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Introduction

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This book takes some initial steps into the twenty-first-century discussion of relations between national governments and multinational firms. This is the issue that defines international business (IB), since business that crosses national boundaries must necessarily deal with at least two national governments. As a result of the necessary interactions, there may be conflict or congruence between two governments' policies or between governments and multinational firms. Differences in policies or interests can often require mediation of some sort, resulting in the establishment of new rules on the relations of companies with home and host governments. Even if policies are mutually supportive between home and host governments, disagreements may arise over the distribution of benefits from company activities such as foreign direct investment (FDI), and thus produce conflicts that must be resolved.

Much of the recent literature on *international* business–government relations has emphasized the more cooperative, accommodative relationship that has arisen between governments that want to pursue economic growth and development, and companies that want access to markets or to production inputs. This is quite a shift from the situation during the 1960s through the 1980s, when many governments were reluctant to permit entry of foreign firms or imposed major constraints on their operations. Even so, this new more welcoming attitude is not the only feature of the relationship that matters today. For example, the issue of environmental protection is one increasingly important element in present and future relations that has potential for very serious conflict between companies and governments. Also, national governments are increasingly facing regulatory competition from local governments and from transnational organizations such as the European Union and the Free Trade Area of the Americas (FTAA). This fact means that national governments have

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to deal with these additional regulatory stakeholders at the same time as they deal directly with the companies.

The range of cooperative and conflictive relations between governments and multinational enterprises (MNEs) covers quite a wide scope. Some of the more conflictive issues in recent years include situations where national governments want:

- to achieve economic growth, but they are not as positive about foreign (firms') ownership of parts of the local economy;
- development of technology and skills, but not necessarily dependence on foreign provision of these key underpinnings of competitiveness;
- economic development, but without the environmental damage or social conflict that foreign (and local) firms might cause;
- the opportunity for local citizens to enjoy products and services from around the world, but still to maintain a national or local culture and values;
- their sovereignty to pursue national interests, when the increasingly global economy often forces supra-national goals on them.

These are not simple problems to resolve, and they will remain as part of the constellation of concerns between governments and international firms in the years ahead. Our interest is to illuminate the main facets of government–international business relations in the early twenty-first century, and to help government policymakers and company managers improve their ability to make decisions in this context.

Conceptual bases

A number of writers in recent years have offered conceptual tools to help understand the relationships between companies and governments. The authors in this volume have been the leaders in exploring the relations between *international* firms and national governments. In addition, very useful insights have been developed by authors in a variety of social science disciplines. For example, the literature broadly called Institutional Theory has developed in political science, sociology, anthropology, and economics. Each discipline shines a somewhat different light on relations between firms and governments, again mainly with a focus on domestic firms and governments.

One line of institutional theory has its roots in sociology, emphasizing the behavior of the firm as mirroring societal norms and traditions. This view of the firm as part of a broader institutional context (Oliver, 1991;

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Powell and DiMaggio, 1991) emphasizes the limits of rational maximizing behavior in the light of pressures from other institutional participants.[1] This perspective opens the analysis to consider organizational behaviors (e.g., follow-the-leader behavior between firms; cultural differences between MNEs deriving from differences among their societies of origin) from a sociological point of view. This line of reasoning has not been applied to the issue of the relation of multinational firms with national governments, though it certainly has been used in analyzing the multinational firm more broadly (e.g., Westney, 1993).

A second line of institutional theory comes from economics. The New Institutional Economics, particularly as framed by Oliver Williamson (1975), opens the way to examine transaction costs as a central element in economic organization. Williamson identified three types of transaction cost problems – information impactedness, bounded rationality, and opportunistic behavior. To deal with each of these problems, firms are organized to internalize the costs (and benefits) of information-sharing; firms pool risk for individuals who are limited by imperfect knowledge of the alternatives available to pursue; and firms constrain individuals to pursue goals that support the whole organization's purpose rather than goals that may reduce overall welfare by raising costs to others while the individual benefits.

At the international level, these transactions costs have been explored by a number of international business authors, including Rugman (1981), Teece (1981, 1993), and Hennart (1982). Rugman and Hennart, among others, have focused on the internalization of external activities by multinational firms as the linchpin of their reasoning. In none of these cases are government–business relations a central concern, though Dunning (who also emphasizes internalization in his theorizing) has pursued specifically the international business–government relationship in his extension of his eclectic model (Dunning, 1997).

[1] "This perspective emphasizes the ways in which action is structured and order made possible by shared systems of rules that both constrain the inclination and capacity of actors to optimize as well as privilege some groups whose interests are secured by prevailing rewards and sanctions" (Powell and DiMaggio, 1991, p. 11).

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A third line of institutional theory comes from political science (March and Olsen, 1984) and emphasizes the hierarchy of relationships from governments to companies to individuals. This point of view opens the analysis to consider such things as the bargaining relationship between governments and companies, and the need for the firm to respond to demands of pro-labor and pro-environment groups, among others.

