Transformations in Global Governance

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Sushil Vachani

Boston University

NEW HORIZONS IN INTERNATIONAL BUSINESS

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To Rita, Samira and Anisha

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Preface

Most of the papers in this book were presented at the conference on 'Transformations in global governance: implications for multinationals and other stakeholders', held at Boston University in October 2004. The conference brought together scholars from international business and international relations to focus on an area of growing importance for multinational enterprises and other stakeholders: how global governance is affecting the context in which multinationals operate, which in turn has ramifications for society in general. The study of multinational enterprises is not central to the agenda of most researchers in international relations, and while international business research focuses a great deal on multinationals it tends to neglect broad contextual issues. I hope that the papers presented in this book will stimulate others to broaden their research. This work complements some of my previous work on multinationals' effect on poverty alleviation, the role of NGOs on international business, and multinational–host government relations.

I am very grateful to Professor Fred Foulkes of Boston University's Human Resources Policy Institute (HRPI) for the financial support provided by the Institute to cover part of the conference cost. HRPI brings together researchers and top-level human resources executives from over 40 companies to focus on HR issues. Its membership is extremely interested in various aspects of global management.

I would like to thank all the contributors to this volume, as well as others who participated in the conference. Louis Wells and Yves Doz presented interesting papers that helped stimulate discussion, but were unable to contribute chapters for the book. The discussion at the conference benefited a great deal from the stimulation provided by session chairs: Lou Anne Barclay, Jonathan Doh, Jeffrey Furman, David Levy, Nishi Sinha and Paul Vaaler.

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Sushil Vachani

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Chapter 5: 'Beyond Seattle: globalization, the nonmarket environment and corporate strategy', 2002, *Review of International Political Economy*, **9**(3), Autumn, pp. 513–37 (www.tandf.co.uk).

1. Introduction

Sushil Vachani

The world of multinational enterprises is changing dramatically. Their complex and dynamic international context presents them with special challenges, threatening their survival on one hand, and presenting them with unprecedented opportunities on the other. Global governance, which affects the way business is conducted, is undergoing significant transformation, and multinationals' ability to rely on traditional sources of competitive advantage is at risk.

The changes in global governance affecting multinationals' strategies, and their impact on society, stem from a number of factors. One principal factor is the formation and evolution of intergovernmental organizations, such as the World Trade Organization (WTO), and various agreements pertaining to trade, environment, labor, competition or investment. Another, equally important, factor is the rise of non-governmental organizations (NGOs), which have a significant impact on strategies of multinational enterprises, governments and intergovernmental organizations (Doh and Teegen, 2003; Teegen *et al.*, 2004; Vachani and Smith, 2004). Both are integral to the process of globalization.

GLOBALIZATION

Globalization implies intercontinental interconnectedness among people, companies, governments, NGOs, and society in general. It is manifested in relatively large and unfettered flows of trade, capital, technology, ideas and people.[1] Globalization creates benefits and pressures of different kinds for a number of stakeholders, and has changed the role of governments, intergovernmental organizations and NGOs in global governance. Multinationals are affected by these transformations, but also contribute to them.

Globalization is not a recent phenomenon. During the first era of globalization, between 1870 and 1914, countries were increasingly linked by trade, investment and migration (World Bank, 2002). Between 1914 and 1945, with two world wars and the great depression, nationalism rose and

globalization retreated. After WWII, developed countries worked actively to build, open and stabilize economies, setting up the Bretton Woods intergovernmental organizations, the World Bank and the IMF, as well as the GATT, to promote trade. These governance institutions helped the world become more economically integrated between 1950 and 1980, globalization's second phase, though developed countries participated in this process, and benefited, much more than developing countries.

Since 1980, however, dramatic changes have occurred, marking globalization's third phase. Many developing countries, previously leery of free markets, warmed toward them. Several developing countries implemented liberalization programs, resulting in greater flow of capital and trade. The share of manufactured goods in developing-country exports rose from 25 percent in 1980 to 80 percent in the early 2000s (World Bank, 2002).

Globalization has been aided by exponential growth in people's ability to communicate across long distances relatively inexpensively, which has facilitated the flow of capital, technology and services across borders, and helped multinationals create and manage international value chains. During the first globalization era the transition from sail to steamships helped lower transportation costs. In recent decades sharp decline in telecommunications costs and the formation of the Internet has brought profound changes by dramatically increasing the ability to procure services offshore and share ideas globally.

Globalization has created concern for unchecked negative externalities, shifts in balance of power, and cultural homogeneity, with consequent demands for changes in global governance (Klein, 2000; Korten, 1998). Even globalization's defenders see the need for 'institutional mechanisms to cope with [its] occasional downsides' (Bhagwati, 2004: 222). An important factor determining globalization's effects is the speed with which it brings change. Rapid change poses adjustment challenges, highlighting the need for governance mechanisms to manage 'transitions to globalization' (ibid.) Globalization has also allowed civil society to coordinate activities internationally, thereby enhancing NGOs' influence, and promoting 'globalization from below' (World Bank, 2002: 3).

This interconnectedness, which is central to globalization, does not link every country. Aspects of globalization are manifested at the regional level, in 'subglobalizations' that are 'movements with a regional rather than global reach that nevertheless are instrumental in connecting the societies on which they impinge with the emerging global culture.' (Berger, 2002: 14). Rugman (2001) points out that most multinationals are regional, not global.

Globalization's economic impact has varied across countries. Developing countries that enjoyed greater globalization in the 1990s experienced

economic growth averaging 5 percent per annum, versus 2 percent for developed countries (World Bank, 2002: 2).[2] For many of the three billion people fortunate to live in these countries, this growth translated into better, though still inadequate, living standards. About 120 million people inched above the lowest rung at the bottom of the pyramid (incomes of less than $1 per day) between 1993 and 1998. Unfortunately, globalization bypassed several other countries, and their two billion people did not enjoy similar benefits.

GLOBAL GOVERNANCE

> Governance is the sum of the many ways individuals and institutions, public and private, manage their common affairs. It is a continuing process through which conflicting or diverse interests may be accommodated and co-operative action may be taken. It includes formal institutions and regimes empowered to enforce compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interest. (Commission on Global Governance, 1995: 2)[3]

The commission saw global governance as not only including intergovernmental relations, but 'also involving non-governmental organizations (NGOs), citizens' movements, multinational corporations, and the global capital market.' (Commission on Global Governance, 1995: 2–3).

Given the domain of International Business (IB), which includes social, economic and political aspects of the activities of multinational enterprises, governments and NGOs, and the societies in which they are embedded, I suggest the following definition. *Global governance is a collection of multifaceted, formal and informal institutions, codes and norms, motivated or enforced by international organizations or coalitions, that regulate and facilitate economic, cultural, social and political activity, and its effects on society.*

While the primary domain of business is economic, it is important to focus beyond economic activity to recognize the important social and political effects of business, and the influence that governments and NGOs have on multinationals. It is also necessary to remember that multinationals, governments and civil society can reach across nations to influence governance within them.

As David Levy and Peter Newell discuss in Chapter 7, global governance has multiple shades; it varies in nature (for example, market-enabling versus regulatory), coverage (for example, number of countries participating in an agreement) and degree of formality, and has asymmetric effects on different countries, industries and social groups.

TRANSFORMATIONS IN GLOBAL GOVERNANCE

Ideological Variations

Institutions of global governance are affected by ideological differences across nations that are molded partly by their historical and cultural contexts. As Robert Kudrle points out in Chapter 2, Japanese antitrust law was affected by US occupation and the Cold War. So after WWII, even though large business groups were dismantled initially, this restructuring process was shelved over time in the interest of maintaining industrial strength to face up to communism. Restrictive vertical distribution arrangements survived for decades. The EU's competition policies developed under the broader objective of creating larger markets. So national distribution arrangements were discouraged. The EU places greater weight than the US on limiting adverse impact on competitors, even in the absence of clear harm to consumers. US policy differs markedly from that of other countries in treating antitrust infringements as criminal violations.

Kudrle also notes differences in implementation. The US places more emphasis on the courts, and the EU on administrative action implemented by an independent body, with provision for legal appeal. In Japan, antitrust laws are enforced by the executive, which resorts to warnings rather than penalties. These contextually determined differences in governance institutions create asymmetries in multinationals' resources and strategies.

There have been changes over time as well. Perceptions of the state's role in the economy evolved over the course of the twentieth century. During the 1980s, under the leadership of Prime Minister Margaret Thatcher in the UK, and President Ronald Reagan in the US, greater emphasis was placed on markets, and privatization and deregulation became popular. Many developing countries, where the state previously controlled the 'commanding heights' of the economy – industries such as steel, telecommunications and power – instituted economic liberalization programs, sometimes as part of conditions accompanying the IMF's financial aid packages. In the 1990s, Prime Minister Tony Blair and President Bill Clinton attempted to balance the effects of the market with greater emphasis on social issues. The 'Washington Consensus', with its three pillars of fiscal austerity, privatization and market liberalization, aggressively disseminated by the World Bank and the IMF, came under stinging criticism (Stiglitz, 2002). These organizations have undertaken gradual shifts (in different degrees) toward engaging civil society, which is getting a somewhat more sympathetic hearing (O'Brien *et al.*, 2000).

James Post and Tanja Carroll (Chapter 6) point to a critical difference in societies' view of corporations that has governance implications. In the

Anglo-Saxon perspective the corporation is viewed as an 'extension of a basic human right to own property', whereas in the view of many other societies 'critical features of the corporate form – legal status, unlimited life and limited liability – are *not* natural attributes of the individual, but extraordinary privileges granted by the state on behalf of the larger host society'.

Governance of Trade and Competition

> Europe must defend its interests at the World Trade Organisation. (Chirac, 2005: 13)

An important change in global governance is the evolution of regimes for trade, investment and competition. The 1990s and early 2000s saw not only the launch of the WTO, replacing the GATT,[4] but also more aggressive implementation of free trade agreements among smaller groups of countries (for example, NAFTA, the expansion of the European Union, and bilateral trade agreements).[5] Even some small countries, such as Chile, have entered into a wide range of bilateral agreements.

As these free trade agreements can have profound effects on multinational enterprises, it has become important for managers to study the relationship between country context and trade strategy, and how they affect multinationals. Policy changes resulting from trade arrangements may be driven by political maneuvers by powerful nations (or groupings of nations), such as the US, EU, China, Russia, India and Brazil, as well as by smaller 'mavericks', such as Chile, which have come to occupy pivotal positions in the politics of trade negotiations (Vachani, 2004). Under President Hugo Chavez's leadership, Venezuela is catalyzing South American resistance to the Free Trade Area of the Americas in a political challenge to the US administration.

While the GATT, and its successor, the WTO, have made steep reductions in trade barriers since World War II, significant barriers remain, and governments appear determined to protect them. In fall 2005, trade officials from Australia, Brazil, the EU, India and the US met in Geneva to settle differences between developed and developing countries that threatened to derail the Doha round of the WTO. Robert Portman, the US Trade Representative, offered a 60 percent cut in the $19.1 billion US limits for farm subsidies, if the EU reduced its $75 billion subsidies by 80 percent (*Economist*, 2005). As indicated by President Chirac's statement in the face of pressures to reduce agricultural subsidies (quoted at the top of this section), nations view the WTO as a forum where battles must be fought to defend national interest. The winners and losers are many: farmers, labor,

consumers, large and small companies, and the underprivileged masses at the bottom of the pyramid, who can see their fortunes radically transformed.

President Chirac exhorted the EU to 'come to grips with globalisation's social consequences' including the adverse effects of multinationals' global strategies, which were driven by short-term profit motives and disrupted employment (Chirac, 2005: 13). His recommendations included modification of the rules of global governance, such as environmental pacts that would go beyond the Kyoto protocol, in addition to strategies to limit erosion of Europe's position in the WTO on agricultural subsidies.

The formation of the WTO has undoubtedly changed global governance significantly. Yet, as Steven McGuire and Thomas Lawton discuss in Chapter 3, IB researchers do not appear to give it much attention. They see the lack of recognition of the WTO as an important player in global governance as stemming from three beliefs: that states are the dominant players, that multinationals are too powerful to be affected by global controls and can mold global governance with their bargaining power, and that the WTO is ineffective without the support of major economic powers such as the US and Europe.

McGuire and Lawton argue that the WTO matters because it affects government policies, which in turn affect multinationals' competitive position and strategies. Its disputes resolution process can affect the resources provided by governments to multinationals, and thereby tip competitive advantage and reduce rents derived from protectionism. This could happen, for example, by changing governments' preference of competing national trade instruments. The implementation of laws resulting from agreements, such as intellectual property rights laws, can affect multinationals' locational decisions.

WTO rulings appear to spare no player, no matter how strong and influential. Both the US and the EU have been handed adverse rulings by the WTO's dispute resolution process that authorized other regions to impose large penalties on them. Powerful players like the US and EU are able to use the process to pressure others more effectively than smaller countries, like the Netherlands and Ecuador, which can ill afford to implement retaliatory action even when authorized by the WTO (Lawrence, 2003).

Competition Policy

Kudrle (in Chapter 2) notes that 'the rapid globalization of business has propelled competition policy to a high place on the international governance agenda'. The 1996 WTO Ministerial discussions identified it as an important issue for international cooperation. While trade agreements have

reduced formal trade barriers, these have been replaced by other practices that obstruct the free flow of goods and shift multinationals' sources of competitive advantage. Kudrle uses the term 'competition policy' to refer to antitrust laws, and highlights several issues that affect multinationals' strategies and operations. Nationalism, manifested in official preferences or more subtle mechanisms, discriminates against foreign companies, favoring local producers over local consumers. Multinationals are locked out of national distribution networks, for example, in Japan and Korea, through local control over distribution, or by land use laws. Governments reach into foreign domains with extraterritorial veto over mergers and acquisitions, sometimes exercised to deny competitive advantage to foreign multinationals. Multinationals are, themselves, culprits in distorting the structure of global industries, primarily through cartels. The US recovered $2 billion in fines from companies engaged in price fixing between 1998 and 2001, and the EU collected €1.84 billion in 2001.

Kudrle discusses three approaches to competition policy: cooperation, based on information sharing; harmonization, aimed at policy convergence; and centralization, involving empowerment of a formal, multilateral, governance structure. He calls for greater clarity and predictability in competition policy, which should reduce transactions costs, facilitate business planning and discourage abuse, and counsels against relying on the WTO to achieve these objectives. Instead, he recommends less formal initiatives such as the International Competition Network. Kudrle notes that skepticism regarding the WTO's role in governing competition policy is predicated on several differences in trade and competition policy; for example, trade policy deals with government action pertaining to control over markets, while competition policy pertains to firm action, and tries to balance demands regarding structure and conduct of firms. The concept of free trade is easy to comprehend. There is a greater challenge, at both national and international levels, in developing consensus on what constitutes appropriate competition policy.

NGOs

By the late 1990s, NGOs were a formidable force in international business.[6] For example, they played a key role in the failure of the 1999 WTO meetings in Seattle. Their influence on global governance was less significant before the 1990s. In 1991, the GATT struck down the US government's enforcement of a ban on import of tuna from countries (principally Mexico) that did not require their fishermen to ensure that marine mammals (especially dolphins) were not killed when they caught the tuna. This ruling, favoring trade over environment, mobilized NGOs to oppose

NAFTA. This influenced President Clinton to negotiate greater environmental protection in an ancillary agreement of NAFTA after his 1992 election (Graham, 2000).

In the late 1990s, when the Canadian government had to back down from its efforts to ban the use of a gasoline additive, MMT,[7] after the US Ethyl Corporation filed a complaint under NAFTA's investor-to-state dispute settlement procedure, environmental NGOs' activism rose substantially (Soloway, 1999). Their opposition to NAFTA hardened, and in February 1998 a group of nine NGOs warned the US administration that they would oppose the Multilateral Agreement on Investment (MAI), which OECD countries had been negotiating since 1995.[8] The MAI, labeled 'NAFTA on steroids', was viewed as 'a major and immediate threat to democracy, sovereignty, the environment, human rights and economic development.' (Kobrin, 1998: 98). There was deep concern that it would limit host countries' ability to implement laws protecting workers, health, and the environment. While the MAI might have been doomed anyway by disagreements among the OECD members, NGOs contributed to its demise (Graham, 2000; Kobrin, 1998).

NGOs are clearly having an impact on the evolution of the texture of global governance. The principle underlying the creation of major intergovernmental organizations was multilateralism, 'an institutional form that co-ordinates relations among three or more states on the basis of generalized principles of conduct' (Ruggie, 1993: 11). NGOs' activism has led to the recognition that society is better served if global governance is informed, not just by governments (and multinational enterprises), but also by civil society. This has resulted in a shift toward a more inclusive 'complex multilateralism', in which NGOs represent society's non-elite segments in the institutions of global governance (O'Brien *et al.*, 2000: 206).

