Shah M. Tarzi examines the bargaining relationship between Third World host governments and multinational corporations (MNCs). While host governments seek to encourage firms to locate within their countries on the best terms possible, MNCs want to minimize the conditions and restrictions the host government is able to impose on their operations. Tarzi identifies several factors that affect the bargaining power of the host government. He distinguishes between factors that influence the potential power of the state, such as its managerial skills, and those that affect the ability of the state to exercise its bargaining power. Actual power, as he terms it, is determined by societal pressures the host government faces, the strategy of the MNC, and the international pressures from the MNC’s home government.

**INTRODUCTION**

In their economic relationships with multinational corporations, Third World countries would seem to have the critical advantage, inasmuch as they control access to their own territory. That access includes internal markets, the local labour supplies, investment opportunities, sources of raw materials, and other resources that multinational firms need or desire. In practical terms, however, this apparent bargaining advantage on the part of the host nation, in most instances, is greatly surpassed by the superior advantages of the multinationals. Multinational corporations possess the required capital, technology, managerial skills, access to world markets, and other resources that governments in the Third World need or wish to obtain for purposes of economic development.

In addition to firm-specific assets—technology, managerial skills, capital and access to markets—the economic power of the multinationals grows out of a combination of additional factors. First, foreign investment accounts for large
percentages of the total stock of local investment, local production and sales. Secondly, multinationals tend to dominate key sectors of the economy that are critical to the host states’ economic development. Thirdly, multinationals usually prevail in the highly concentrated industries in the Third World—petroleum, aluminum, chemicals, transportation, food products and machinery. This economic concentration in single industries gives the multinational firms oligopoly power, allowing them to monopolize and control supply and price in a way that does not occur in more competitive industries.

In the first decade and a half after World War II, the multinational corporations were so powerful that they could essentially prevent any challenges to their dominance from host governments. The unique position they held as the sole source of capital, technology and managerial expertise for the Third World states gave them special negotiating advantages. Third World governments in their developing state could not easily duplicate the skills of the corporations, and when they did attempt to bypass the assistance of the multinationals, the cost to them in reduced efficiency was extremely high. Furthermore, the exposure of individual corporations was low, except for corporations in natural resources, plantations and utilities. In Latin America and the Middle East, where most of direct foreign investment in raw materials was concentrated, long-term concession contracts protected companies from immediate risk exposure. Host countries could neither remove nor replace them without sustaining enormous costs to their economies. Thus, the multinationals were usually able to exercise de facto sovereign power over the pricing and marketing of output.

Nevertheless, despite the colossal power of the multinational corporations, the historic trend has been one of increasing ascendancy of Third World host states. By the 1960s the multinationals were facing pressure from the host states to make substantial contributions to the long-term goals of economic development. Regarding foreign investment in natural resources, for example, ownership and control over raw material production was transferred to OPEC members. In the process, the Seven Sisters (the major oil companies) were relegated from their positions of independence and dominance to the role of junior partners of host governments in the Middle East. Similarly, in manufacturing there is a visible trend toward a sharing of ownership and control in foreign manufacturing ventures.

Several factors help to explain the relative ascendancy or improved position of some Third World host states with respect to their relationships with multinationals. A number of changes have increased the bargaining power of the Third World countries. And in addition to favourable changes in their bargaining power, other constraining factors in both domestic and international environments of the host countries have been eased, improving the ability of the hosts to exact better terms from the multinational corporations.
THIRD WORLD GOVERNMENTS: DYNAMICS OF POTENTIAL BARGAINING POWER

In order to examine the extent to which host states in the Third World can influence the behaviour of multinational corporations, we call attention to the distinction between potential power and actual power (the power to exercise or implement).

Potential power connotes the relative bargaining power of the host state which is dependent upon: (1) the level of the host government’s expertise, (2) the degree of competition among multinationals, (3) the type of direct foreign investment, and (4) the degree or extent of prevailing economic uncertainty.

Actual power, on the other hand, may be defined as the ability and willingness of host governments to exercise their bargaining power in order to extract more favourable terms from foreign firms. Domestic factors, including host country politics, along with international factors, such as foreign political and economic coercion, constrain Third World host states in their efforts to translate potential bargaining power into power that engenders favourable outcomes with foreign investors. These domestic and international factors act as a wedge between potential and actual power. The dynamics of potential bargaining power for the Third World governments is examined below.

