereas the advanced industrialized countries are both hosts and home bases. Consequently, developing countries' concerns about foreign domination are not tempered by the need to ensure that foreign governments respect the investments of the developing countries' own MNCs.

The basic conflict between capital-importing and capital-exporting countries is evident also in the international politics of MNCs. In the international arena, politics have revolved around efforts to negotiate comprehensive rules for international investment. Yet, conflict between the capital-exporting and the capital-importing countries has so far prevented agreement on comprehensive investment rules. As we have seen, this conflict reflects a basic disagreement about what the rules should regulate. Should international rules regulate the ability of host countries to control the MNCs that invest in their countries, or should international rules regulate the range of activities that MNCs are allowed to engage in? The inability of the advanced industrialized countries and the developing countries to agree on an answer to this question, as well as the apparent unwillingness of both groups to compromise, has prevented the creation of comprehensive rules to regulate international investment.

KEY TERMS

Bilateral Investment Treaties
Calvo Doctrine
Export-Processing Zones
Locational Incentives
Multilateral Agreement on Investment
Obsolescing Bargain
Performance Requirement
Sovereign Wealth Fund
Trade-Related Investment Measures
United Nations Resolution on Permanent Sovereignty over Natural Resources

SUGGESTIONS FOR FURTHER READING

For a detailed discussion of the obsolescing bargain model and an application of this model to Chile, see Theodore H. Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile* (Princeton, NJ: Princeton University Press, 1974). You can trace the subsequent development of state-MNC relations in Jean J. Boddewyn, 2016. “International Business–Government Relations Research 1945–2015: Concepts, Typologies, Theories and Methodologies.” *Journal of World Business* 51(1): 10–22.

Rachel Wellhausen’s *The Shield of Nationality: When Governments Break Contracts with Foreign Firms* (Cambridge: Cambridge University Press, 2015) offers an excellent analysis of host-country and firm relationships.

For an equally excellent introduction to Bilateral Investment Treaties, see Helen V. Milner, 2014. “Introduction: The Global Economy, FDI, and the Regime for Investment,” *World Politics* 66(1): 1–11, and Beth A. Simmons, 2014. “Bargaining over BITs, Arbitrating Awards: The Regime for Protection and Promotion of International Investment.” *World Politics* 66(1): 12–46.