Despite the rise of NGOs, the IB research community has been slow to recognize their increasing impact on multinational–government relations, and the implications for multinationals' market and nonmarket strategies.[9] IB research focuses on multinational enterprises, for their value creation through international operations, and governments, for their effect on institutions that govern multinationals. Teegen *et al.* (2004) highlight how the addition of NGOs affects the IB research agenda. They propose a co-evolutionary perspective to study the interaction of NGOs and institutions. NGOs are affected by the business systems in which they exist (and which vary across countries) and, in turn, stimulate evolution of their institutional context. The inclusion of NGOs is especially important for broadening the multinational–government bargaining framework, which has constituted an important stream of IB research (Eden and Lenway, 2001; Kobrin, 1987; Vachani, 1995; Vernon, 1971).

Several authors in this volume include NGOs in their analysis. John Ahlquist and Aseem Prakash (in Chapter 5) trace forces that have resulted in activism by citizens' groups, who suspect that governments are more sensitive to multinationals' interests than the welfare of labor, consumers and other stakeholders, when they negotiate international agreements. The lack of transparency in deliberations of intergovernmental organizations, for example, the WTO's dispute resolution proceedings, heightens skepticism. They suggest it is not always easy to predict if multinationals and NGOs support or oppose regulatory regimes, and if they prefer national versus supranational governance. For example, multinationals might be expected to oppose regulations that curb corporate activity, but some companies may favor arrangements that give them an advantage over others. While some multinationals might prefer supranational governance to move beyond the reach of domestic non-governmental adversaries, others may favor national governmental regulation if they have influence at that level.

Carlos Rufín (in Chapter 4) points to the dramatic spread of democracy in the 1980s as instrumental in giving rise to NGOs, and the demands for government accountability. He suggests that increased NGO activism, combined with developing countries' institutional weaknesses, makes multinationals' investments in infrastructure especially vulnerable. As governments respond to NGOs' pressures by changing the bargain with multinationals there is less opportunity for multinationals to find legal recourse than in developed countries. Reform has often been implemented with inadequate participation of civil society, and poor communication with consumers, reducing the legitimacy of multinationals' investments.

Jonathan Doh (in Chapter 10) discusses the pressures multinationals face to engage in activities with more tangible social benefits, and how alliances with NGOs can help relieve this pressure by enabling multinationals to be more socially responsive. Jeffrey Hart (in Chapter 11) describes the broadening in focus of the G8's cyberspace governance to include bridging the digital divide, which he traces to criticism from NGOs about a democratic deficit in governance. This led to a multi-stakeholder approach in which NGOs were invited to participate.

IMPLICATIONS FOR MULTINATIONALS, GOVERNMENTS AND OTHER STAKEHOLDERS

Multinational enterprises have a tremendous impact on their environment, especially on societies they interact with through marketing, manufacturing and procurement. For example, in industries with life-saving (or life-enhancing) products, such as pharmaceuticals, strategies of differential

pricing can contribute significantly to social welfare (Vachani and Smith, 2004). These strategies, which can simultaneously benefit shareholders and poor consumers, are deterred by barriers that can be overcome through cooperation among multiple stakeholders: multinational enterprises, host governments, home governments, NGOs and intergovernmental organizations. Examples like these underscore the importance of multinational managers recognizing the motivations and roles of different players in global governance, and formulating nonmarket strategies that may include striking alliances with them to mold and navigate their international context.

Nonmarket strategy can help multinational enterprises proactively influence their context (Baron, 2000; Boddewyn, 2003; Ghemawat and Vachani, 2002). In Chapter 7, Levy and Newell observe that multinationals are not only affected by global governance but actively participate in its development. They stress it is important for multinationals to proactively develop strategies and organizational competence to deal with opportunities to shape the agenda and enhance their chances of influencing perspectives and approaches to regime development. They point to examples such as the fossil fuel lobby's 'unprecedented influence' on US climate policy, and chemical companies' impact on the Montreal Protocol for ozone depleting substances, as evidence of increasing privatization of governance.

Post and Carroll (in Chapter 6) redefine modern corporations as 'extended enterprises', subject to diverse governance mechanisms that vary in the extent to which participation is voluntary or mandated, and in which interaction may range from adversarial to collaborative. The goal of this redefinition is to broaden the managerial agenda to include concerns of those both voluntarily and involuntarily associated with companies. Post and Carroll analyze how relationships with different stakeholders serve as inimitable resources and contribute to organizational wealth, and suggest that the network of relationships constitutes the company's governance system. Organizational wealth can be enhanced by trustworthy behavior, which legitimizes governance. Corporations are experimenting with greater transparency, accountability and stakeholder engagement as ways to enhance trust.

In reviewing multinationals' nonmarket environment, Ahlquist and Prakash (in Chapter 5) predict greater demand for stronger supranational institutions that affect multinationals' operations, which face citizen group pressures in the market and nonmarket environment at the domestic and supranational levels. They expect national governments to remain responsive to domestic interests. They see this as creating a need for multinationals to engage in rather complex versions of Putnam's (1988) 'two-level games' with coherent supranational market and nonmarket strategies that simultaneously address variations in country characteristics.

Levy and Newell (in Chapter 7) underline the delicate and complex nature of multinationals' task as they attempt to influence the course of regime development; they can lose control over the process and end up facilitating unfavorable outcomes. Levy and Newell suggest that multinationals' posture toward governance negotiations can vary with their position on the value chain; for example, in the biotechnology industry, companies like Cargill, which were at the consumer end of the value chain, did not resist stringent regulatory controls as vigorously as companies like Monsanto that were at earlier stages, relatively distant from consumers. They suggest that multinationals' attitudes toward governance, manifested in corporate political activity, are also affected by home country norms (Lin, 2001); for example, European companies engage in less adversarial lobbying than US companies (Coen, 1999).

Multinational–Government Relations

IB researchers have long been interested in multinational–government relations and the strategies of multinational enterprises in international environments strongly influenced by governments (Boddewyn and Brewer, 1994; Eden and Lenway, 2001; Grosse, 2005; Kobrin, 1987; Vernon, 1971). Savvy managers who develop a nuanced understanding of multinational–government relations can succeed in turning adversity into opportunity; for example, by using preemptive strategies that anticipate hosts' needs and signaling a willingness to tradeoff the multinational's objectives with those of the host (Encarnation and Vachani, 1985).

Even in 'normal' circumstances the bargain struck between multinational enterprises and governments evolves with time (Eden and Lenway, 2001; Kobrin, 1987; Vernon, 1971). Various factors associated with the multinational and its context affect the static and dynamic manifestations of bargaining success with host governments (Vachani, 1995). With added complexity resulting from shift in global governance, the texture of multinational–government relations is changing, and calls for reexamination of both market and nonmarket strategies (Boddewyn, 2003; Ghemawat and Vachani, 2002).

In Chapter 8, Pervez Ghauri and Xuefei Cao examine the evolution of relations between multinational enterprises and governments, which have become considerably more interdependent with time as multinationals have grown to control impressive shares of trade and technology transfer. How this interdependence is managed affects the distribution of value created from improved technology, communications and productivity. Levy and Newell (in Chapter 7) suggest extending the bilateral bargaining framework to include NGOs and international organizations. They see multinationals

deriving power from their technical expertise, which allows them to be involved in standard setting and gives them the strategic opportunity to frame the agenda in the development of multilateral regimes, and influence the level at which regulations are enforced. For example, in some industries multinationals may prefer regulation at the national level if they feel they lack influence at the international level (Levy and Egan, 1998). However, in market-enabling regimes, such as those for intellectual property rights, they suggest multinationals favor multilateral arrangements where NGOs' influence is weaker (Sell, 2002).

Focusing on infrastructure investments in Chapter 4, Rufín notes that, while developing countries eased restrictions on FDI inflow, liberalization did not appear to have improved multinational–host relations. Multinational enterprises were sought for their capital and technology, but with time the obsolescing bargain emerged across a range of countries. As local currency value declined, multinationals that had invested in infrastructure such as power generation, where revenues were local and costs in foreign currency, were more vulnerable than multinationals in extractive industries, where costs were local and revenues denominated in hard currency. Given consumers' inability to absorb higher prices for essential goods and services, historical suspicion of multinationals, and governments' need to win votes, multinationals found themselves facing gradual expropriation. As Rufín notes, in 2002, during the Argentinean economic crisis, the government suspended convertibility of the peso and simultaneously froze utility rates in violation of contracts with multinationals.

In Latin America today, even if reforms appear to welcome FDI, multinational enterprises risk being painted as exploitative during economic crises. Rufín recommends that reform programs provide for greater involvement of local companies in infrastructure management, which would help develop pro-reform stakeholders and strengthen local capital markets. Alluding to the example of Electridad de Caracas, he suggests firms can enhance legitimacy by sharing ownership with local stockholders (Gómez-Ibáñez, 2003). This echoes strategies adopted in the 1970s by some European and US multinational enterprises in India, which spread ownership among thousands of domestic shareholders while retaining management control. They not only preempted penalties placed on foreign firms, but succeeded in being treated on a par with local companies and creating new investment and diversification opportunities (Encarnation and Vachani, 1985).

Rufín suggests that multinational enterprises would be well served to seek greater legitimacy not just for themselves, but for the reform movement as a whole; for example, by pushing for greater transparency in regulatory decisions, rather than attempting to exploit opaque systems that

might promise benefits. Strategies for enhancing legitimacy may prove more effective than legal recourse when the environment is institutionally weak. Greater legitimacy, and support of local stakeholders, can blunt opportunistic demands to erode the bargain with which multinationals entered the host country. Alliances with NGOs can be critical in achieving these objectives.

Multinationals' Self-governance

Globalization has created concern about the state's inadequacy in addressing problems associated with globalization (Florini, 2003; Strange, 1996). Multinational enterprises are criticized for 'racing to the bottom', rushing to move operations to countries with lax labor and environmental standards (Spar and Yoffie, 2000). Environmental degradation can cause great harm through spread of disease and deprivation; for example, inappropriate use of fertilizers and pesticides can poison farmworkers (United Nations Development Programme, 2000). However, the impact of trade and foreign direct investment on a host country's environment is often difficult to assess. It can have positive effects in some parts of the value chain and negative effects elsewhere (United Nations Development Programme, 2005). For example, as China liberalized cotton imports, land under cotton cultivation shrank, reducing use of pesticides and fertilizers and helping the environment (United Nations Environment Programme, 2002). On the other hand, textile production grew with higher cotton imports, increasing water pollution and consumption. Export earnings increased but so did the cost of resource use and environmental damage. The effect on employment was negative in cotton cultivation, but positive in textile manufacture. With globalization, environmental standards in some countries and industries may rise as they are diffused through global value chains and as foreign customers' expectations induce companies to raise standards (Christmann and Taylor, 2001; Lundan, 2001).

Doubts about governments' inability, or unwillingness, to deter neglect of environmental, ethical and labor standards, by multinational enterprises and their suppliers, has led to NGOs and industry associations promoting development of standards that multinationals can adopt voluntarily. As Petra Christmann and Glen Taylor explain (in Chapter 9), this alternative system of governance 'intends to govern corporate conduct by substituting standards established by various stakeholders for government regulations, and independent auditors that certify compliance for government monitoring'.

The greater the participation of multinational enterprises in voluntary adoption of standards, the greater the chances that such standards can serve as credible governance mechanisms. Multinationals are motivated to

participate in the system to enhance their image in the eyes of important stakeholders, such as customers, shareholders and employees. The adoption of standards can be slowed by proliferation of multiple, competing, standards. Christmann and Taylor discuss three approaches to standard setting. The technical approach, typical of groups developing engineering codes, has produced standards such as ISO 9000 (for quality) and ISO 14000 (environmental management systems). The social responsibility approach, favored by advocacy NGOs, led to the SA 8000, an international workplace and human rights standard. The industry-centered approach, used by industry associations, attempts to bolster the reputation of industries with codes such as the 12 principles for socially responsible garment manufacture developed by the Worldwide Responsible Apparel Production (WRAP) organization.

Voluntary standards offer strategic options for multinationals, giving them an opportunity to enhance their reputation, segment consumer groups and price differentially, and, when adoption requires a certain level of resource commitment, create barriers for competitors poorly positioned to muster resources. Adoption of standards can be profitable, as variable costs are sometimes a fraction of the price premium selected customers can be charged. If coffee shops charge 15 cents extra per cappuccino made with 'fair trade' coffee, they get to keep 85 percent of the price premium, even while the supplier, such as Cafedirect, pays poor Guatemalan farmers a higher price for coffee beans that nearly doubles their income (Harford, 2005). Of course, some companies might choose not to charge customers a price premium and reap the benefit in good will or employee morale.

Post and Carroll (in Chapter 6) suggest that companies have the opportunity to build trust among stakeholders by endorsing broad sets of principles; for example, the CERES Principles for environmental conduct. Over 70 companies, including multinationals like Bank of America and Ford Motor Company, that have endorsed these principles, issue annual reports on their environmental performance and engage in discussions with relevant stakeholders to improve performance. Levy and Newell (in Chapter 7) observe that decision making tends to be quicker in 'private regimes', which also protect companies from state regulation, reduce costs, and open markets. States might also benefit from lower enforcement and other costs, which has led to private–public cooperation in some instances.

NGO Relations

The most enterprising multinational enterprises are poised to reach into the bottom of the pyramid, which comprises the poorest third of the world's population, to benefit these people as well as multinationals' shareholders

(Prahalad, 2005; Prahalad and Hammond, 2002). Some multinational enterprises have developed innovative programs to address their needs by aggregating demand, extending reach, cutting costs, and developing markets and opportunities where none seem to exist (Jain and Vachani, 2006). Their effectiveness depends on factors ranging from the nature of global institutions to the interactions between multinationals, governments and NGOs. This requires crafting innovative market and nonmarket strategies, including alliances with multiple stakeholders such as NGOs and governments. Such coalitions were advocated, for example, by the Digital Opportunity Task Force as a way to help disadvantaged segments gain better access to information and communication technologies, as discussed by Hart in Chapter 11.

As Doh suggests in Chapter 10, alliances with NGOs present multinational enterprises with both opportunities and challenges. NGOs can provide multinationals with scarce resources and enhance their legitimacy in the face of pressure from stakeholders demanding action to address environmental and other social concerns. But differences in NGOs and multinationals pertaining to mission, values, structure and leaderships' attitudes and experiences can pose serious problems. Doh presents a model that explains the propensity of multinationals to form alliances with NGOs. His model includes factors at multiple levels: country (for example, institutional development and culture), industry (for example, level of technology and regulation), organization (for example, financial performance and stakeholder orientation of companies, and sector and orientation of NGOs), and individual (for example, experience and education).

Hart (Chapter 11) notes that a multi-stakeholder approach can increase trust in governance mechanisms, which is enhanced when criteria for participant inclusion are clear. Not all stakeholders are enthused with the multi-stakeholder approach. In the Digital Opportunity Taskforce initiative, while NGOs were happy to be included, business representatives viewed NGOs as 'interlopers who not paid their dues' to justify their seat at the table. Government representatives were unsure whether business deserved access to international governance bodies, but if it did it was preferable to also include its critics.

Levy and Newell (Chapter 7) caution against generalizing multinational–NGO relations as adversarial. They note that multinational–NGO alliances can provide business with 'legitimacy, networks of contacts, and a degree of scientific expertise', while business can offer NGOs 'financial resources, global organizational reach, and the prospect of direct influence on the industrial practices'. Governments, facing resource constraints, also seek out collaborations with NGOs and multinational enterprises. They

suggest this does not mean the state's influence is declining; states may actually be expanding their regulatory reach using a network of relationships with companies, NGOs and intergovernmental agencies.

Competitiveness

Managers of multinational enterprises, as well as large and small domestic companies, need to appreciate how institutional changes affect competitiveness. For example, liberalizing environments can have an asymmetric effect on the sources of competitive advantage of different kinds of companies: multinational enterprises, large local companies, state-owned enterprises and cottage firms (Vachani, 1997). McGuire and Lawton (in Chapter 3) discuss how multinational enterprises can use the WTO to create conditions favorable for enhancing competitive advantage. This depends on multinationals' ability to mobilize globally, present coherent and feasible proposals for framing the rules of trade, investment and competition, and effectiveness in convincing diverse governments to accept those changes.

Small-firm competitiveness in developing countries

As Lou Anne Barclay describes in Chapter 12, exporters from small economies like Jamaica may be especially vulnerable to adverse effects of liberalization. Many small exporters tend to have low-cost, low-differentiation strategies, and rely on foreign distributors who wield power over them. Their competitive position is not particularly strong to begin with, and the enhanced local competition accompanying liberalization could have a serious adverse impact. Such environments also have some more competitive companies, which rely on differentiation strategies, and are better able to weather liberalization's effects.

Local institutional and infrastructural support is often inadequate to help small exporters survive. In Jamaica, for example, companies complain of challenges such as high energy and input costs, serious security issues, and poor information about market opportunities. Barclay reiterates the observation of previous researchers that the viability of local manufacturers in small liberalizing economies is critically dependent on concerted action by firms and the government (Wint, 2003).

The need to focus on the challenges faced by SMEs is not limited to developing countries. Imbalances in economic growth rates across countries have also forced developed-country SMEs to seek foreign markets; for example, the extended recessionary conditions in Japan resulted in SMEs investing abroad in increasing numbers, and facing serious challenges stemming from institutional and other factors (Vachani, 2005). The challenges

facing SMEs can be worsened by multinationals' maneuvres. Levy and Newell (in Chapter 7) note that multinationals might favor stricter regulations if asymmetries in the ability of large and small companies to deal with regulations put SMEs at a significant competitive disadvantage, as is reported to have happened in the promotion of ISO 14001 standards (Clapp, 1998).