The political-science-based view of Hall and Soskice (2001) has received extensive comments in the past few years. They argue that capitalist economies are quite varied in their institutions and their relationships between firms and between firms and governments. They trace two major categories of countries, following either the US–UK model (liberal), or the German–Nordic model (coordinated). Countries in the former category tend to use markets (contracts) to resolve such issues as wages, forms of collaboration between companies, and corporate governance issues. These countries tend to have weak collaborations between companies and with government. Countries in the latter category (coordinated) tend to use inter-group cooperation between firms and between companies and employees to resolve those same issues. These latter countries tend to have much stronger forms of collaboration between companies (e.g., *keiretsu* or similar groupings) and with government (e.g., greater amount of shared economic planning).

Hall and Soskice then argue that the institutions that characterize each set of countries have pervasive differences that tend to support firms that operate in ways that are consistent with those institutions. Inter-firm collaboration is much more acceptable in coordinated economies; while such collaboration is frequently subject to anti-trust policy in the liberal economies. At the level of international business, their argument could be extended to treatment of foreign multinational firms, possibly reasoning that firms from other similar (liberal or coordinated) countries would have greater success in dealing with the government of the host country. Their argument could be extended to explore the kinds of incentive policy and tax treatment that could be expected in different countries. In sum, the perspective offers the potential for exploration at the international level, but it has not yet been pursued in that context.

The present volume offers a variety of conceptual perspectives on the relations between national governments and multinational firms,

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without any one being central to all of the analyses. Several of the chapters do use a bargaining model of these relations, based on Vernon's obsolescing bargain, or Stopford and Strange's tripartite relationship, or Behrman and Grosse's three-dimensional bargaining model. The bargaining models are not overarching views of the corporation or of the organization of economic activity, but rather they are tools to help understand the specific context of dealings between national governments and international firms. Each of these bargaining approaches is discussed below, along with the other conceptual approaches that are used to describe and understand the relationship between MNEs and governments.

Approaches to these relations in the chapters below come from the academic areas of business strategy, organizational theory, economics, and international business – and each develops conceptual views of the government–business relationship, rather than testing hypotheses through the use of new empirical evidence. The full set of analyses then are useful in looking at international business–government relations, by offering a multifaceted understanding of how each side can or should deal more successfully with the other.

An overview of the analyses

The book is divided into four parts:

1. History and theories of analysis of international business–government relations
2. The shifting international business–government partnership
3. Bargaining theory and the obsolescing bargain
4. Host and home government views of international business

The first takes a purely conceptual approach, looking at the last four decades of research on the subject and reviewing the perspectives that have been brought to bear on the international business–government relationship. The second part takes up the current context in which relations between firms and governments have become more positive, with each side looking for ways to work successfully with the other, rather than being antagonistic. The third part looks at a number of aspects of the bargaining view of IB/government relations, originating from Vernon's (1971) idea of an obsolescing bargain, and proceeding on to present patterns. The final part looks at the government view, both home and host.

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Part I: History and theories of analysis of international business–government relations

The first chapter lays out an initial overview of theoretical perspectives on government–business relations (from authors such as Hymer, Behrman, Fayerweather, and Vernon). The second looks at the changing relationship in transition economies, based on an institutional theory framework and specifically looking at direct investment decisions. The third takes a broader stakeholder point of view and considers the question of corporate governance. The fourth brings the earlier Stopford and Strange perspective forward into twenty-first-century relations.

Jean Boddewyn's study reflects on the contributions of Behrman, Fayerweather, and Robinson to the understanding of government–international business relations in the 1950s and 1960s. They wrote numerous analyses of the impact of governments on company activities and decisions, of the risks to companies in dealing with (foreign) governments, and of the interactions between multinational companies and governments. In that period the relations tended to be relatively conflictive, in the sense that governments and companies tended to view their interests as different. Their interactions could have qualified as either accommodating or protective, but seldom collaborative. Boddewyn traces the intellectual tradition established by these early leaders in the field, and shows how their work led to subsequent analyses such as the Stopford and Strange view that appears later in this section.

Boddewyn points out that none of the early writers developed an overarching theory of international business–government relations, but that Fayerweather came closest to doing so. According to Fayerweather,

> The two processes of "resource transmission" and "relations with host societies" are "interconnected" and constitute "the distinctive aspects of an international business as distinguished from a domestic one." They result, on the one hand, in "mutually beneficial, constructive activities for both the multinational firm and the interests of the affected nations" and, on the other hand, in "elements of conflict related to the confrontation of the interests of the firm with different national interests and nationalistic attitudes." These transmissions, relations and conflicts in individual foreign countries lead toward "a fragmented, diversified pattern of policies and activities [that] weakens the effectiveness of the multinational corporation whose unique potentials vis-à-vis local national firms lie

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largely in its unified, global capabilities. The achievement of balance between fragmentation and unification therefore composes the final element in the conceptual framework." (1969, p. 12)

Boddewyn concludes that the groundwork had been laid in the 1960s and early 1970s for the understanding that we have today of the multifaceted relationships between international companies and home/host governments.