Level of Host’s Expertise

Most host states have antiquated government structures and inadequate laws for collecting taxes and controlling foreign business. These institutional weaknesses impair the ability of host states in their negotiations with multinational corporations. Shortages of competent, trained, and independent administrators exacerbate these institutional problems and make it difficult for host states to manage multinationals and monitor their behaviour.

The trend, however, has been toward tougher laws in the host countries. Frequently, the host countries become dependent upon the revenue generated by foreign investors in order to finance government services and meet domestic requirements for employment. In turn, the desire for economic growth produces certain incentives within host states to strengthen their administrative expertise in international tax law, corporate accounting and industrial analysis. Thus, the development of economic and financial skills in host states is facilitated by the need to monitor multinational corporations and negotiate with them more effectively. Over time, therefore, host countries have developed or acquired many of the managerial skills which had long been employed by the multinationals as bargaining tools. By improving their expertise and capacity to monitor the corporations more closely, some host states were able to renegotiate terms when conditions permitted. The development of producer cartels also created a strong impetus for improving expertise within host countries to manage multinationals better. Multinational corporations can be expected to regain their bargaining advantage vis-à-vis a Third World government, however, when certain conditions
arise: (1) the rate of change in technological complexity of the foreign investment regime grows faster relative to the host country’s capabilities and rate of innovations; and/or (2) if the optimum scale of the investment regime expands so as to make it extremely difficult for the host government to manage it, in spite of initial strides in managerial expertise.

Both technological and managerial complexity for developing products or extracting resources correlate positively with bargaining power for the multinational corporations. Nevertheless, during the last two decades, the cumulative effect of improvement in the host countries’ expertise has resulted in a relative tightening of terms with respect to direct foreign investment. This phenomenon has resulted in a relative improvement in Third World governments’ bargaining positions.

**Level of Competition for Investment Opportunities**

Competition among multinational corporations for investment opportunities in a Third World country also affects the bargaining power of host countries. Essentially, a lack of competition among multinationals predicts a weak bargaining position for the host country. Conversely, increased competition is likely to improve the bargaining power of the host government. Competition among multinationals is likely to be greater where a host country provides a cheap source of needed labour and also functions as an “export platform” when the purpose of the investment project is to serve external markets. Competition for investment projects is likely to be limited, however, when projects are both capital intensive and designed to serve only local markets.

During the 1950s and 1960s, the absence of competition for investment opportunities served to diminish the bargaining power of host states in the Third World. The availability of alternative sources of raw materials and the existence of cheap labour elsewhere also work together to weaken the bargaining power of any individual country. In the last two decades, the spread of multinational corporations of diverse national origins (American, Japanese, European) has provided host countries with alternatives. In the international oil industry, for example, host countries have successfully used competition among multinationals to increase revenues from oil production. As a case in point, J.Paul Getty’s Pacific Western Oil Company upset the stability of other corporations’ agreements when it acquired an oil concession in Saudi Arabia by offering larger tax payments than the established oil companies were then willing to pay.

The option of choice from several willing foreign investors is extremely important to a host country. The ability to choose allows a host state to avoid the concentration of investment from one traditionally dominant Western country. Thus, for instance, Japanese multinationals have emerged as an alternative to U.S. firms in Latin America, and American firms have, in turn, emerged as an alternative to French firms in Africa.

If competition were to intensify among the multinational corporations for the resources of Third World countries and host governments’ ability to manage and
monitor multinationals were to improve, it is likely that host nations would pay less than before for services provided by the corporations.

**Economic Uncertainty and the Obsolescing Bargain**

Uncertainty about the success of a particular foreign investment project, its final cost, and the desire of a host country to attract investment create a marked asymmetry of power favouring the multinational corporations. During this initial phase, the host country must pursue permissive investment policies with the corporations. But as uncertainty decreases and the investment projects become successful, the multinational’s initial bargaining advantage begins to erode. Invested fixed capital becomes “sunk,” a hostage to and a source of the host country’s bargaining strength as it acquires jurisdiction over valuable foreign assets. The foreign firm’s financial commitment to assets located in host nations weakens the bargaining advantage it enjoyed at the beginning of the investment cycle. Consequently, when the bargaining advantage begins to shift to the host state, the initial agreements that favoured the multinationals are renegotiated.

In manufacturing, high technology, and services ventures, the probability of obsolescence is extremely low. Multinational corporations in natural resources, on the other hand, are most vulnerable….