Leveraging Country Governance Quality

Companies in home environments with weak governance standards suffer a disadvantage in capital markets, which place greater confidence in investment opportunities that assure high governance standards. Companies could signal higher adherence to governance standards by cross-listing their securities in countries with high governance standards. Paul Vaaler and Burkhard Schrage (in Chapter 13) test whether the extent of US cross-listing by foreign companies can be explained by home country governance quality (HCGQ). They find an inverse relationship between extent of US cross-listing and HCGQ only for emerging market countries, and not for home countries at lower or higher ends of the governance quality scale, presumably because the costs of cross-listing are perceived to exceed benefits at the two ends.

CONCLUSION

There are significant transformations occurring in global governance with evolution in the role of intergovernmental organizations, like the WTO, greater NGO activism, and change in relations between multinational enterprises, governments, NGOs and intergovernmental organizations. It has become especially important for IB researchers and managers to understand the implications of these changes for various stakeholders.

The forces transforming global governance are unlikely to abate. For example, as the information revolution has made it possible for multinational enterprises to implement radical cost savings through 'offshoring', by reconfiguring their value chains, the asymmetric effects on stockholders, consumers, and workers in different countries have led to protectionist calls for government action to change the institutional environment for trade in services. This has consequences for multinational enterprises, which are challenged as it is by the need to formulate offshoring strategies to effectively align their resources with opportunities (Foulkes *et al.*, 2005). It also has implications for the workforce in home and host countries (Foulkes *et al.*, 2006; Mann, 2005).

Organization of the Book

The following chapters include several themes that have been introduced in this chapter. While the chapter is organized into two broad sections, one on transformations in governance and the other on implications, the following chapters are not similarly grouped as they cut across both topics. However, they differ in degree of emphasis. The early chapters have a greater emphasis on shifts in governance and the later ones on implications.

NOTES

1. There are many definitions of globalization. Their scope is limited by researchers, depending on their perspective. For example, Bhagwati (2004: 1) focuses on *economic* globalization and defines it as constituting 'integration of national economies into the international economy through trade, direct foreign investment (by corporations and multinationals), short-term capital flows, international flows of workers and humanity generally, and flows of technology'. Prakash and Hart (2000: 2) define economic globalization as 'the increasing integration of input, factor and final product markets coupled with the increasing salience of multinational enterprises' (MNEs) cross-national value-chain networks'.
2. While some researchers have found a correlation between openness and growth (for example, Dollar, 1992), there is debate about causality, and concern about identification issues; for example, it is difficult to identify if growth results from openness or stronger institutions, as liberalization programs often promote both simultaneously.
3. The commission was set up in 1992 at the initiative of former West German Chancellor, Willy Brandt. It was co-chaired by Ingvar Carlsson (former Swedish Prime Minister) and Shridath Ramphal (former Commonwealth Secretary General) and had 28 members from around the world who served in their individual capacity. Its aim was 'to contribute to the improvement of global governance' (Commission on Global Governance, 1995: 368) at a time when 'global society faced the forces of both integration and division' (366).
4. The WTO has a broader mandate than the GATT, extending to agricultural liberalization, services, investment, and intellectual property rights. It also has a dispute settlement process with more teeth, providing greater coercive powers to resolve disagreements stemming from national laws.
5. There is debate about the pros and cons of bilateral and regional trade agreements, which run counter to the spirit of the WTO's most-favored-nation principle. See, for example, discussion in Schott (2004).
6. Teegen *et al*. (2004: 466) define 'social purpose' NGOs as 'private, not-for-profit organizations that aim to serve particular societal interests by focusing advocacy and/or operational efforts on social, political and economic goals, including equity, education, health, environmental protection and human rights'.
7. Methylcyclopentadienyl manganese tricarbonyl.
8. These NGOs were the Center for International Environmental Law, the Community Nutrition Institute, the Defenders of Wildlife, Friends of the Earth, Greenpeace, the Institute for Agriculture and Trade Policy, the National Wildlife Federation, the Sierra Club and the World Wildlife Fund (Graham, 2000: 40). Other powerful organizations, including the AFL-CIO, United Steelworkers of America, Oxfam and Amnesty International, joined the opposition movement (Kobrin, 1998).
9. IB research that has noted the impact of NGOs on international business includes Doh and Teegen (2003); Ghemawat and Vachani (2002); Kobrin (1998); Teegen *et al*., (2004).

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2. The globalization of competition policy

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The rapid globalization of business has propelled competition policy to a high place on the international governance agenda. WTO ministerial discussions in 1996 made trade and competition policy one of the four 'Singapore Issues' demanding urgent attention by those charting the course of international economic cooperation (Hoekman and Kostecki, 2001: 4). The case for greater attention to competition in individual markets appeared to grow along with the rapidly integrating world economy. Formal trade barriers have been lowered multilaterally or negotiated completely away in a large part of international trade. Those who bargained for lowered trade barriers did so with the expectation that foreign goods – and some services as well – would otherwise be available in the newly opened markets on essentially the same terms as those of local provenance. The substitution of private restraints for official barriers clearly frustrates those expectations. This is one kind of competition policy issue in the current global economy: *nationalism*. In some cases this nationalism rests on the same obvious official favoritism that underlies traditional trade protection, but some nationalism may be subtler and indeed may never actually be provable. As an example, many point to the advantage-blunting conditions that the EU successfully set on Boeing's acquisition of McDonnell-Douglas in 1997.

Another dimension of international competition policy made frequent headlines in the 1990s. Even very experienced business people (particularly in the United States) were surprised by the huge volume of cartel behavior uncovered by US, EU and other authorities. Among many other firms, US-based Archer-Daniels Midland was fined $100 million for price-fixing in a lysine cartel and Swiss-based Hoffman LaRoche $500 million for participation in six global cartels for bulk vitamins (Connor, 2004: 254–5). Such cartel behavior is a violation of nearly all national competition laws in the hundred or so jurisdictions that now have them. This problem can be called *global private abuse*.

A third competition policy problem area is illustrated by the current conflict between Microsoft and the European Commission over just what

may be sold by Microsoft under what conditions. This might be called *strategic constraint*. Such constraint may vary from the requirements that a firm modify its sales or distribution practices to meet the varying legal requirements of particular markets to the far more serious threat that one jurisdiction may effectively veto a multinational firm's global strategic choices, such as the EU's thwarting of General Electric's acquisition of Honeywell in 2001.

As international business surveys its policy environment, the competition policy practices of various states and attempts by those states to coordinate, harmonize, or centralize their content and enforcement appear in three broad clusters with blurred and overlapping bases: issues connected with government practices that advantage firms of a certain nationality, issues related to business practices that abuse the competitive system in global markets, and issues connected with constraints on a multinational firm's competitive strategy.[1]

WHAT IS COMPETITION POLICY?

Some writers use the term 'competition policy' to refer to virtually all government actions that aim to assist or retard firms in their market endeavors at home or abroad. This would include, among many concerns, much of trade policy, and the usage is highly defensible.[2] Nonetheless, to provide a clearer focus, the term will be used here synonymously with what Americans call 'the antitrust laws', defined by Dennis Carlton and Jeffrey Perloff as intended to 'limit the market power exercised by firms and to limit how firms compete with each other' (Carlton and Perloff, 2000: 601).

A few simple ideas underlie most of modern policy to promote competition. In perfect competition, producers are 'price takers' who simply extend their production until the cost of the last unit sold (including a competitive rate of return on the capital employed) equals the market price for which it is exchanged. If demand changes, the number of firms participating in the market changes as well. Imperfect markets in which firms sell identical or nearly identical goods must have characteristics that prevent newcomers from competing (excess) profits away.[3] Whatever those characteristics are, they typically allow incumbent firms a sufficient share of the market so that each firm operating independently faces a downward-sloping demand curve. Depending on the interaction among the firms, substantial market shares usually yield outcomes with at least some (excess) profit. Where the output of a seller differs non-negligibly from that of others, the process is roughly similar.

Gifford and Kudrle (2002, 2003) have argued that virtually all competition policy – construed as policy to direct competition and not necessarily

to promote it – over the past century or so can be understood in terms of several goals, not always consciously articulated or pursued by those in charge of drafting, enforcing, or adjudicating the law. One strand appears to privilege the protection of competitors over the promotion of the competitive process. Remaining border controls on the entry of foreign goods and firms do this, but so too do various laws that place roadblocks in the path of more efficient domestic firms in their market struggles with weaker incumbents. Another goal, sometimes difficult to distinguish in practice from the previous one, is the preservation of market rivalry. But while the first goal, when clearly identified, has typically inspired derision from economists for nearly two centuries, the second would have been widely accepted in the United States until a few decades ago. It could be summarized as 'Competition is the process and many competing firms is the policy objective' largely because such a strategy was believed to be the most reliable approach to the ultimate goal of consumer welfare.

Not until the so called 'antitrust revolution' based on Chicago School economics in the 1970s did US policy move away from a prejudice against the claim that successful firms were eliminating their rivals because of superior products or efficiency rather than antisocial behavior. That revolution, largely confined to the United States, shifted the focus of both policy administrators and the courts towards the goal of what is usually called 'consumer welfare', the maximization of consumer surplus. In short, what matters is not what the market looks like but how it functions. Specifically, if one structure appears to deliver higher quality goods at lower prices than another, it should be allowed to develop even if the number of competitors becomes quite small. This goal might be summarized as 'Competition is the process; consumer welfare is the goal.'

For many lawyers and business people, the goal just stated would appear to be the obvious resting point for sound policy, but most economists would demur. If the merger of two firms promises to lower costs but also to increase market power considerably, each unit of the good sold might reflect a smaller amount of society's resources but might still be sold to purchasers at higher price. Inefficiency results when consumers are unable to expand their purchases until price matches the resource cost of a good, but if the value of that inefficiency is overbalanced by the value of resource saving, the total welfare criterion for an economic change is satisfied. The goal of competition policy using this criterion is simply to make the pie as big as possible without attention to who gets pieces of various sizes. The rationale for inattention to distribution rests on essentially the same ground as in traditional cost–benefit analysis: the resource savings are there to compensate market losers if society chooses to do so. Cost–benefit analysis in government decision making typically rests on the hope that a set of

projects will approximately match payers and beneficiaries. In competition policy, it might be assumed that price rises would be randomly distributed across purchasers and that the tax system could be adjusted for any non-negligible increase in the overall rate of return on capital from adopting the efficiency principle. Here, 'Competition is the process, efficiency is the goal.'

There is evidence that this 'total surplus' principle applied to competition policy may be one that only an economist can love. The recent retreat of Canadian policy from essentially this criterion attests to its failure to capture popular support (*Commissioner of Competition* v. *Superior Propane*, 2001; Ross, 1997). It should be noted immediately that very few actual competition policy cases appear to turn on the distinction between consumer and total surplus, yet the difference looms large at the level of principle.[4]

COMPETITION POLICY PROBLEMS AND THEIR SERIOUSNESS

The literature reveals considerable agreement about what scholars and policymakers regard as the major international competition policy problems. Cartels are probably the major example of private abuse.[5] Most states with any competition policy place severe legal restrictions on firm collusion on prices and other conditions of sale. Where such behavior is governed by an explicit agreement, a cartel results, and cartels appear to play a significant role in the world economy. When the US Justice Department tried three lysine cases in the mid-1990s, it had been decades since a global cartel had been nailed, yet, between 1998 and 2001, more than $2 billion was collected in criminal pricing fines in the US, and the EU collected 1.84 billion Euros in fines in 2001 alone (Connor, 2004: 253, 255). Despite these numbers, one expert has estimated that the current chances of a cartel being detected is between 10 and 20 percent if it operates in Europe or the United States, and it is negligible elsewhere (Connor, 2004: 273).

Nationalism also impedes competition. Nationalist policies restrict trade, but to an extent that varies widely by country. They also restrict the ability of firms to enter and operate in a market on the same terms as domestic firms. These problems appear to be ones of trade and investment rather than competition policy, but this is a question of language and not of logic. For most industries in most countries, a full embrace of global sources of supply would be the most effective way of assuring minimum prices for domestic buyers. Although tariffs in most states are lower now than at any previous time in modern history, much trade is still restricted. Additionally, foreign direct investment is banned from many sectors in nearly all countries and is sometimes subject to case-by-case review. Finally,

even where barriers to trade have been removed, discretionary 'administered' protection mechanisms exist in virtually every country to provide at least temporary respite from global competition-beleaguered local firms.[6]

Many observers have pointed out that the laws restricting trade (both traditional barriers and schemes based on administered trade) as well as most restrictions on foreign direct investment are based on a logic that turns the goal of enlightened competition policy on its head. Instead of maintaining a steady focus on consumer welfare (even when in some cases allowing prices to go up would actually be associated with greater national income) these laws routinely give essentially no weight to consumer interests and all weight to producer interests. For reasons that cannot be explored here, dominant political opinion typically sees foreign competition as less legitimate than that stemming from domestic sources. This analytically indefensible bias is worldwide, and much remaining protection, including administered protection, has robust political support. Indeed, this is the major problem facing those attempting to restart the Doha Round. Both rich and poor countries as groups face great difficulty assembling concessions that can withstand a domestic political test (Schott, 2004: 2). So political perception must be added to common parlance as a barrier to looking at trade and investment barriers as 'competition policy'.

Some national distribution systems have proved largely impervious to foreign penetration, and this is widely regarded as an important issue of competition policy. The minor role played by foreign goods and services in many sectors of the Japanese economy, for example, is assigned to some combination of controlled distributorships, exclusive dealing, and land use controls that discourage the use of large retail outlets. Similar complaints have been made about the substantial Korean market and many others. Would-be foreign sellers seek to replace apparent official acquiescence in restrictive practices with a vigorous attack and favor outside pressure to gain that outcome. In fact, any official connivance in the use of such barriers would constitute 'nullification and impairment' of trade concessions made under the GATT, Article XXIV. Kodak attempted to make such a case against Japan's Fuji in the mid-1990s, but it failed.[7]

Finally, states present differing constraints on firm behavior that sometimes thwart global strategy. Each unit of the Triad, the US, the EU and Japan, now makes extraterritorial claims, and if only one major state disapproves of a merger, the more restrictive preference prevails.[8] The most important and best known of these conflicts have involved the US and the EU, but, in addition, scores of other states now use extraterritorial claims to review mergers under their competition policies and the expense, delay and uncertainty of these filings have generated considerable interest in reform (Wood, 2004: 183).[9]

THREE APPROACHES FORWARD: COOPERATION, HARMONIZATION, CENTRALIZATION

This chapter will examine three major approaches for dealing with outstanding competition policy problems. The categories present somewhat fuzzy boundaries, and they are obviously not mutually exclusive. Cooperation stresses communication, consultation, and information sharing. Harmonization considers convergent policy movement among jurisdictions, while centralization looks at what a formal multinational structure could add to the effectiveness of the policy regime, either now or in the future.

This chapter concludes that the impulse for international action in the competition policy area should, and likely will, move principally through greater cooperation with increasing harmonization over time. In fact, a high priority on a minimum international agreement seems likely to squander energy with little likely payout.

THE VARIETY OF COMPETITION POLICIES

As business confronts competition laws around the world, problems relating to the variety of practice almost certainly dominate all others. Any consideration of the prospects for global governance must first establish the extent of current policy harmony and the pace and direction of any current harmonization. That vantage point can provide perspective on the likely content of greater cooperation, the most promising areas for more determined harmonization, and the utility of any central governance.

Prior to World War II, only the United States and Canada had competition policies that resemble those of today. Germany and Japan gained such policies during the postwar occupation, and the EEC drew on German experience as well as US practice in the competition sections of the Treaty of Rome. Most poor countries first considered competition policy as means of controlling foreign firms as part of the 'New International Economic Order' of the 1970s. As *dirigisme* gave way to liberalization in the 1980s and 1990s, the UNCTAD assistance that was first sought to bring MNCs to heel was redirected to the devising of policies to direct competition more broadly in the domestic market.[10] In addition, virtually all of the political entities that escaped dominance from the Soviet Union in the 1980s soon developed competition policies (Kovacic, 1998). By the early years of the new century, over a hundred competition policy regimes were in place (von Finckenstein, 2002b: 1).

Despite the rich variety of global competition policy development, this chapter will focus on the Triad for three major reasons. First, the three areas

account for over half of all world output. Second, each has a competition policy that differs considerably from the other two. Finally, no other established competition policy of a substantial state differs radically from some combination of the features of these three jurisdictions.[11]

Policy Concerns

At a sufficient level of abstraction Triad competition policies present some major similarities. All deal in one way or another with the three major concerns that have animated modern competition policy: *collusion* among firms that would allow 'monopoloid' behavior in making product and pricing decisions, *amalgamation* that would create such power directly, and *exclusion*, which refers to firm behavior designed to disadvantage other participants or to deter entrants.