The chapter by John Dunning presents a view of the importance of government in the process of foreign direct investment (FDI), and the institutional (government-related) factors that encourage or discourage FDI. This view is then explored with empirical evidence as presented in several recent studies by other authors, and applied specifically to policies and practices in the formerly communist countries of Central and Eastern Europe. Dunning's interest is to evaluate the importance of institutions and of institutional reforms in attracting direct investment. His conceptual base is founded on institutional theory, as proposed by North (1990), in the context of a set of countries where major institutional change took place during the 1990s, namely the "transition economies." The key questions are whether and how institutions affect FDI. Dunning concludes that more transparent institutions and policy liberalization lead to increased FDI.

Lee Preston next takes on the question of *legitimacy* of the international firm from the perspective of host societies. His concern is with the ability of firms to achieve sufficient acceptance by governments so that they can pursue their corporate goals in harmony with societal goals. He says that "the issues involved can be best understood as aspects of *corporate governance*, which includes both the pattern of enterprise ownership (including state ownership) and the ways in which ownership, regulation, and other bases of control are utilized to legitimate the corporation as an institution and direct/restrict its activities."

Preston reviews a number of analyses of corporate governance, toward the goal of identifying trends of convergence among countries. He believes that the German model, with a managerial board and a separate oversight board, is the model around which governance rules are coalescing.[2] If this is true, then governments need to establish

[2] There is certainly not a consensus of opinion on this issue. A number of authors argue that convergence is not occurring, while others maintain that convergence is occurring on the US model (e.g., Sundaram et al., 2000).

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policies that foster constructive collaboration between corporations and the various relevant stakeholders with whom they interact.

John Stopford's chapter revises his earlier analysis of the triangular relationship among international companies and governments (i.e., between company and government, between two companies, and between two governments) (Stopford and Strange, 1992). He argues that the end of the Cold War changed the global political structure, and the internet age changed the global economic structure, such that a new triangle of interactions is needed to think about government–business relations. Stopford's new triangle includes: (1) the balance of power between States, but particularly between any other State and the one remaining superpower, the USA; (2) the balance of power between markets and States; and (3) the balance of power between individuals and States.

This new set of dimensions reflects the changed reality of the twenty-first century, and puts government–business relations into a context in which both sides are embedded in webs of stakeholders – the firms with strategic alliance partners, among other stakeholders, and the governments in regional blocs as well as with sub-national jurisdictions and pressure groups. Decision making by both national governments and multinational companies now must take into account these added complexities to pursue their goals. For example, companies face "reputational risk" in that their activities in one country (e.g., manufacturing there and causing pollution or allowing substandard working conditions) may be used by pressure groups in another country to try to influence company behavior and/or government regulation. The terms of reference have expanded in a world that is more and more integrated, and decreasingly divided.

Part II: the shifting international business–government partnership

This part presents a series of analyses of particular industries and countries, in each instance focusing on the evolving relationship of host countries with foreign multinationals, as political conditions, technology, and competitive conditions change over time. While the general trend toward less confrontational relations is evident in the 1990s, more recently government policies and company positions have moved from accommodation to conflict and back as conditions have changed.

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Klaus Meyer and Camilla Jensen explore how the efforts of governments in the formerly communist countries of Central and Eastern Europe to deal with the problems of economic development have led to greater or lesser success. They compare country experiences in three categories of transition from command to market economy, and they demonstrate how greater direct investment flows have occurred under conditions of greater liberalization. They also compare company experiences with acquisitions versus greenfield investments, showing that greenfield investments tend to have greater bargaining power relative to the host government than do acquisitions of existing firms, especially acquisitions of state-owned firms.

For FDI that takes place through *acquisition*, the foreign firm's key concerns have related to bargaining with government authorities and their ability to restructure formerly state-owned enterprises to reduce inefficiencies. Over time, foreign investors increasingly are acquiring private firms, thus reducing the intensity of their interaction with the authorities.[3] Foreign investors pursuing *greenfield* entry have more degrees of freedom with respect to their intra-country location choices. This gives them greater bargaining power vis-à-vis localities (states, counties, cities, etc.), and the opportunity to take advantage of special incentives in Special Economic Zones and industrial parks.

Thomas Brewer focuses on the problem of global warming, an issue that is increasingly salient in government–MNE relations. Global warming is responsible for a variety of changes in the economic and political environment of firms. His study focuses not only on the relationship between host governments and foreign multinationals, but more generally on the issues of business–government relations that have ensued from it.

For instance, the European Union has created an Emissions Trading Scheme that imposes greenhouse gas emission targets on more than 10,000 individual establishments throughout the EU and establishes a system for trading emission allowances. Other issues of business–government relations involve regulations on auto emissions, which require auto and energy firms' responses, subsidies for use of renewable energy sources and the development of alternative-fuel vehicles, and

[3] Even so, when buying a recently privatized firm, direct investors may face very significant restructuring needs, to shed the legacy of a firm once run as a socialist enterprise.