This paradigm interprets the interaction between multinational corporations and host countries as a dynamic process. Furthermore, given the level of economic uncertainty for both parties, the interests of host countries and foreign investors are likely to diverge. The two parties then become antagonists. Gradually, a change in the bargaining advantages on the side of the multinational shift to that of the host country. The developments that follow may result in the renegotiation by the government of the initial concession agreement.

**Characteristics of the Foreign Investment Project**

As noted earlier, the probability of obsolescence is, to a large extent, a function of the foreign investment assets. Thus, the bargaining power or negotiating ability of a host country substantially depends on the type of direct foreign investment that is involved. Characteristics of the foreign investment project affecting the outcome of the bargaining process are: (1) absolute size of fixed investment; (2) ratio of fixed to variable costs; (3) the level of technological complexity of the foreign investment regime; and (4) the degree of marketing complexity.

Those foreign investment projects which do not require high fixed investments have a low fixed-to-relative cost ratio. Based on changeable technology and marketing complexity, they are less vulnerable to the dynamics of obsolescing bargaining than are foreign investment projects having high fixed costs, slowly changing technology and undifferentiated project lines. Investment projects in
natural resources, plantation agriculture and utilities fall into this group. Once the investment is sunk and the project becomes profitable, foreign firms may be exposed to the threat of nationalization or, more likely, the renegotiation of the original terms of investment.

Knowing these economic and political risks, multinational corporations would not commit large sums of money unless they were likely to get extremely generous terms. These “over-generous” terms to which the host country initially agrees often become a major source of national discontent and resentment against the foreign firm.

In manufacturing, where marketing skills are complex and products differentiated, foreign corporations have considerable flexibility in their response to the host country’s demands. In order to counter the demands of the host government, these firms can diversify product lines, move to a new activity such as export, incorporate additional technology, or threaten to withdraw their operation altogether.

Corporations in the vanguard of scientific and technological development such as computers or electronics have only recently begun to penetrate Third World economies. This group is especially immune to the obsolescing bargain. The pace and complexity of research and development (R&D) in computers and electronics is, for the most part, beyond the capability and geographic reach of any of the host governments in the Third World.

**Constraints on the Exercise of Power: Implementation**

The literature on bargaining provides a prevailing conceptual framework of bilateral monopoly to describe Third World-multinational corporation interaction. According to this model, the distribution of benefits between multinationals and Third World countries is a function of relative power. It is assumed that power is a function of the demand of each party for resources that the other possesses. This model is essentially static, however, because it does not deal with political and economic constraints on the exercise of power arising from the international environment. Similarly, it fails to account for constraints that are posed by the multinational’s economic power. More importantly, it ignores the constraints posed by the host country’s domestic politics. Specifically, the bilateral monopoly model does not distinguish between potential bargaining power and its implementation. Domestic politics within a host country, as well as international political and economic pressures from multinationals (or their home governments), may hinder host countries in their efforts to exploit the bargaining advantage once gained from the relative demand for its resources.

In order to fill this theoretical gap in the literature, we identify and analyse various constraining factors in both the domestic and international environments. The objective is to illuminate the extent to which a host government is able or willing to translate its bargaining advantage into actual power, to exercise this power in order to extract favourable terms from foreign investors. These relationships are presented below.
Domestic Constraints on the Exercise of Power

Key determinants in translating potential power into actual power are the attitudes and beliefs of the ruling elite regarding foreign investment, and their willingness and ability to discount international economic and political pressure in their confrontation with multinational corporations. During the 1950s and 1960s, Third World governments provided stability to foreign investments by working to preserve the status quo, despite changes that improved their bargaining power. At least two reasons can be given for the leadership of these countries to favour the status quo. One possibility is that their ideological predisposition was such that they saw multinationals as a benevolent force for economic development. Another possibility is that they may have feared that the international political and economic costs of seeking change would outweigh the benefits. There were also, of course, those instances where individual leaders in host countries were known to accept private payments in exchange for their efforts to preserve the status quo. In other instances, changes in the host country’s leadership led to classic confrontations. The new elite, having divergent ideological and policy priorities, attempted to persuade the foreign investment regimes to become more responsive to domestic economic priorities. When Mossadeq became the prime minister of Iran in the early 1950s, for example, in efforts to finance Iran’s First Development Plan he attempted to nationalize the British-owned Anglo-Iranian Oil company. Similarly, the Kinshasa government’s struggle to use earnings from the copper mines of Katanga to pay for post-independence development of the Congo led to a major confrontation. The ultimate result was the nationalization of foreign assets.