Most commentators find it remarkable that the Sherman Act of 1890 has remained the backbone of American antitrust. It passed as a largely atheoretical reaction to the impact of big business on small firms and particularly on agriculturalists in the West (Scherer and Ross, 1990: 12), but was fortuitously written with broad and open-textured language that has allowed for continual refinement (Gifford and Kudrle, 2003: 755). Section 1 aims at collusion: the banning of cartels and other forms of price fixing, while Section 2 forbids the monopolization of a market by exclusion or amalgamation. The latter could include, inter alia, various actions to thwart entry by new competitors and predatory behavior towards established competitors or a permanent combination with them by takeover or merger. Other suspect single firm practices along with a more explicit treatment of mergers were spelled out in the Clayton Act of 1914 (which has seen some subsequent amendment) (Fox and Pitofsky, 1997).

Sections 81 and 82 of the Treaty of Rome and the Merger Regulation of 1989 nominally include so many of the same concerns as US law that many reading them for the first time infer that they were more closely modeled on the US experience than careful scholarship suggests they actually were (Gerber, 1998: 337–99). EEC and later EU policy attacked collusion such as price fixing, exclusion through the 'abuse of a dominant position' and amalgamation through merger.[12]

The immediate political sources of European competition policy differ dramatically from those of the US; instead of populist suspicion of big business, the central motive was the forging of a unified market. And EU policy largely filled a vacuum rather than superseding or complementing established national practice. At the signing of the Treaty of Rome in 1954, only Germany had a well-developed national competition law. It had been devised as part of the postwar political and economic establishment's

rejection of the cartelized world of the National Socialists. For most of Europe up to that time, antitrust had appeared too bourgeois for much of the left and too liberal for much of the right to generate a serious and consistent national effort.

As in Germany, Japanese competition policy was introduced during the occupation, but with no indigenous credentials.[13] The Antimonopoly Law of 1947 resulted from negotiations between Japanese and Occupation officials; it banned holding companies and cartels as well as forbidding many collusive practices. Although the law therefore appeared to deal with collusion and exclusion, the reality was otherwise. The Fair Trade Commission of Japan pursued its first criminal price fixing case in 1974, and the Ministry of Trade and Industry provided much administrative guidance over most of the postwar period through officially recognized cartels.[14]

The four large Zaibatsu that dominated the prewar economy were abolished shortly after the Japanese defeat, but to preserve Japanese strength for the gathering Cold War the US soon shelved plans to continue deconcentration by dismembering hundreds of other major firms (Gifford and Kudrle, 2002: 235). Moreover, no mergers were blocked for more than 20 years after 1969. The merger guidelines issued in 1997 signaled a possible new departure (Rosenthal and Matsushita, 1997: 322–3).

Both EU and Japanese competition policies contain language that aims to control collusion, amalgamation, and exclusion, yet the record suggests great differences in the objectives actually pursued by authorities. In sharp contrast to Japan, the EU, even quite recently, has often banned mergers that would have been approved in the US. This is often interpreted as at least partial adherence to the rivalry view of competition policy that the US abandoned the 1970s. The contrast between Japan and Europe also looms in 'vertical restraints': agreements between manufacturers and those bringing the product to the final purchaser. Europe moved less rapidly and less far than the US did to abandon the view, generally held as late as the mid-1970s, that any such restrictions served to support an umbrella over the final sales price.[15] Again in contrast, Japan is dominated by highly restrictive distributive practices that have gone largely untouched by the authorities despite the success of the United States in persuading the Fair Trade Commission of Japan to produce an impressive-looking set of guidelines on vertical restrictions in 1991 as a part of the 'Structural Impediments Initiative' (Matsushita, 1997: 184–92).

Patterns of Enforcement

Beyond policies towards specific market practices, the French antitrust expert Frédéric Jenny has suggested three major patterns of antitrust

enforcement. Most national practice falls into one category far more than the other two (Jenny, 2003: 985). Despite its long history, the US system remains nearly unique in lodging most enforcement with the civil and criminal courts. Europe's basic practice has been far more influential: administrative rather than criminal sanctions are enforced by an independent body whose decisions can be appealed through the courts. Finally, Japan follows the Asian model by lodging enforcement with the executive and relying heavily on warnings rather than immediate sanctions.

Outside of Asia, EU policy in both content and administration has been more widely imitated by countries adopting competition policies for the first time than has the US system (Foster, 2001). This probably results from some combination of the appeal of tighter direct political control, more emphasis on cooperation than conflict, and greater concern for the welfare of market participants other than the final purchaser.

The US system contrasts with virtually all others in a least four major dimensions. First, major changes in policy direction (towards both greater stringency and greater tolerance) can actually be traced to scholarship. Within a setting of largely unaltered basic law, the courts, the administering agencies, expert witnesses and commentators have interacted to drive policy. Thus US policy has developed with greater political insulation than has been the case almost anywhere else. In fact, antitrust policy change has more closely tracked intellectual argument and evidence with less partisan politics than perhaps any other major area of US public policy. In Europe and Japan, the effective policy, largely based on written law and administered largely by political and bureaucratic actors, has innovated largely by imitating the US.

Second, the right of private parties to sue for triple damages under the Sherman Act means that the actual size of American competition enforcement is much larger than the combined size of the Antitrust Division and the Federal Trade Commission (which now share enforcement through cooperative non-duplication) would suggest. Private cases were 93 percent of all antitrust cases brought before federal district courts between 1970 and 1989 (Viscusi *et al*, 1995: 65).[16] Third, largely as a result of the first two factors, competition law and policy loom large in the curricula and research agendas of American law, business and public policy schools, and economics department. This academic activity, together with the size of the sector and its relative sequestration from partisan politics, has helped create and sustain the United States as the leader in argument and evidence about competition policy. Finally, the US treats most antitrust matters as criminal violations, and individuals are sometimes charged with felonies, although imprisonment is rare. This severity of penalty puts the US at the most stringent end of punishment, a difference that greatly complicates

international cooperation. For example, individuals cannot be sanctioned for competition law violations under EU law (although they may be under national statutes: see Evenett *et al*., 2001: 19).

HARMONY: LEVEL AND CHANGE

Mario Monti, the EU Competition Commissioner until late 2004, made numerous statements stressing strong and growing competition commonalities across the Atlantic (Monti, 2001a, 2001b, 2002a, 2002b). Gifford and Kudrle (2002, 2003) have concluded, however, that such convergence remains largely aspirational. This can be seen most clearly in two major competition policy areas, mergers and vertical restraints. The former controls amalgamation, and the latter strongly affects both collusion and exclusion.

The differences in merger policy appear in two cases that created headlines on both sides of the Atlantic. When Boeing proposed to acquire McDonnell-Douglas, US authorities regarded the latter as a 'failing firm' and not a viable competitor; hence the acquisition gained easy approval. In sharp contrast, the EU Commission, exercising extraterritorial claims based on effects in the European market, insisted that Boeing void long-term purchase contracts with several major airlines as a *quid pro quo* for approval (among several demands).

Many observers, both then and since, saw the EU conditions as an attempt to bolster the fortunes of Boeing's EU rival, Airbus, but the logic rather than the motive of the action demands attention here. Boeing's argument was that the contracts, which were supported by the airline purchasers, gave Boeing an advantage based on real economic savings, that is greater efficiency (Gifford and Sullivan, 2000). In 2001, the Commission blocked the acquisition of Honeywell by General Electric, once again after US authorities had cleared it, because the ability to combine avionics and propulsion units in sales to airlines appeared to promise lower prices that would disadvantage competing sellers.[17] To an outsider these cases look more like a 'rivalry' than a 'consumer surplus' standard. They bring to mind proposed US mergers in the 1960s and 1970s when merging firms went out of their way to deny efficiencies that might threaten competitors and hence create trouble in the courts.[18]

Japan has recently clarified what had been the least easily interpreted merger guidelines of the Triad. Rosenthal and Matsushita concluded that the Merger Guidelines of 1997 intended greater stringency than practiced in some other national markets and that this is appropriate given the greater difficulty of entry in Japan, partly due to tightly controlled distribution

channels (Rosenthal and Matsushita, 1997: 323). There have been so few known blocked mergers in Japan, however, that the actual criteria employed and the weight given to them cannot be known. A recent Tokyo law firm report notes that in controlling mergers 'the JFTC may (and does) take into consideration relevant public and industrial policy issues. Among the various government Ministries, it is generally considered that the Ministry of Economy Trade and Industry (METI) has a strong influence over competition policy' (Ezaki *et al*., 2004).

According to the 1997 Guidelines, an efficiency defense will count only if the merger is 'expected to promote increased competition' (Gifford and Kudrle, 2002: 237). While this could be interpreted as permission only for weak firms to increase their potential to provide more serious rivalry to market leaders, this is not the likely intention in a polity traditionally lax on mergers. Instead, the Guidelines appear to have been consistent with the thinking associated with US and EU practice: the higher the level of concentration achieved by the merger, the higher must be the promise of efficiencies to avoid a price increase.[19] This interpretation is consistent with the revised Guidelines released in the summer of 2004. They embrace the American approach to market definition and, in general, quite closely parallel their US counterpart (Amemiya, 2004: 1–2).[20]

Approaches to distribution control also differ sharply among the three large jurisdictions. A sharp change in US policy can be seen in two Supreme Court cases. *Schwinn* of 1967, banned exclusive territories, and *Sylvania*, only a decade later, reversed *Schwinn* and credited efficiency motives for vertical restrictions (Carlton and Perloff, 2000: 638–9). Since that time, most US courts have given a green light to virtually all distribution agreements freely struck by producers and resellers, leading to what some have judged to be the least restrictive vertical legal regime in the world (Wood, 2004: 184).

In Europe, the situation remains sharply different from that in the US. Those writing and administering the competition policy sections of the original Treaty of Rome saw tightly controlled distribution, especially at the national level, as a threat to the *raison d'être* for the entire enterprise: a common market. National distributorships were banned and, more generally, the ability of goods to reach final buyers through a variety of channels was favored. This was based partly on the notion of a right of maximum commercial participation that one sees elsewhere in EU competition policy.[21] And EU distribution cases reveal another pervasive European thread: the idea of 'fairness' as the absence of commercial surprise and disappointment. Once a reseller becomes well established, the producer's right to alter the relation diminishes.

The operating presumption in the EU remains that any diminished welfare of other firms should weigh negatively unless the strategy of the

firm in question unambiguously increases consumer welfare. In the United States the welfare of other firms is generally not an issue unless harming them also harms the consumer. This apparently minor difference in approach can make substantial differences in policy. And it links EU policy not just to rivalry but to producer protection as well.

Japan has a global reputation for impenetrable distribution, and part of this stems from the complex pattern of retailing that has historically exceeded even that of Europe and has only recently begun substantially changing in the direction of larger outlets. Japan's trading partners found market entry so difficult that the United States in the late 1980s launched the 'Structural Impediments Initiative' that resulted, among other outcomes, in a strengthening of the Anti-Monopoly Law by the promulgation of distribution guidelines. These guidelines put virtually all of the major vertical restrictions, including resale price maintenance and all forms of exclusivity, under a burden to demonstrate to the Fair Trade Commission of Japan that they neither unduly hinder entrants nor raise final prices. Yet, as a leading commentator notes, 'the relationship between enterprises is more sociological than contractual. Challenges to such sociological entities under the AML would be difficult' (Matsushita, 1997: 192).[22] Any second-guessing of Japanese market supervision by foreigners would presumably be more difficult still.

Although differences in the structure of the Japanese economy may justify some special policy controls on vertical restrictions from the standpoint of the welfare of the final consumer, much of the US pressure on Japan appears somewhat akin to the European penchant for promoting a right of participation. The high tide of business pressure on the US government to assist in penetration of Japan seems to have passed, perhaps owing to Japan's economic stagnation in recent years as well as the success of some US firms. Overall, however, US complaints about Japan and Europe tend to differ dramatically. US firms and officials complain about the extent to which firm strategies are constrained by the stringency of EU rules. In Japan, they complain that the law insufficiently controls the distribution strategies of incumbent Japanese firms. After the Structural Impediments Initiative successfully pressured Japan for legal changes that spelled out the limits of incumbent control without much subsequent change in foreign penetration, the Americans often asserted that the new rules were not really being enforced.

Differing merger standards pose the most innately intractable problem for international business because the major jurisdiction with the most stringent regulation will prevail, regardless of the strength of the merging firm's case and the possible efficiencies and lower prices that might be experienced all over the world. And this presents an area in which only the

really large players can veto mergers with a truly 'global reach'. If Australia or Korea alone objected to a merger and were simply ignored, their only recourse would be an attempt to collect fines from the offending firms, a move that would predictably lead to the withdrawal of firm assets and sales from the penalizing jurisdiction. This action, in turn, would almost certainly leave that jurisdiction worse off than before, destroying the credibility of the threat. Many economists would doubt that this apparent inequity is worth trying to solve, however. From a global welfare point of view, it is hard to construct a plausible merger scenario with net global losses that would not be scotched by one or more of the US, the EU or Japan. It is much more likely that one of the three will block a merger with widespread benefits.

Disagreements about specific merger cases among various jurisdictions could be clarified by putting them into a common framework. Well-trained analysts can come to different conclusions in at least four major areas: what, when, for whom, and with what degree of certainty. The outcome of allowing or forbidding some market practice or structural change in terms of prices and quantities may be subject to differing best estimates; there may be disagreement about when those changes will take place; gainers and losers may have their outcomes differentially weighted; and the best point estimates of outcomes may be surrounded by varying levels of subjective uncertainty.

A new analytic packaging might appear to accomplish little, but reams of confused findings and argument from multiple jurisdictions suggest otherwise. Some means of clarifying how various jurisdictions come to different conclusions (different short-term scenarios, different distributional preferences, different forecasts, and different treatments of uncertainty) could help sort out why overall judgments on a particular case diverge between or among authorities. A series of case comparisons could greatly clarify similarities and differences among national practices (Gifford and Kudrle, 2004).

Despite the persistent differences within the Triad just noted, there are nonetheless some signs of convergence of both Europe and Japan with the United States. Both now employ a market definition based on demand and production substitution drawn from the US Merger Guidelines first promulgated in 1982. And both have considerably increased not only the size of their competition enforcement staffs, but, far more importantly for long-run compatibility, the number of highly qualified economists employed in considering all aspects of enforcement (Ezaki *et al.*, 2004). In addition, the EU has introduced the concept of 'shared dominance' as its characterization of oligopoly to replace the previous dichotomy between 'dominant' firms and all others.[23] The Japanese stagnation of the 1990s shook

confidence in the traditional concept of a 'harmonization culture' and increased the appeal of the 'competition culture' championed by the Japan Fair Trade Commission for a part (though perhaps not a majority part) of the Japanese business community (Uesugi, 2004: 2). The JFTC is now part of the Cabinet Office rather than farther down in the bureaucracy in the Ministry of General Affairs, a change consistent with Prime Minister Koizumi's slogan: 'No growth without structural reform.' According to the Secretary General of the Fair Trade Commission of Japan, 'Enhancement of competition policy is the core of [the] Koizumi structural reform' (Uesugi, 2004: 1,2).

COOPERATION

International antitrust cooperation has deep roots and has blossomed into a profusion of activity in the last few years. Perhaps the most useful distinction is between case-specific and policy cooperation.

Case-specific cooperation involves varying kinds of information sharing and the gaining of advice relevant to a specific matter under review in one or more jurisdictions. Such cooperation certainly grew substantially in the 1990s, but the precise extent is difficult to track because so much cooperation has been informal (Jenny, 2003).

The United States signed an agreement with the EU in 1991 that provided for positive comity in competition policy. This means that each jurisdiction is expected to make serious commitments to assist the other in gathering information of interest to the requesting party even if the activity under review is not offensive to the cooperating party. By 2000, there had been only one case handled under the auspices of the agreement. On the other hand, informal cooperation outside of the agreement grew substantially over the same period, particularly on merger and cartel cases of interest to both jurisdictions. The United States also has bilateral agreements for formal cooperation with Canada and Japan and a very thorough 'International Enforcement Agreement' with Australia. But many jurisdictions shun formal ties with the US because of its criminal provisions and treble damages in civil cases. The EU and Japan struck an agreement in 2000 (Kyodo News Service, 2000).

Most authorities agree that informal consultation between any two states rather than the exact nature of any agreement on competition has been central to the growth of cooperation. In particular, it appears that one state can be extremely helpful to the efforts of another without revealing confidential information. While enforcers may have political motives for putting the most positive face on extent and quality of current cooperation

and it may be difficult to pinpoint cases in which cooperation was clearly necessary for the resolution of a case (Jenny, 2003: 988), there seems little reason to doubt that the swelling sea of contact offers many advantages and few serious drawbacks.

The other major strand of cooperation concerns general policy, and case-specific linkages obviously contribute to such a broader understanding as well. The OECD has sponsored competition policy discussion and review for decades. As in other major policy areas, it attempts to bring high-income country competition policy officials together to share experiences. Frédéric Jenny has pointed out that the OECD's practices in competition policy shifted in the 1990s from an evaluation of various countries' efforts to careful and non-judgmental accounts of varying practice on a wide variety of competition topics. This apparently minimized friction and greatly increased mutual learning (Jenny, 2003: 987). Thirty-nine major 'Roundtables on Competition Policy' were held between 1996 and 2002 (OECD, 2002: 3).

Another cooperative institution developed in the new millennium to increase the international sharing of competition policy information: the International Competition Network. The Network was formed following a recommendation by the US International Competition Policy Advisory Committee (IPAC), a group set up by the US Justice Department to consider international competition problems (Janow, 2000). It was specifically asked to consider multijurisdictional merger review, the trade–competition interface, and the future of international competition agency cooperation. The EU Commission also officially endorsed the founding of the ICN (von Finckenstein, 2002b: 2).

Those establishing the ICN in 2001 were particularly anxious to distinguish the new group from the OECD. The differences are considerable. The most obvious is focus: the ICN is 'all competition all the time' (von Finckenstein, 2002a: 3). In addition, while the OECD is an intergovernmental organization of mainly rich countries, the ICN is open on equal terms to all states with functioning competition agencies; non-governmental participation in OECD activities is by invitation, whereas the ICN embraces legal, academic, consumer and business participation; the OECD is funded by governments and has a permanent secretariat while the ICN has neither secretariat nor permanent financing but is mainly manifest as a website; the OECD makes recommendations while the ICN aims only to produce 'best practice' proposals and reports; the OECD's imprimatur creates some member obligation while the ICN aims only at peer pressure (von Finckenstein, 2002a, 2002b, 2003).

Those devising the ICN see it as a complement rather than a competitor for the OECD. Konrad von Finckenstein, the Canadian jurist who chaired

the ICN Steering Group during the organization's first two years and served as its chief spokesman simultaneously chaired the OECD's working party on International Cooperation. The WTO, UNCTAD and the OECD, along with private practitioners play a role as non-governmental advisors in preparing work products on an equal footing with other participants (von Finckenstein, 2002b).

Although the 'ultimate goal is to facilitate procedural and substantive convergence', the product of the ICN so far is almost entirely informational and procedural.[24] And in these areas, the ICN has sponsored a large amount of substantive activity. Much exchange and discussion has aimed to clarify, coordinate and lower the cost of multijurisdictional merger review. And, reflecting the universal character of the organization, much attention has been devoted to 'competition advocacy', that is making the case for the use of markets among government decisionmakers, including many from newly liberalized low-income countries. Considerable attention has been paid to 'capacity building' in developing countries (von Finckenstein, 2003).

The volume and quality of ICN output so far bodes well, but nothing done yet shows promise of bringing substantive policy convergence. And part of this problem grows naturally from the very nature of the network. As noted, the basic competition laws of many states constrain convergence, and the US allows more enforcement autonomy than is found elsewhere. The ICN's discussion paper on the analysis of mergers illustrates the situation: it is far more skeptical of non-economic criteria for merger control than is the public policy of many members of the ICN, yet other considerations are often written into law (International Competition Network, 2002). The true significance of the ICN's 'competition advocacy' becomes clear from such examples. One can imagine that the ICN will develop ever-greater commonality among global competition policy officials as the 'epistemic community' approach to global networks predicts (Haas, 1992; Slaughter, 2000). But this very commonality could either increase the capacity of competition authorities to influence domestic policy or isolate and estrange them from the general thrust of governance. The outcome will likely differ widely across states.

CENTRALIZATION

National competition policy is highly varied in many dimensions and is almost everywhere deeply embedded in domestic law and practice. The various policies show only partial and halting signs of convergence, much of which is driven by the demonstration effect of other states. What role, if

any, is left for competition policy in a formal organization with real penalty power such as the World Trade Organization?

The idea of global governance for competition policy goes back a long way. The International Trade Organization, rejected by the US Senate in 1947 as a threat to US sovereignty (Odell and Eichengreen, 2000: 168), included language from the Havana Charter that obliged states to counter 'business practices affecting international trade which restrain competition, limit access to markets, or foster monopolistic control' (US Department of State, 1948). The US withdrew support from a 1952 UN attempt to gain agreement on the competition policy sections of the Charter on the grounds that it was premature: so few states had such policies that effective implementation was problematic (Sell, 1998: 143). Given that virtually all major and scores of lesser states now have competition policies, that domestic competition policy now pervasively affects foreign firms, and, more broadly, that foreign value added in the domestic commerce of most states is at historic highs, can a case be made for the revival of such a formal multilateral commitment?[25]

In his attempt to position antitrust in policy space, Scherer argues that ideal competition policy and ideal trade policy have similar basic objectives, ultimately, to 'maximize real income' (Scherer, 1994: 2). As history clearly shows, however, actual trade policy moves toward this goal only with much backing and filling, and the closest competition policy typically comes is consumer surplus maximization. While free traders see unimpeded free trade as their ideal, many, perhaps most, advocates of a vigorous (and non-nationalistic) competition policy balk at the total surplus principle, the goal that would really 'maximize real income'. Beyond this, however, the bracketing of competition with trade policy in the context of the evolution of international governance misleads for two reasons. First, any shift of WTO attention from removing government trade barriers to mandating government action towards private business would move the young organization into largely uncharted territory. Second, as this work documents, there is far more to competition policy and international disputes over it than the market access-related issues that now command nearly all of the WTO's attention.

Skepticism about the appropriateness of a major role for the WTO in competition policy rests on five major observations. First, the function of trade policy is overwhelming to *control* access to the domestic market while much competition policy in the major high-income countries attempts to *balance* competing arguments about the structure and conduct of business firms. Second, trade policy focuses mostly on *government* action, while competition policy deals mainly with *firm* action. This difference implies a third: competition policy necessarily involves continuous non-routine

processes while much of trade policy simply aims to remove official interference with market forces. Fourth, open trade is a fairly clear concept; wise competition policy in many dimensions remains changing and contested both within countries and among them. Finally, even where competition policy was grafted onto the rest of domestic policy only in recent decades, as in much of Europe, Japan and all transition and developing countries, both its exact content and its procedures are intertwined with highly idiosyncratic national legal variations.

The possible short-term role of the WTO can be considered in the three problem categories noted earlier: abuse, discrimination, and strategically relevant substantive variety. In 1999, the EU proposed that all WTO members be required to have at least a 'bare bones' competition policy that banned cartels and 'monopolization' or the 'abuse of a dominant position', that provided for non-discriminatory enforcement, that embraced cooperation among authorities, and that envisioned ultimate convergence of policy (World Trade Organization, 1999).

Abhorrence of price fixing as antisocial goes back to Adam Smith. Yet some kinds of horizontal agreement involving prices, such as fixed fees for the use of copyrighted music, have been found to increase the efficiency of the industry as a whole. Far more importantly, nearly every state employs cartel-like arrangements somewhere: in agriculture, to restructure declining industries, to respond effectively to foreign antidumping judgments, or to charge higher prices to foreigners. Most of these official practices have been condemned by economists as hostile to an economy based on well functioning markets, but such cartelization seems unlikely to be handled effectively by the WTO. Antidumping practices, however abhorrent, are now in place in scores of countries that have typically based their laws on apparently immovable US practice. Disinterested professionals everywhere are strongly opposed to penalizing foreign sellers by using different criteria than those for domestic sellers. Low prices can sometimes have predatory intent, but, as an empirical matter in international trade, this is a rare phenomenon[26] and does not warrant a different standard based on the national provenance of goods involved. In this case a bad policy (antidumping) breeds more bad policy (a cartel to respond). Similarly, agricultural protection is a major problem facing the WTO, not the cartel-like measures often used to maintain high domestic prices by protectionist states. On the other hand, legally sanctioned cartels to promote exports have never been shown to have an important role in international trade (Dick, 1992).

If such cartels as those just sketched are not dealt with, this still leaves a great deal of 'hard core' cartel activity in the world economy (Evenett, Levenstein and Suslow, 2001). Yet the connection between WTO institutionalization and a substantially more effective assault on such cartels

remains to be made. Sufficient cooperation has already been established among authorities in the US, the EU and Japan, to pursue nearly all suspected global cartels. There is no substantial cartel equivalent of 'tax havens', where lax local regulation allows for flagrant system abuse.

The path to elimination of the cartel problem apparently lies more than anything with the deterrence that could be achieved only by greatly strengthened penalties. For example, careful research has demonstrated that the triple damages provided by the US antitrust laws effectively leave cartelization as a rationally attractive strategy in many industries (Connor, 2004: 274). More leverage would certainly be gained by a high likelihood of jail time for perpetrators, but even the US is quite sparing about incarceration, and this option is not available in most other jurisdictions.

The lion's share of international business experiences cartels just as final purchasers do: as a cost rather than a benefit.[27] The absence of national treatment is a very different story. This problem divides into at least four: trade discrimination, FDI discrimination, discrimination in the general legal process, and discrimination in the application of competition policy. International firms certainly suffer from the fourth, but the first three appear overwhelmingly more important for most firms most of the time.

The liberalization of trade is the WTO's principal domain and, as this is written, a deadlock continues that pits the North's desire for greater access to Southern markets against the South's determination to yield no more access without far more definite progress on the removal of barriers to its agricultural exports and on administered protection (especially antidumping) (Schott, 2004). E.M. Graham conducted interviews with important officials from both North and South and found little ground for advance on competition policy. While the EU supports the universal adoption of some kind of barebones agreement, it envisioned no substantial enforcement power and rejected a role for the WTO's Dispute Settlement Mechanism on substantive issues. The South, however, still reacting to what it sees as excessive concessions on the Trade Related Intellectual Property (TRIPS) agreement, the most tangible outcome of which appears to have been higher pharmaceutical prices, suspects that the North wants nothing more than less restricted entry into Southern markets. (Graham, 2003: 952–3). While some trade progress is eventually inevitable, pushing competition policy issues higher on the WTO agenda now would likely increase complexity and confusion rather than providing any ingredients for constructive compromise.[28]

The ill-fated Multilateral Agreement on Investment (MAI) held under OECD auspices promised right of establishment and national treatment

for foreign firms until talks collapsed in 1998. Although leftish NGOs claim credit for sinking the MAI and the proceeding ranked low in legitimacy by being conducted almost entirely below the radar of the political processes of the affected states (Graham, 2003: 966), any agreement that might have emerged would likely have been so full of reservations and exceptions as to leave a document of uncertain value for business anyway. This explains the virtual abandonment of a quest for general agreement on this subject in the period since. Most countries want more foreign investment and make its attraction a high priority; piecemeal liberalization continues.

Both business and government policymakers have doubted the payoff from the major investment of political capital necessary to attain a general international agreement on direct investment in either the OECD or the WTO (Graham, 2000: 198–200). If this is true of investment, it would appear to be even truer of competition policy where the feasibility of agreement would be compounded by even more difficult enforcement challenges. Unlike the case of trade policy, domestic legal administration in all modern countries is predicated on impartiality. At the very least, the system can be made to appear impartial, and the prospect of persuasive second-guessing by the WTO, an organization with virtually no competition policy competence or experience, does not inspire confidence.[29]

In short, the WTO appears to offer little prospect for improved governance of international competition policy even in those areas that seems closest to its basic mission.[30] Moreover, the ICN has picked up on a couple of activities that some had advocated for the WTO. The ICN is providing substantial technical expertise to low-income countries, and its willingness to do so may be attracting more of them to adopt and strengthen basic competition laws.

Substantive issues beyond cartels and national treatment appear even less suited to any WTO role. This includes the range of issues related to the competitive legitimacy of various horizontal and vertical firm practices that preoccupy most enforcement attention in most countries, that differ sharply among them, and that must importantly condition the competitive strategies of multinational firms. The terrain here is varied and complex, and few scholars have identified a pressing need for immediate international agreement.[31]

Consistent with the arguments above, regional trade agreements have typically trodden lightly in the competition policy field. NAFTA is both brief and cautious: it stresses cooperation to support domestic enforcement and indefinitely postpones substantive harmonization. Competition issues are explicitly omitted from dispute settlement procedures. Several other agreements within the Americas are identical or similar (Tavares de Araujo and Tineo, 1999: 446–60).[32]

CONCLUSION

The integrating world economy needs clearer and more predictable competition policy. Improvements in both areas would lower transactions costs, improve business planning, and counter abusive practices. This chapter argued that progress is being made, and that the best way forward should largely avoid entanglement with well established, highly structured bodies such at the World Trade Organization. Instead, institutional competition policy progress, in the short run at least, should focus on modest but immediately valuable initiatives such as the International Competition Network.

Nationalist economic policies harm both the perpetrating state and others, but nationalism in competition policy is a small part of economic nationalism and would be especially difficult to monitor by outsiders. At the same time, private system abuse can be fought quite effectively by strengthening national laws and extending the cooperation that is currently practiced. Finally, the international variations in policy that so complicate business strategy can only be effaced through growing mutual understanding within an epistemic community that already exists and is rapidly increasing its level of communication. Harmony will increase slowly and uncertainly through cooperation and demonstration. Substantial central authority appears neither feasible nor desirable now.

NOTES

1. Overlaps can be seen in the examples chosen. Both GE–Honeywell and Boeing–McDonnell Douglas are seen by many as attempts by the EU to bolster Airbus; they also both clearly constrained and shaped firm strategies. The laws of some states, most notably the United States and Canada, have long banned price fixing, and firms from those countries clearly recognized the illegality and illegitimacy of cartels. Firms based in other countries may see such activity in less stark terms and even regard it as an important part of their overall strategy. Morever, the US government continues to approve cartel behavior for purposes of penetrating foreign markets (Dick, 1992) and employs antidumping laws that encourage cartel-like behavior by both domestic and foreign firms (Hoekman and Kostecki, 2001: 324–5).
2. The prominent industrial economist F.M. Scherer stresses the commonality of trade and competition policy by characterizing the ideal goals of the latter as 'the removal of restraints upon and barriers to competitive transacting' (Scherer, 1994: 2).
3. The usual barriers to entry include economies of scale, cost advantages, and consumer preference (see Carlton and Perloff, 2000: 76–82).
4. For a vigorous defense of the basic Canadian approach, allowing for some attention to distributional concerns, see Ross and Winter (2004).
5. Many have complained that firms also practice international price discrimination and prevent arbitrage with what some regard as 'abusive' intellectual property claims. But the pattern of such discrimination typically has lower prices in poorer countries and higher ones in rich because of differences in price elasticity. From a global perspective the solution of a single price would likely lower welfare from sales in many industries including

pharmaceuticals (Danzon, 1997). The relation between varying intellectual property rules and competition policy, including its international congruence, lies beyond the scope of this chapter. For an excellent discussion of the several dimensions of intellectual property–competition policy interface, see Maskus (2000).

6. One well known, but now dated, estimate found the 1984 cost to consumers of such protection in 31 US industries to be $53 billion, with additional losses to society from increased inefficiency of $8 billion more (Hufbauer and Rosen, 1986).
7. The WTO found no convincing evidence that Japanese government acts of omission or commission disadvantaged foreign sellers including Kodak (Hoekman and Kostecki, 2001: 86–7).
8. Japan has not yet acted in this way, but it has claimed extraterritoriality in competition policy only since the late 1990s.
9. Canada's is the most highly developed competition policy that does not make extraterritorial claims based on the effects of foreign action in the home market (Goldman, Bodrug and Warner, 1997: 64).
10. For an excellent account of the two phases of policy among poor countries and the development of the transition between them, see Sell, 1998: 141–73, 198–212. For a discussion of the variegated content of the policies developed in the second period, see Kudrle and Bobrow (1998).
11. Canada stands as an arguable exception in two dimensions: it partially embraces the total surplus principle, and it rejects extraterritoriality (see Gifford and Kudrle, 2002: 226–30). Regrettably neither Canadian policy nor that of the individual European states can be considered systematically here.
12. Mergers now need to be reviewed at the EU level when the firms' worldwide sales are over 5 billion Euros with European sales of at least 250 million Euros (European Commission, 2001).
13. In Germany, the *Ordoliberalismus*, nurtured by the Freiberg School during the Nazi period, was embraced almost immediately thereafter by the long-dominant Christian Democratic Party. It provided the intellectual foundation for much of German economic policy including policy towards competition (Gerber, 1998: 232–65). For a detailed discussion of the antitrust zeal of the occupation authority in both Germany and Japan under the direction of Assistant Attorney General Thurman Arnold, see Wells (2002).
14. The Fair Trade Commission has tried to combat the impact of industry cooperation on prices with a system of fines aimed to remove the profit from collusion. This approach has been generally criticized as ineffective and has recently been slated for modification largely by increasing penalties (Uesegi, 2004: 4).
15. Careful examination of actual practices suggests that vertical agreements are often based mainly on such motives as the encouragement of dealer promotion efforts that increase sales for that dealership rather than for 'free-riders'.
16. Of course private litigation brings risks of its own: potential legal adversaries may be 'bought off' by reduced competitive pressure.
17. Just what the Commission believed would cause the lower prices seemed to change over the Commission's consideration of the case, but a concern about the impact of those lower prices on rivals remained the focus (Nalebuff, 2004: 391, 410). Another major example of a fear of the impact of lower prices can be seen in the de Haviland merger case which was approved by the Canadian government but blocked by EU authorities because the new firm was judged likely to benefit from exchange rate movements relative to its rivals (Gifford and Kudrle, 2003: 759–60).
18. For a discussion of these cases that stresses their economic perversity, see Williamson (1985: 367).
19. 'Anticompetitive effect' is a frequent synonym for a price increase in both the US and the EU, so one might hazard that the Japanese intend 'increased competition' simply to mean a price decrease.
20. As this is written, in late 2004, the Japanese Diet has before it a set of measures to strengthen the Anti-Monopoly Act. Among other measures, it would give the JFTC search powers to assist with the documentation of criminal complaints (Uesugi, 2004: 4).