Since the mid-1960s there has been a change in attitude among most Third World leaders with respect to foreign investment. Exposes of political intervention by multinational corporations in the domestic politics of host states, the IT&T scandal in Chile in particular, contributed to this change. Unlike IT&T’s interference in Chilean politics, most multinationals do not pursue such ruthless politics of intervention. Nevertheless, the degree to which multinationals can influence, by legal or illegal means, the domestic political process can reduce the host country’s ability to change corporate behaviour and to make it cater to domestic needs.

A major force for change has been the emergence of new diverse groups which have become involved in the host country’s political processes. Students, labour, business, intelligentsia, middle echelon government technocrats and even farmers’ associations have greater political clout than ever before. Mobilized by the processes of industrialization and urbanization, and facilitated by global technology, these groups came to place intense pressure on their governments for improving the domestic economy; providing welfare, housing, transportation; and creating jobs. The extractive sector in particular, dominated by foreign firms, became a focus for nationalistic demands of an intensity that could not be ignored by the leadership of Third World states. Among the above groups, business and labour are especially noteworthy. The lack of a strong labour movement, however, remains a major source of institutional weakness in underdeveloped countries. In a similar vein, the lack of competition from local businesses creates another source of institutional weakness. Too often local businesses, for whom
multinational corporations might mean intense competition, are unable to compete with the giant corporations because the latter have access to cheaper sources of capital, better terms from suppliers, and marketing and distribution advantages. The absence of countervailing power via a competitive indigenous business sector helps to explain why the global corporations are able to continue to exert dominant power in underdeveloped countries. A similar and more prevalent situation is one wherein local business owners find that by cooperating with global firms, they too can benefit.

There often exists a strong alliance between the foreign corporation and various powerful home state groups such as landowners, or other pro-business conservative groups. All these groups tend to share the multinationals’ distaste for radical social change. This alliance serves as a major constraint on the ability of host countries to translate their bargaining power into favourable outcomes. The effect is the perpetuation of the status quo.

**International Constraints: Non-State Actors**

We can distinguish between two types of constraints in the international environment. First, there are constraints posed by non-state actors. Second, constraints often emerge as a result of home governmental actions on behalf of the multinational corporations. Constraints posed by non-state actors include the level of global integration of multinationals, local political risk and transnational risk management strategies.

Global integration includes the flow of raw materials, components and final products as well as flows of technology, capital and managerial expertise between the units and subsidiaries of a global corporation. In essence, it is a complex system of a globally integrated production network, at the disposal of the corporation. This complex transnational system is augmented by global logistical and information networks, global advertising and sometimes global product differentiation. The host government’s desire to acquire access to this global network and the dependence of host states on the foreign firms who created it produce a constraint on the former’s bargaining power.

Global integration, therefore, is an important determinant of multinational strategy. Increasingly, multinational corporations have developed globally based systems of integrated production, marketing and distribution networks in order to reduce costs and enhance their global outreach. A host country that engages in joint ventures with highly integrated and sophisticated foreign firms invariably becomes dependent on the multinationals’ controlled globally integrated networks.

Global integration is usually found in companies having very complex technology. There is little that the host country can do to influence integration, and consequently the host country may be severely constrained in its bargaining position. The majority of research and development is undertaken by highly integrated firms and is located in the industrialized home countries. As a result technological developments are beyond the reach or control of developing host countries. Royalties charged by highly integrated firms on the use of their technologies further increase the relative
vulnerability of host states. International Business Machines, for instance, continues
to maintain an unconditional 10 per cent royalty for the use of its technology
despite the efforts of host countries to reduce it.

Another constraint on a host government’s ability to exercise power arises from
the use of political risk management strategies by multinational corporations. In
order to diminish or control better their political risks, multinationals often establish
transnational alliances that dramatically increase the cost to the host state of changing
the foreign investment regime in their favour. The experience of Third World
governments with the pharmaceutical and automobile industries demonstrates how
a web of alliances built by the global corporations can seriously impair their exercise
of governmental power.