21. An example of the difference between the US and Europe can be found in a recent OECD report on fidelity discounts. The US finds them generally acceptable as promoting efficiency while EU authorities are concerned about the 'discrimination' among dealers that results from using cumulative sales as a criterion for the profitability of a marginal sale (among those who have the same current level of sales and quality of service) and finds the practice 'abusive' (OECD, 2003: 198). For a broad early discussion that touches on this issue, see Fox (1986).
22. As an example, many resellers maintain extracontractural loyalty to producers with the expectation of financial protection in difficult times (Matsushita, 1997: 192).
23. Since the 1992 Guidelines the Americans have also been paying increasing attention to the effects of increased concentration on the market power of the merged firm itself rather than increased ease of tacit collusion with others (Kwoka and White, 2004: 19).
24. A conference is held once a year, hosted by a national competition authority. A somewhat more extensive core organization has been proposed partly to raise sufficient funding for conference participation by a larger number of agency representatives from low-income countries (von Finckenstein, 2003: 8).
25. To continue the earlier argument about the role of scholarly argument in the development of American antitrust, it might be noted that the ITO was an American idea, and its competition policy provisions were anticipated by the Harvard economist Edward S. Mason (1946).
26. Willig (1998). An exception is provided by the case of Archer Daniels Midland, whose first objective when entering the world lysine market in 1991 was apparently to drive at least one other major participant out of business with prices below the long-run competitive level. The firm subsequently entered into a cartel with other major producers (Connor, 2004: 267).
27. A good example is the impact of the aluminum cartel of the 1990s on all of the users of that product as an intermediate good. The complication is that the US government cooperated in the multinational cartel aimed at countering the depressing influence on price of a surge in exports from Russia and Ukraine (UNCTAD, 2003: 15).
28. The treatment of intellectual property rights affects competition in many markets, and the global intellectual property regime is therefore relevant to one in competition policy. As Maskus explains, the policy interface is most important in three areas: regulating monopoly prices, overseeing licensing restrictions that can serve as powerful barriers to entry, and controlling 'parallel' imports, that is imports of identical or similar goods from the same source but through unapproved channels. States vary greatly in their approaches in the first two areas, and those hoping for a worldwide standard on the third as part of the Trade Related Intellectual Property (TRIPS) section of the Uruguay Round Agreement were disappointed (Maskus, 2000: 205–16). Susan Sell (1998) documents how low-income countries traditionally viewed the two policy areas as strongly overlapping because of their focus on multinational corporations. The text reports how disappointed much of the South has been with TRIPS.
29. In fact, the WTO working group on these matters has focused on process: transparency, non-discrimination, procedural fairness and cooperation among authorities, along with some consideration of action against cartels (Graham, 2003: 955).
30. For a strong statement of the case for a WTO role that still recognizes the difficulties, see Hoekman and Kostecki (2001: 425–34).
31. Andrew Guzman has been an exception. He has argued that national interests, driven by the structure of production and trade, distort decision making in competition policy on matters with important international spillovers such as mergers (Guzman, 1998). The empirical evidence for the tendencies deduced by Guzman is very weak, however, and in a recent article he has advocated only very modest first steps towards a centralized competition policy (Guzman, 2004: 118–20).
32. The greatest departure is the Andean Pact, where, prior to the five nation agreement, only one state, Colombia, had a competition policy. The founders apparently saw the

chance for competition policy to grow along with the integrating market, as was the case with uniting Europe, and the competition policy sections were based on the Treaty of Rome (Tavares de Araujo and Tineo, 1999: 446–60). Despite their long shared history and the Closer Economic Relations Trade Agreement of 1983, Australia and New Zealand still have largely separate competition policy regimes (Thomson, 1997: 385–404) that will likely come closer as the result of a ministerial agreement on harmonization of August 2003 (New Zealand Ministry of Economic Development, 2004).

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3. Does the WTO matter?

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INTRODUCTION

Any discussion of global governance is incomplete without considering the nature and influence of the World Trade Organization (WTO). It is lauded and lambasted with equal ferocity: supported by those favorably disposed to liberal economic principles and policies and attacked by critics of globalization and free trade practices. Despite its austere structures and tedious legal processes, the WTO is rarely considered a dull participant in the global economy. Despite this, it has not tended to be a focal point for international business scholars or practitioners. One reason may be the misplaced belief that, as a transnational organization, the WTO has little effect on company strategy or operations. Rather, it is often argued that the primary research focus ought to be on national regulatory regimes and their influence on businesses seeking to locate there. Companies are not members of the WTO, states are, and so the WTO–firm link is at best indirect. It is true that companies do not have 'standing' at the organization; that is, they cannot be actors in the disputes process. However, we argue in this chapter that this does not diminish the importance of the organization to international business, as WTO decisions can and do influence the context and choices of multinational enterprises.

We use the term 'transnational organization' deliberately, to distinguish the WTO from supranational entities like the European Union (EU).[1] 'Transnational' simply means involving or operating in more than one nation. 'Supranationalism' refers to a level of political and regulatory authority above the nation state and implies a diminution of national power and sovereignty (Lawton and McGuire, 2001). The WTO is intergovernmental by design but in practice it does influence and shape member state policies. It has a supranational element, as this influence can contribute to changes in national government policy choices and direction. In spite of this, the WTO does not have the 'pooled sovereignty' of the EU and cannot strike down member state laws, unlike the European Court of Justice. Thus 'transnational' conveys the essence of our argument: the

WTO is not merely an international agreement that states take up without consequence; its existence affects the domestic interests of member states and its operation helps shape the subsequent policy trajectory of members.

This chapter focuses on the impact of the WTO as a global governance actor and as an organizational force within the world economy. A large body of literature argues that the WTO – and other global governance institutions – are, at worst, largely irrelevant as actors in the world economy and at best, pawns of the powerful. WTO detractors fall into three distinct categories:[2] first, those who argue that the nation state remains the dominant, if not sole, source of authority and power in the international system (Waltz, 1979; Gilpin, 1987, 2000; Mearsheimer, 2001); second, scholars who contend that business interests, particularly transnational corporations (TNCs), can avoid regulatory controls through going global, or are able to influence global governance mechanisms in their favor through their bargaining power with national governments (Stopford and Strange, 1991; Lawton, 1996, 1997; Sell, 2000; Cutler *et al.*, 1999; Helleiner, 2001; Hertz, 2002; Levy and Prakash, 2003); and third, those who argue explicitly that the WTO has little or no power independent of the United States (US), the EU and other dominant economic forces (Strange, 1987; George, 1999; Goldstein, 2000; Showstack Sassoon, 2001; Gill, 2002; Sen, 2003).

Our argument is unambiguous: the WTO matters, both to international business and within global governance structures. Responding to those who directly or indirectly challenge the WTO's influence, we advance the following rejoinders. First, the WTO does affect the policy trajectory of nation states, by privileging particular forms of economic governance. Second, companies are affected by the changing policy environment and, unsurprisingly, take a keen interest in how the WTO evolves. Finally, the WTO disputes process can force changes in policies designed to support business in particular ways. The record for dispute settlement rulings shows a significant number of rulings against the US and other powerful economies. We contend that the WTO has three means of influence: first, curtailing the selection and use of national trade instruments; second, indirectly catalyzing alterations to industry structure; and third, the disputes process and resultant decisions.

The nonmarket strategy context remains a complex and unpredictable realm for most multinational enterprises (MNEs). In sectors ranging from oil and gas to textiles, it is accepted that non-governmental organizations (NGOs) and other constituents of civil society can have a profound impact on consumer perceptions, corporate identity and foreign investment decisions. National governments remain powerful nonmarket influences on company strategy and structure. As regulators, customers, and market

gatekeepers, they wield varying degrees of influence over both home and host MNEs. Significantly less evidence exists concerning the influence and impact of transnational or supranational organizations on MNEs. In particular, there is a relative dearth of evidence linking WTO actions and MNE behavior. Instead, where firm–government relations are concerned, most of the research and managerial focus remains on national governments. Sanyal and Guvenli (2000) note that 'more and more governments' have accepted liberal economic policies, yet they fail to recognize that this liberalism has an institutional manifestation in the WTO. In her review of the government–business relations literature, Getz (1997) argues that, as international business expands, it is reasonable to expect that international-level regulation will become more salient for scholars and practitioners. However, she does not attempt to develop either theoretical frameworks or case studies to pursue this point. Dunning (1997), similarly, raises the potential importance of supranational or international regulation in his edited work on business–government relations. He notes that the expansion of international commercial activity challenges states to reconsider their governance of economic affairs. Dunning also stops well short of examining the actual interaction of business and transnational institutions like the WTO. In sum, the business and management literature suggests that there is 'something' important about transnational organizations like the WTO, but no agreement exists on how to interpret or measure the significance. This may be due to the relative novelty of the WTO: it has only existed formally since 1995. However, another reason may lie in the misplaced belief that, as a transnational organization, the WTO has no effect on firm strategy or operations. Rather, the primary research focus ought to be on national regulatory regimes and their influence on corporate strategy and industry structure. We do not argue that the WTO is the only important environmental variable for international business. We do argue, however, that the organization's potential impact on the conduct of international commerce is underresearched. In contrast to legal studies, the business and management literature has generally not grappled with the details of WTO decisions but has concentrated on the WTO's place within the international regulatory system (Rugman, 2000). A proper assessment of the WTO's influence on international business can be gained only by a careful examination of actual cases. Significant further work needs to be done in this area. The aim is to illustrate how WTO decisions may affect firms through shaping national-level industrial and trade policies. In this sense, the approach is not so different from work that examines the impact of NAFTA on North American business. The NAFTA treaty is an important intervening variable in the conduct of international business in North America, particularly where locational decisions are concerned (Globerman and Shapiro, 1999).

Therefore, in this chapter, we consider how the WTO affects the international economy and the companies that populate it. We disagree with Rugman (2000) who asserts that regional configurations are more important than global frameworks and with Gilpin (2000) who argues that nation states are the only influential actors in the international system. We argue that, although nation states remain the most powerful systemic actors, global regimes or institutions, particularly the WTO, do exert authority in matters of international trade and investment. The organization's main influence lies, not in the dramatic 'striking down' or overruling of national laws, but rather in the shaping of the range of options that member states have for protecting or promoting their companies and industries. This argument is set within the wider discourse that considers whether or not global governance is, in any real sense, an existing or emerging reality. The growing consensus towards varying forms and degrees of global governance in the mid-to-late 1990s was derailed by the economic downturn and the rise of global terrorism in the early 2000s. Unilateralism appeared to usurp the multilateralism of the previous decade. Thus, any discussion of the WTO and its influence on international business must be set within the contemporary norms and principles of the international political economy.

THE WTO AS AN INSTITUTION

The precise 'governance reach' of the WTO has been the subject of increased attention from political economy and international law scholars. Hufbauer argues that the WTO is exceptional among international organizations in the extent to which the system 'renders decisions on a variety of domestic measures that may affect . . . other Member States' (2002: 8). Hence, our use of the term 'transnational' organization. The WTO is a much more robust and formal organization than its predecessor, the General Agreement on Tariffs and Trade (GATT), as even the GATT could not constrain national trade policy (Lenway, 1985; Lawton and McGuire, 2001). The WTO has elaborated a set of rules governing the use of traditional trade policy instruments, including antidumping (AD), where states seek to counteract predatory pricing by exporters, and safeguards, where states can suspend their trading obligations in response to a crisis. Moreover, dispute settlement procedures were changed so as to permit a nation to lodge an appeal with a permanent appellate court if there was probable cause to believe that another nation was violating a WTO rule (Goldstein, 2000: 263). Consequently, the binding disputes process is much more judicialized and can seem to present states with a choice of accepting a ruling or facing retaliation. It is this power that WTO critics fasten upon.

Goldstein and Martin (2000) explore the implications of increased legalization and note that WTO decisions could constrain national economic policymaking by presenting states with a choice of complying with an adverse decision or facing retaliation.

The first observation to be made is that the WTO is a strengthened successor to the GATT. The GATT enjoyed spectacular success in reducing tariffs in the decades following World War II. The GATT's central principle of non-discrimination among trade partners was and remains a powerful norm among states. The GATT was successful in reducing tariffs, but was silent on how internal economic arrangements might affect international trade. The compromise of 'embedded liberalism' allowed governments to develop welfare states – with all the intervention in domestic economies that implies – while pursuing liberalized trade externally. This bargain came under increasingly severe pressure, particularly in the US, in the 1970s and 1980s, resulting in calls for a more robust international organization regulating international trade. As Sally (2002) notes, the WTO retains the core business of its predecessor, the GATT, of negotiating and enforcing rules for market access in industrial goods. However, it has transcended the GATT by moving well beyond this narrow sphere of influence. Sally states:

> The WTO also provides rules for market access in agriculture, textiles and clothing, and services; it has a strong agreement on intellectual property protection; and more detailed coverage of trade procedures (for example on subsidies, technical barriers to trade, sanitary and phytosanitary standards, customs valuation and import licensing). (2002: 1)

The WTO is significantly more authoritative than its predecessor. As Sally (2002) points out, it includes a strong, legalistic and quasi-automatic dispute settlement mechanism, in stark contrast to the GATT's weak dispute settlement procedures that relied less on strict rule-adherence and more on diplomacy. He further argues that its jurisprudence has become the most important aspect of public international law.

For an organization that some commentators believe is irrelevant, the WTO has a remarkably large membership: almost 150 countries within a decade of its inception. Developing states now dominate the membership and are increasingly active in both the ongoing work of the WTO and the periodic negotiations concerning the organization's agenda and structure, such as the ill-fated Cancun Ministerial in late 2003. Much has been made of the 'crisis' in the WTO manifest in the breakdown at Cancun, but the crisis is not one of irrelevance. Rather, it is precisely because the WTO matters that diplomats from the Americas, Europe, Asia and Africa pay so

much attention to the arcane detail that is the backbone of international trade talks. This makes for torturous negotiations. It is easy to agree to commitments that are revocable; it is quite another to sign up to a treaty with a robust disputes process and underpinned by widely accepted norms about the preference of liberalized trade over protection.

WTO membership signals credibility in the international marketplace. In their study of the accession of Eastern European states, Drabek and Bacchetta note that 'WTO membership provides powerful guarantees of governments' future policy direction' (2004: 1090). Moreover, membership induces states to implement institutional changes that promote liberalized trade and transparency in commercial relations (Drabek and Bacchetta, 2004). This aspect of the WTO is most controversial as it clearly has implications for sovereignty. WTO rules and norms do indeed affect domestic policymaking, but they hardly destroy it. In the realm of services, sovereignty is protected via a negotiation process that allows states to liberalize only those services they wish to: negotiations proceed by 'offers' made by participating countries. In respect of industrial subsidies, Weiss (2003) argues that WTO rules allow states to develop a more strategic, 'activist' approach to industrial and technology policies. This is because WTO regulations proscribe direct, export-related subsidies, but do allow a wide variety of regional economic development and blue-skies research and development grants (McGuire, 2002). In short, the WTO provides incentives to shift policy trajectories.

REGULATION AND INTERNATIONAL BUSINESS

The international business literature has a long tradition of examining how host government regulation might affect firm-level decisions. The vast literature on foreign direct investment decisions is one example (Vernon, 1971; Boarman and Schollhammer, 1975; Fagre and Wells, 1982; Stopford and Strange, 1991; Brewer, 1992, 1993; Boddewyn and Brewer, 1994; Henisz and Zelner, 2005). It is taken for granted that firms consider whether a candidate host country has investment incentives, whether it offers a stable political environment, and if it offers an appropriately skilled workforce. More sophisticated examinations of the topic understand that firms do not take the national political environment as a given, rather they may actively try to shape it to accord more closely with their preferences. Frynas and Mellahi (2003), for example, demonstrate how oil companies try to influence the political environment of states before initial or subsequent investments.

In principle, the WTO should act in the same way as a national-level investment regime; it should produce incentives for firms to do something they would not otherwise have done. But does it actually work this way?

Broadly, WTO liberalization undercuts the regulatory rents incumbent firms, whether domestic or foreign-owned affiliates, gain from a protectionist trade regime. Chase (2004) points out that multinationals do not necessarily support freer trade if it threatens to eliminate rents earned in relatively protected foreign markets. The accomplishment of the WTO, and even its GATT predecessor, was to erode these rents. Messerlin (2001) notes that GATT panel decisions were crucial in leading to the creation of a much more liberal oilseed market in the EU. This conclusion is more startling as it refers to a GATT panel that was convened before the more judicialized and binding WTO process came into play. Firms can also use the WTO process to open up markets and create opportunities. One of the most spectacularly successful, and controversial, efforts was the intense lobbying of pharmaceutical companies in support of the inclusion of intellectual property provisions in the Uruguay Round negotiations (Sell, 2000).

A substantial body of work exists to provide an understanding of how business lobbies pressed for an extension of WTO rules to services (Ryan, 1998; Sell, 2000, 2003; Stegemann, 2000). The inclusion of intellectual property right (IPR) provisions in the Marrakesh Treaty owes an enormous amount to the determined efforts by American multinationals to gain international protection for their patents and copyrights. More generally, firms succeeded in convincing governments that 'services' were tradable across borders, and that investment issues required multilateral rules to constrain states on matters like expropriation (Sell, 2000: 174). The WTO was the preferred arena for these efforts as other agencies, such as the World Intellectual Property Organization (WIPO) lacked robust dispute settlement procedures (Stegemann, 2000: 1238). However, the key insight of Sell is to understand that firms do not always succeed in getting their preferences accepted. In her analysis of financial services, GATS, TRIPS and TRIMS, Sell notes that these agreements vary in the extent to which they offer protection for business: 'The US private sector actively pushed for all these agreements, so the variation in outcomes suggests that private authority is not triumphant in all areas' (2000: 174).

What conditioned this success? First, firms seemed to have the most success when they were able to mobilize transnationally (Risse-Kappen, 1995; Michaels, 2001). In particular, when American and European firms developed a common position, it was more difficult to block proposals. Second, while transnational membership is important, it also seems crucial that the private sector proposals are coherent, feasible and consistently pressed. It took two decades for IPRs to be accepted by the US government as a legitimate topic for multilateral negotiations. Finally, governments must be persuaded. In multilateral forums like the WTO, developing states have some bargaining power (Panagariya, 2000). In the case of intellectual

property rights, tradeoffs with other issues, such as textiles, helped secure agreement.

INFLUENCING THE CHOICE OF TRADE INSTRUMENTS

Activity in the disputes process can shape the use of national trade instruments: attenuating the use of some, while encouraging the development of others. The subsidies provisions in the Subsidies and Countervailing Measures (SCM) agreement provide incentives for states to shift government support toward precompetitive research and development and away from direct support for firms' exports. Young, in his study of EU trade policy, notes that the European Commission tends to avoid pressing WTO cases that would set precedents in respect of European trade instruments: 'There are some issues, such as export subsidies, that the Commission seems reluctant to tackle due to possible adverse implications for EU policies' (2004: 5; see also McGuire, 1999). Should the Commission press an export subsidies case, there would be nothing to stop a counterparty from filing against the EU.

When a nation's trade instruments are dragged into the WTO disputes process, there may be pressure to reduce the use of that instrument to prevent litigation diminishing its utility. The American use of safeguards to protect the domestic steel industry is an example. The US use of steel safeguard provisions presents us with something of a puzzle: the US steel industry has never been an extensive user of safeguards. Schuler notes that, from 1976 to 1989, the industry used safeguards only once (1996: 722). AD was the preferred option, undoubtedly because the success rate for AD petitions was so high: 80 percent of all AD petitions lodged with the Commerce Department are successful (Rosegrant, 2002). Moreover, safeguards had lost favor with governments in the wake of the 1995 creation of the WTO, whilst AD provisions had grown in popularity. Bown calculates that, while over 300 AD measures were taken by member states from 1995 to 1997, only 20 safeguard actions have been taken from 1995 to 2002 (2002: 49). Bown goes on to argue that the operation of the disputes body in the WTO has offered states an opportunity to conclude de facto managed trade agreements via AD action – an option not offered by the safeguards agreement (ibid.: 50). Drawing on both recent US trade policy history and Bown's analysis, we might have expected the US to use its AD provisions to address its steel trade concerns. Indeed, this was the expectation of foreign trade officials in the months before the announcement.[3] However, the US had already lost several AD cases at the WTO, and the instrument was

a central complaint of important trading partners like Japan in the Doha negotiations.[4] This prompts us to propose that the US government chose to use safeguards partly to take some of the attention off US AD laws. The domestic political dynamic also played a role. Many industries relied on AD as the key protectionist device. WTO cases that called into question the mechanics of American AD investigations would have effects well beyond the steel sector.

The US Congress is acutely sensitive to political lobbying from domestic firms. Frequent elections, and the concomitant need to raise campaign funds (combined with the widespread view that firm lobbying is an entirely legitimate democratic activity) mean that Congressional legislators are keen advocates of local firms (and unions).[5] Legislators are also more likely to grant access to selected firms when they expect the same issues and circumstances to continue to be politically important (Schuler, Rehbein and Cramer, 2002: 663). As a result, a number of congressional caucuses are in fact organized around industries such as steel. Members of these caucuses are usually sympathetic to the policy concerns of the represented industry. The firm that is able to effectively gain such political access and influence may increase its chances of survival through a reduction in uncertainty and may even influence the regulatory process in a manner more favorable to itself and its industry (Hillman, Zardkoohi and Bierman, 1999: 68). The recognition that this preferential access could cause protectionism lay behind the legislative reforms of the 1930s and postwar years when the US Congress handed the President extensive powers to negotiate international trade agreements. These powers were eroded in the 1980s as Congress used the competitiveness debate in the US to regain its lost powers in the development of trade policy.[6] In addition to the shifting legislative–executive balance, the US system also institutionalizes the role of firms to a greater extent than other states. Beginning with the Tokyo Round, industry sectoral advisory committees were created with the requirement that US trade negotiators consult with these groups, but this has led to the criticism that US trade policymakers have been captured by corporate lobbies. As one trade diplomat observed: 'the US government doesn't have trade policy, it has clients' (Ostry, cited in Peterson, 2001).

INFLUENCING CORPORATE STRATEGY AND INDUSTRY STRUCTURE

The WTO process is working, unintentionally, to alter the locational decisions of companies. India, for example, toughened its intellectual property laws partly in response to a WTO case brought against it by the US.

American and other foreign firms had complained that India offered little intellectual property rights (IPR) protection, with the resultant rise of piracy and counterfeiting. India has subsequently redrafted its IPR laws and this has had two effects. First, it has increased substantially the number of Indian firms operating in IPR-sensitive industries like pharmaceuticals. Domestic firms, too, benefit from regulatory environments that allow them to appropriate the gains from innovation. Second, it has made foreign firms more willing to partner Indian firms and locate high value-added research and development facilities in the country (*The Financial Times*, 11 January 2000: 31).

WTO-sponsored liberalization can also help to catalyze new structures in specific industries. For example, the Trade-Related Intellectual Property (TRIPs) agreement seeks to extend robust patent protection for intellectual property globally. An important expectation was that the economic geography of intellectual property-rich industries and services would shift. The Indian pharmaceutical industry developed on the back of loose intellectual property protection and specialized in the development and production of generic drugs. Indian accession to the TRIPs agreement required the country to improve and tighten its intellectual property provisions. The results? Interestingly, there are clear indications that Indian firms began to move out of the – now more constrained – generic market and into the development of new, proprietary drugs (Scherer, 2004). The textile industry is undergoing even more thoroughgoing change, catalyzed by the WTO's liberalization of the sector via the Agreement on Textiles and Clothing (ATC).

The Textiles Sector

In the textiles sector, regionalism and multilateralism interact in complex ways. For example, it is perfectly true that Mexico emerged as an important regional center for textile production, and that this was catalyzed by the NAFTA agreement. However, the economic geography of textile production, including the development of regional centers, now arises from the liberalization of the sector under the Agreement on Textiles and Clothing (Strange and Newton, 2003). China's emergence as a textile production center now threatens Mexico's status as a regional supplier to the US market; again, this flows from multilateral liberalization. In short, regional arrangements and the WTO interact in complex ways. It is simplistic to see them as substitutes.

The EU is the one of the world's largest importers of textiles and clothing: in 2001, imports were worth almost €72 billion (European Commission, 2003a). It is also a major exporter of textiles, with Italy

second only to China in the value of exports (Strange and Newton, 2003). The industry is relatively regionalized both within member states and in the EU overall, and relatively labor-intensive. These characteristics, which the EU shares with many other developed states, mean that the industry is particularly successful at gaining political support for protection (Hoekman and Kostecki, 2001: 226).

The sector's labor intensity meant that developing countries have a comparative advantage, particularly in the production of bulk textiles like cotton and base fibers. Developed states succeeded in protecting their domestic industries by pressuring developing states (which in the 1950s included Japan) into a series of managed trade agreements for the sector, the most (in)famous being the Multi-Fiber Arrangement created in 1974. The sector's decisive shift toward liberalized trade came about in the Uruguay Round negotiations, where developing states successfully linked progress on intellectual property rights (important to developed states) to market-opening measures in textiles. Thus the Agreement on Textiles and Clothing (ATC) negotiated during the Uruguay Round was supposed to herald the demise of the highly protectionist and heavily regulated Multi-Fiber Arrangement. The MFA protected textile and apparel manufacturers in the developed world by creating a system of quantitative restrictions (quotas) on imported textiles. The ATC phased these out in four stages, the last deadline being 1 January 2005. After that point, quotas and voluntary export restraints were banned and WTO rules for the application of safeguard measures apply. The ATC does not eliminate tariffs, which remain relatively high in the sector compared to other traded-goods industries.

The EU adjustment to the phased-in liberalization was decidedly 'back-loaded': most of the quotas of interest to importers only coming off in 2005. Early liberalization involved 'liberalizing' textile products not heavily protected in any event, and where no EU-based producer existed (Messerlin, 2001: 229). This has led to complaints by a number of developing states that, while the EU is adhering to the letter of the ATC, it refuses to follow the spirit of the agreement. It has also left the EU with a 'big bang' liberalization. As the Commission itself noted, phase four was a 'substantial liberalization' of some 22 percent of all textile and clothing imports worth €13 billion (European Commission, 2000a).

A key expectation of the ATC was that AD would be an increasingly important trade tool with the abolition of Quantiative Restrictions (QRs) and Voluntary Export Restraints (VERs), but there is no evidence to support this – quite the opposite in fact. Overall, EU AD activity dropped off sharply after 1999 and this was true of textiles as a sector. China, the leading textile producer in the world and usually a favorite target of AD activity, did not see a single case filed against it from 1998 to 2000; indeed,

the EU did not launch a single AD or anti-subsidy case in 2000 (Liu and Vandenbussche, 2002). Although cases were initiated in 2001 and 2002, the numbers remained low: five and two for the respective years (European Commission, 2003a). The relative quiet on the AD front may have been due to three factors. First, the WTO disputes process was used by trade partners to force changes in the EU's AD regime. Second, the Commission has aggressively used bilateral negotiations to open up export markets for EU textile producers. Third, the Commission pressed EU-based producers to move up the value chain and make themselves less vulnerable to labor-intensive competition.

The first pressure point on the protection offered to EU textile producers came in the form of a complaint by India to the Dispute Settlement Body (DSB) in 1998. The EU had placed AD duties on bed linen from India, Egypt and Pakistan in 1997 after complaints from European industry. The case was resolved some three years after the first filing and the result did not offer comfort to European producers. A crucial element of the EU's methodology for calculating dumping margins, 'zeroing', was found to be WTO-incompatible. Brussels announced that it would comply with the decision and suspended the duties applied to India. But the Commission went further and announced the unilateral withdrawal of similar duties against Egypt and Pakistan. The European cotton industry's trade association, Eurocoton, succeeded in reviving the action in late 2002 (*EU Official Journal*, 2002). It is noticeable that Eurocoton is peculiarly successful at gaining protection (Smith, 2004). It was responsible for several other AD initiations. Other elements of the European textile industry have not followed suit: only two petitions were filed in 2002 and these were Eurocoton's. In short, Eurocoton is the exception to the general pattern of avoidance of trade protection.

As to the second adjustment mechanism, the Commission adopted a strategy of explicitly linking its progressive liberalization under the ATC with progress on market access (European Commission, 2002). In announcing the decision, the Commission noted that the policy acknowledged 'that EU producers are concentrated to a large extent in a number of regions – among which are areas experiencing economic difficulties' (European Commission, 2000b). Between 1995 and 2001, the European textiles sector shed approximately 400 000 jobs (European Commission, 2003a). By late 2001, the Commission had engaged with Pakistan, Philippines, Thailand, Brazil and Peru in bilateral discussions on greater market access (European Commission, 2002b). The Commission's position was bolstered by the active efforts of the European Apparel and Textile Organisation (Euratex). Euratex had argued that non-tariff barriers (NTBs) had 'mushroomed' in the wake of the Marrakesh Agreement in

1994 (Euratex, 2005). Euratex was encouraged by the Commission to use the Trade Barriers Regulation (TBR) as a means of forcing concessions from developing states. Argentina, for example, was the target in 1999 and, while customs procedure continued to concern Euratex, the association noted that the overall situation had improved (Euratex, 2005). Brazil was similarly a target in 2000. Bilateral agreements with the accession countries also offered a means for European textile producers to respond to liberalization. Bilateral agreements with central European countries, under the aegis of the Europe Agreements, gave producers in these states preferential access to the EU market, provided they sourced many of their inputs from the EU (Messerlin, 2001). Another push in this direction emerged in 2003 with the Commission again calling for the lowering of developing country tariffs on European textile products.[7] It also suggested that preferential access to the European market might be offered to states that adopted labor and environmental regulations.

Finally, there is evidence of product adjustment strategies developing on the back of an increasingly bifurcated industry. Brussels wanted the textile industry to move up the value-added ladder. Erkki Liikanen, then EU Commissioner, noted that 'the delocalisation of certain activities of the sector especially in clothing, involves structural transformations in the sector' (European Commission, 2000c). The industry cannot compete on labor costs, so it began actively to move toward higher value-added textiles and lean production methods. The Italian textile industry is the classic example. When intra-EU trade is included, Italy is the second largest textiles producer in the world, after China. Italian regions like Emilia-Romagna succeed because they make no attempt to compete in the commodity end of the global textiles market (Nordas, 2004). In late 2003 and early 2004, the Commission floated the notion of a 'Made in Europe' labeling program as a means of convincing consumers of the alleged benefits of European textile products.[8] As one industry report noted, previous adjustment efforts in textile-producing areas involved replacing the textile industry with another economic activity. The problem with this approach is the difficult task of identifying the appropriate industry. Newer policies for these areas thus envisage the region staying in the sector, but with a new strategy.

In sum, the textiles sector has not resorted to AD to the extent that might have been expected. This is partly due to the provisions of the AD code, but also to the availability of other avenues. First, the ATC back loading allowed the Commission to insulate the most vulnerable producers for the longest period of time. Second, market-opening strategies were implemented to offset market-share erosion in the European market. Third, the accession process allowed EU-based firms to shift some production

'off-shore', but without the political fallout that would accompany a move to, say, Thailand. Indeed, entering into agreements with central European producers could be portrayed as good European citizenship. Finally, there are indications that the Commission is helping to catalyze a higher value-added strategy.

The Chemical Industry

The European chemical industry is another sector undergoing WTO-related pressures for change. In contrast to textiles, the chemical industry remained an active user of AD until the end of 1999, when its activity, too, began to tail off. In the same 10 years that China suffered only 12 textiles-related AD initiations, the EU chemical industry launched 34 (Liu and Vandenbussche, 2002). As with textiles, the European chemical industry is a world giant. The EU accounts for 54 percent of global exports and 45 percent of imports (CEFIC, 2003). On a regional basis, only Asia produces more chemicals: EU chemical industry exports were €150 billion in 2001, accounting for 28 percent of global production, whilst imports were €85 billion (European Union, 2003b). Germany dominates the EU chemical industry with a 26 percent share of total EU production. France and Italy are other significant national industries (CEFIC, 2002).

Employing an Olsonian collective action logic (1965), European chemical firms have been spectacularly successful at protecting the home market via AD actions. Liu and Vandenbussche (2002) suggest that AD petitions from the chemical industry enjoy strong support from the major firms – and this translates into political power. Evidence that European firms work very closely together to protect this market comes from Messerlin (2001). He notes that the industry was the subject of several anti-cartel cases in the 1980s and 1990s. Why is this important? Messerlin argues that AD was a manifestation of a broader pattern of collusive behavior among EU chemical firms (2001: 266). In his study of the chemical industry, Arora notes that cartel-like behavior is nothing new: 'The chemical industry was one of the earliest "global" industries and cartels, both domestic and international, were an important aspect of this globalization' (1997: 394). In short, this is an industry concentrated in key member states and exhibiting a talent for nonmarket strategies in preserving managed competition in the home market. Its large constituent members 'are not always seeking the extension of supranational regimes to lower regulatory standards; indeed they sometimes seek to enhance domestic governments' capacities to establish stringent regulations' (Levy and Prakash, 2003: 132).