One tactic used by the multinationals is to spread the equity in the foreign
investment project over a number of companies from other developed countries.
This strategy increases the legal, political and economic obstacles to unilateral
alterations in contracts with host states. Another tactic is to raise debt capital for
the foreign investment project from banks of different countries (United States,
Japan, Germany). Multinationals structure the financing in such a way that banks
are paid only if the project is profitable. Host governments’ retaliatory actions
against the corporations could, therefore, alienate these powerful global banks
which have bankrolled the investment project. In view of the significant role of
some of the largest global banks involved in the Third World debt problem, this
particular risk management strategy may act as a powerful constraint on the host
state’s ability to turn its potential bargaining power into actual power. Another
tactic that multinationals use for protection is to involve the World Bank, IMF
and Inter-American Development Banks. The formidable power and prestige of
these institutions and their ability to deny financing to host governments’
development projects can also deter the host governments from taking actions
against multinational corporations.

These and other transnational risk management strategies tend to support the
general proposition that multinationals can structure the international economic
system and respond to their own financial needs to the detriment of host states in
the Third World.

**International Constraint: Home Government of Multinational Corporations**

The extent to which multinational corporations can mobilize the support of their
home government, and the ability (or inability) of the Third World government to
withstand retaliation from the powerful governments of the United States and
Western Europe on behalf of multinationals can also affect the bargaining equation.
For example, between 1945 and 1960 the bargaining power of the multinationals
was strengthened by the actions of the United States, which was home to most of
the corporations. The American government prevented the emergence of multilateral
lending institutions that might have provided alternative capital sources to
multinationals. It promoted instead direct foreign investment in the Third World
as a major aspect of its foreign assistance program. It also provided diplomatic
support to protect the assets of American multinationals. In a few instances, the American government used covert operations and force to protect economic and strategic interests and, in the process, promoted corporate interests.

The home government may support multinational corporations for a variety of national security reasons, to maintain access to cheap sources of foreign raw materials, to improve its balance of payments position or to use the corporations to transfer aid to pro-Western governments in the Third World. In addition, global corporations are powerful domestic political actors in their own right. They can (and do) take advantage of the fragmentation and decentralization of the democratic political process in Western countries in order to influence government policy. Since business groups are likely to be the best organized and best financed groups, with a persistent interest in the outcome of U.S. policy, they could bias the “pluralism” of the political process in the Western countries. For example, in the United States, the Hickenlooper Amendment and the Gonzalez Amendment were the result of corporate lobbying, and both tied American foreign economic interests to the preservation of corporate interests in the Third World.

To be sure, there is no systematic relationship between the home government’s interests and corporate interests that might automatically trigger home government support for multinational corporations vis-à-vis Third World governments. In the first place, if there is a conflict between the strategic interests of the nation and narrow corporate interests, the former is likely to prevail. An example of this is American support for Israel in the Arab-Israeli conflict. Secondly, there often exist sharp divisions among multinationals so that they cannot articulate a unified view of their interests. Finally, the result of American extraterritorial diplomatic support on behalf of established corporations—Alcoa, Reynolds, Anaconda, Exxon—in Latin America did not result in favourable outcomes for the corporations. As a result, corporations are becoming more reluctant to seek the support of their home government.

In spite of the above reasons, the potential for conflict with the U.S. government weighs heavily in Third World governments’ decisions to confront foreign firms. Since investment in the Third World tends to be highly concentrated according to the interests of the multinationals’ home country (often raw materials are key to national security), and because multinationals are highly influential political actors in the politics of their home country, Third World governments’ fears of the U.S. superpower are well-founded. Thus, the host government’s willingness (or lack of it) to discount the corporation’s home government’s potential retaliation (in the form of economic, political or military pressure) may crucially alter both decision-making processes and potential bargaining advantages.

SUMMARY AND CONCLUSION

…[T]he model presented in this paper predicts that multinational corporation/Third World country interaction will tend to be unstable over time and that the interests of the two actors are likely to diverge increasingly as the relative bargaining position of the host country improves.
In order to model the bargaining power of Third World countries with respect to multinational corporations, we have made a distinction between potential and actual power. The former is the capability, as yet unrealized, of a host Third World country to alter or influence the behaviour of multinationals. The latter connotes the ability or willingness of the host government to exercise this power in order to extract favourable terms from foreign firms. Potential power is a function of four variables: (1) the level of the host country’s expertise, (2) the degree of competition among multinationals, (3) economic uncertainty, and (4) the type of direct foreign investment.

This discussion leads to policy implications for host governments. Obviously, they need to build national capabilities that would help them to regulate better the multinationals. More importantly, in order for them to be effective, national policies need to be revised to conform more closely to the stage of foreign investment cycle. This article’s principal thesis is that, despite their apparent bargaining advantage, the dependence of Third World countries which are host to multinational corporations on the international economic system severely limits the ability of host countries to exercise their potential power.