The operating environment has become more difficult for European firms. The growth of licensing arrangements after World War II started the

gradual process of intensifying competition (Arora, 1997). Initially, new competitors were based in Europe, but the growth of Asian chemical firms has also come to symbolize the true globalization of the sector. However, globalization does not mean that firms operate seamlessly across the world. In some important sectors, there is a strong regionalized industry structure (European Commission, 2003c). These firms are offering stiff competition in both Asian and European markets. Proximity to market is important and domestic industries have grown up to service growing downstream industries in Asia. Proximity to market also affects the choice of entry mode for foreign firms; foreign direct investment with vertically integrated operations are often the preferred option.[9] The Commission argues that EU chemical firms encounter a variety of non-tariff barriers in export market. One of the most serious is lax enforcement of intellectual property rights: an important consideration in an industry of relatively high R&D intensity. However, the Commission has also complained about onerous labeling and health and safety requirements in some states, such as Egypt and Russia, which it alleges are designed to hamper market access. In Asia, the Commission also complains about poor distribution systems that impede market access and serve to protect local producers (European Commission, 2003c). This seems to have affected the use of trade instruments. The EU chemical industry has seen its favorite instrument (AD) used against it with increasing frequency. As industry sources point out, there is a big issue now, at a European level, as to how to manage the sheer number of cases being brought against the European industry by China and elsewhere.[10] India has also emerged as an active user of AD measures, with the European chemical industry being the most common target (European Commission, 2003c). The International Council of Chemical Associations (ICCA) (2003) noted their concern regarding the increased use by 'certain countries' of this instrument and their concern at its misuse for protectionist purposes. By 'certain countries', the ICCA was primarily referring to China and India, as well as a number of other emerging economies. One of the more significant developments in trade instrument use has been the emergence of developing states as active users of AD, aimed at blocking efforts by foreign chemical firms to develop local customer networks and so threaten domestic chemical firms (Mayer *et al.*, 2002).[11] A BASF official noted that the company's efforts to enter the Chinese market and develop customers for its new plant in Nanking were being hampered by Chinese AD activity.[12] Why this might be a concern to EU chemical firms can be understood by considering that they generated a trade surplus of €65 billion in 2001 (CEFIC, 2002). Exports to developing states exceed imports by almost two to one. Clearly, foreign states are using AD both to protect home firms from EU competitors and to place increasing pressure on the

EU to further open its market. The European Chemical Industry Council (CEFIC) responded to these developments in the run-up to the Doha Ministerial in late 2001.

In 1999, the EU was second only to China as a target for AD provisions in the chemical sector, accounting for 15 percent of all cases (167 measures) (CEFIC, 2000). The CEFIC lobbied to 'harmonize' AD regulations through the WTO process to get what the association called 'WTO-Plus' regulations.[13] WTO-Plus included new rules for *de minimus* calculations on dumping margins and other procedural changes designed to reduce the scope for extremely high dumping margins to be calculated. The template, according to one official, was the EU's own AD code.[14] This is a clear example of Dymond and Hart's (2000) positive rulemaking in action. The WTO AD code currently operates in a negative way: it spells out what is not allowed, but otherwise allows states considerable scope for their own AD regulations. The CEFIC called for WTO-mandated standardization of AD investigation procedures with an eye toward curbing the abuse of the system.

We cannot draw any definite conclusions about the chemical industry's AD practices but some observations can be made. In contrast to the textiles case, there is little scope for product adjustment strategies in the chemical industry. Product differentiation is low, so there is little scope to reconfigure a firm as a niche producer. The industry's efforts to diversify into specialty chemicals have not resulted in many financially viable new products. As a result, international competition remains focused on commodity bulk chemicals (Firn, 2003). Another difference is in industry structure. Textiles is a highly fragmented, labor-intensive industry with multiple players ranging from multinationals to small and medium enterprises. Indeed, a set of firms in the industry are brokers who intermediate between producers of the raw material and buyers. This industry structure is conducive to adjustment as firms have multiple options. Spatial relocation is relatively easy for labor-intensive products. Kaplinsky (1993) notes that major firms in developing states display a nomadic existence: they move to take advantage of the quota system. Finally, in such a labor-intensive sector, it is difficult to imagine high-cost European producers ever being able to withstand the erosion of margins that would be required for a dumping strategy to succeed.

The capital-intensive chemical industry offers no such option. It is made up of numerous multinationals operating from a strong domestic base. Although foreign investment – particularly in China – is accelerating, it remains the case that the industry is one where firms trade relatively undifferentiated products. Where firms are largely spatially fixed, product differentiation is low and it is no surprise that trade protection remains

a popular option. For countries like China and India, the chemicals industry is a 'platform' industry whose indigenous firms are needed to catalyze the growth of downstream manufacturing sectors. Moreover, contrary to Akbar's (2003) findings for the European car distribution business, chemicals companies continue to resist liberalization through the influence they exert over both national and European regulatory regimes. The dispute settlement process in the WTO offers developing states an opportunity to force major players to operate by the rules. The dramatic growth of AD activity by states like India and China is proof that this is happening. Faced with few other options, the European industry reacts by calling for harmonization of AD laws so as to minimize the impact on members.

THE DISPUTES PROCESS: ARBITRATING BETWEEN THE POWERFUL

The key institutional innovation of the WTO, relative to the GATT, is the binding disputes process. When a trade dispute is taken to the WTO, the parties will face a panel process not unlike a court proceeding. The panel, having heard arguments from the parties, issues a report and recommended action. Parties to the dispute can appeal the result to a standing appellate body. The decision of the appellate body is final: no further appeals are allowed. Crucially, final reports will be adopted by the WTO council – and so will be binding on the losing states – unless there is a consensus against adoption. Mustering a consensus against is effectively impossible: reports of the appellate process are, in essence, binding and final. States must comply with the WTO recommendations or face trade sanctions. Since compliance with WTO decisions may require changes in domestic law, firms can be affected.

Some WTO decisions have caused considerable public anger, and this reflects the fact that the disputes process places states in the position of complying with decisions, by changing domestic law if necessary, or run the risk of trade sanctions. While some of the more controversial decisions concerned environmental protection, other cases centered on firms. The Kodak–Fuji dispute, for example, centered on the question of fair access for Kodak to Japan's retail film market. There was considerable anger in Congress when the US government – and hence Kodak – lost the case. The case examined here, the regional aircraft dispute between Brazil and Canada, is similar to the Kodak case in that the world of trade policy became blurred with corporate strategy. As Baron (1999) has noted, corporate strategy involves not only market activities like product development, finance and marketing, but also nonmarket issues like government

aid, regulatory policy and trade policy. Canada has had to develop new policies to support the key high-technology sectors of aerospace and pharmaceuticals. In the former, direct export subsidy support to Bombardier was deemed WTO non-compliant after a complaint by Brazil on behalf of its aircraft manufacturer, Embraer (Goldstein and McGuire, 2004). In the latter, Canada's policies in respect of compulsory licensing, designed to encourage the development of Canada-based pharmaceutical firms, was likewise found to be in contravention of WTO regulations.

We do not argue that the WTO is the only important environmental factor facing international business, but we do suggest that the organization can have an influence and so its operations deserve closer study by business and management scholars. We argue that the Bombardier–Embraer case is merely an early example of what may confront more and more internationalized firms: the importance of transnational regulation for strategy formulation and implementation. This process is indirect; WTO decisions apply to governments and their domestic legislation. However, given the importance of the domestic economy to the competitiveness of firms, indirect effects matter nonetheless. In the aircraft case, lack of product differentiation made government intervention a key element in the competitive struggle. WTO subsidy regulations have forced Canada, Brazil and firms based in both countries to reassess their funding plans and strategies. However, the effects may reach far beyond the aircraft sector. Canada has had to redraft its entire program for supporting R&D. Its programs were designed, not merely to assist Canadian firms, but to influence the locational decisions of foreign firms seeking to access the North American market. The WTO decision will make this harder to do. Similarly, since the Proex scheme was supposed to assist various Brazilian exporters, the WTO decision may make the task of numerous Brazilian firms more difficult.

The regional aircraft case is but one instance, but it should not be discounted. Other WTO decisions that might have a profound impact on international firms have arisen since. In February 2000, the WTO announced that US tax legislation concerning the treatment of export-earned income constituted an illegal subsidy and ordered its withdrawal (WTO, 2000).[15] The EU did, in the end, impose sanctions on the US for non-compliance. In 2004, the EU suspended this action, citing progress on a final resolution (European Commission, 2004). This ruling may ultimately force firms such as Boeing, Microsoft and Caterpillar to restructure their exporting procedures. It may well also result in their paying more tax, though the US Congress has worked hard to develop legislation that would avoid this. Other WTO decisions have struck down protectionist barriers to the sale of liquor in states such as Korea. Famously, the WTO decision that Japan was not excluding Kodak from the Japanese photographic market to

protect Fuji caused uproar in the US and forced Kodak to reconsider its international strategy (Baron, 1997). In 2000, an Australian company, Howe & Co. was forced to pay back some of the export subsidies it received from the Australian government. Aside from the punitive aspect of the case – requiring repayment of subsidies was unprecedented – one Australian official observed that Australia would have to rethink its entire set of industry support programs (McGuire, 2002).

CONCLUSIONS

In sum, it is time to emphasize the significance of transnational regulation to the strategic direction of modern business. Global governance is still in its infancy and there is widespread disagreement about the appropriate scope of international-level regulation. Some companies have developed a sense of the growing importance of global governance and have begun to factor it into their strategy-making processes. The task facing international business scholarship is to catch up with these firms and trace the tangible impact of WTO decisions on specific companies. There is a rich literature on the 'input' side of trade policymaking and strategy; that is, the role of companies in lobbying for specific policies to be adopted by their governments, or inserted into WTO treaties. What we lack at the international level are 'output' side studies that examine what the WTO decided and how it decided it (Hocking and McGuire, 2002). Further down that line, we also lack studies of the actual adjustments made by firms and states to WTO rulings. In turn, the responsibility confronting the majority of multinational companies and strategically minded managers is to ensure that they are aware of WTO structures and procedures and familiar with how the WTO's operations might affect their business.

NOTES

1. Our approach is supported by a variety of sources, including the Institute on Globalization at Santa Clara University, which lists a number of 'transnational organizations', including the WTO (http://www.scu.edu/globalization/links/index.cfm?id=3).
2. We do not consider the small but vocal set of commentators who contest the very idea of a global economy, arguing instead that power and authority resides at the regional level: Europe, North America, East Asia and so forth (Rugman, 2000; Rugman and Verbeke, 2004).
3. Interview with Brazilian diplomat, 20 June 2002.
4. Most US AD measures are not contested, but it is significant that Korea and Japan, among other longstanding opponents of US AD laws, did pursue their cases through the WTO. This was in addition to using the Doha Round negotiations to press for reform of American laws.

5. Interviews with a variety of US steel industry executives, May–June 2002.
6. Nonetheless, the president retains flexibility through escape clause actions. The President can alter the policy recommendations given to him by the USITC.
7. 'Brussels seeks to shore up textiles and clothing sector', *Financial Times*, 29 October 2003, p. 15.
8. This approach is not unique to textiles, or confined to labeling. In advance of the Cancun summit, the Commission suggested that stronger protection ought to be given to foods and products identified with European regions, such as Parma ham. Critics regard this as barely concealed protectionism.
9. Telephone interview with head of BASF International Affairs office, 29 September 2003.
10. Interview conducted with Mr Stephen Elliott, Director for Trade and Competitiveness, UK Chemical Industries Association, London, 5 September 2003.
11. Telephone interview with CEFIC official, Brussels, 10 November 2003.
12. Telephone interview with head of BASF International Affairs office, 29 September, 2003.
13. Telephone interview with CEFIC official, 10 November 2003.
14. Ibid.
15. This was the appellate review, which largely upheld the panel's decision. See WTO (2000), 'United States – tax treatment for "foreign sales corporations" ': report of the Panel, Geneva: WTO, 8 October.

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4. Multilateral institutions and market-oriented reform: have they changed the nature of MNC–government relations?

Carlos Rufin

INTRODUCTION

During the 1970s and 1980s, the economics profession underwent a profound change in the orientation of its members' views. Previous notions about the importance of public policy and public action were challenged by what appeared to be the increasing ineffectiveness of Keynesian policies, an apparent slowdown in the growth rates of high-income economies, and the stinging criticisms of Chicago and public choice economists. During these years, the profession began to place a greater emphasis on the role of markets and to harbor increasing suspicion about state-led solutions.

Perhaps nowhere was this shift more pronounced, or more painful, than in the field of development economics. Development economics had possibly been the most state-focused of all major fields in economics; development economists generally accepted that the state had to play a leading role in the process of economic development. By 1981, one of the foremost development economists, Albert O. Hirschman, was intoning his *mea culpa* about the failures of development economics (Hirschman, 1981).

Not surprisingly, the World Bank and its multilateral 'sister' institutions such as the Inter-American Development Bank, as institutions that were largely dominated by economists, also experienced this shift. It also helped, of course, that some of the major shareholders of these institutions, especially the US, were being led by strongly pro-market governments during the 1980s. Thus, by the time the debt crisis of the 1980s hit developing countries, the 'Washington Consensus' (Williamson, 1990) was emerging as the standard policy prescription of the multilateral development banks. The Washington Consensus emphasized the role of market forces through privatization, trade and investment liberalization, and deregulation, as the recipe to promote economic growth and development. This went far

beyond the standard remedies of the International Monetary Fund, which typically focused on the macroeconomic goals of restoring fiscal and foreign balances; among other things, it entailed a shift in the role of the public sector from not just an interventionist position but leading the development process, to being an arbiter between private interests to ensure that private initiative worked in reasonable harmony with the interests of society as a whole. In other words, the Washington Consensus, as reflected in the policy prescriptions of the multilateral financial institutions, entailed a major change in the governance of the economy in developing countries.

The Washington Consensus offered particular hope for an aspect of economic governance that had proved highly contentious: the relations between multinational companies (MNCs) and host governments. Under the new vision of governance, foreign direct investment was to be welcome in developing countries as a wholly positive force that would bring physical capital, technology, and managerial know-how. Developing countries would invite MNCs instead of viewing them suspiciously as exploitative and imperialistic entities.

As the debt crisis dried up private capital flows to developing countries, multilateral lending often became a major source of capital for these countries. This provided strong leverage for the multilateral banks to require privatization and deregulation as conditions for loans to developing countries. 'Conditionality' became a byword of the international financial system, resulting in the implementation of the tenets of the Washington Consensus across many developing countries. The subsequent fall of the Communist regimes only opened the door for further extension of these tenets to another large set of countries.

This chapter is an initial attempt at reviewing the experience of the reforms pursued by the multilateral banks along the lines of the Washington Consensus ('pro-market reforms' in the rest of the chapter) in the specific area of MNC–host government relations. The chapter seeks to examine the degree to which traditional relations, characterized by significant tension between MNC goals and the perceived interests of host governments, have actually become less adversarial after more than a decade of reform as a result of the government taking a less interventionist stance, as sought by the multilateral banks.

Importantly, this chapter is deliberately silent about the desirability of pro-market reforms. This is indeed a fundamental question, but one that has been extensively analyzed elsewhere.[1] For the foreseeable future, the reality is that pro-market reform, however tempered, is likely to retain its primacy. Despite setbacks and adverse reactions (Argentina, Bolivia, Venezuela), few countries seem prepared or able to turn the clock back in any extensive way on the scope of market forces and foreign investment,

and few ideological alternatives enjoy any credibility. The starting point of this chapter is thus the 'realist' perspective of the likely prevalence of pro-market reform, rather than the desire to elucidate the merits or demerits of pro-market reform relative to possible alternatives.

The experience of reform and its aftermath is examined here for the specific case of infrastructure industries, such as electricity supply, natural gas distribution, water and sanitation, fixed-line telephony, or transport. It might be objected that these sectors are far from representative of MNC–host government relations in general. As sectors typically subject to price regulation, and highly visible to the public, they are more likely than other sectors to be characterized by conflict between governments and private suppliers, thus being unrepresentative of the experience of the reforms as a whole. There are, however, good reasons for the choice: because of their capital intensity and importance as basic inputs for technologically dynamic activities (hence 'infrastructures'), these sectors have traditionally received the bulk of multilateral bank investment flows, so the success of the reforms to a significant extent will hinge on the outcome in these sectors. In addition, as will be explained below, these sectors have been the subject of the most ambitious attempts to introduce market forces in the economies of developing countries. As such, they are arguably the flagship of economic governance reforms. Finally, it might be argued that the 'amplification' of conflict in these sectors, for the previously mentioned reasons, provides a powerful augmenting lens to analyze problems that may exist in other sectors but in latent form only and would thus be harder to examine in other industries.

The chapter is organized as follows: the next section describes in greater detail the nature of the changes in the governance of MNC–host relations sought by the reforms pursued by the multilateral banks, with a specific reference to infrastructure sectors; the third section examines the actual record in these sectors on the basis of a number of cases and examples; in light of the contrast between objectives and reality, the fourth section of the chapter considers what could be done to bridge the gap; and the final sections point out the limitations and implications of the chapter, and conclude by summarizing its main conclusions.

REFORMING ECONOMIC GOVERNANCE: MNC–HOST RELATIONS

The reform packages advocated and at times imposed by the multilateral banks envisaged a fundamental change in the nature of the economic governance of developing countries, with major implications for

MNC–government relations. Prior approaches to economic development had emphasized the primacy of the public sector in the development process. Pervasive market failures were thought to hamper the action of market forces, requiring public action to make development possible (for a classic statement, see Rosenstein-Rodan, 1943). For example, failures in financial markets, which increased capital costs and hindered the development of new sectors of the economy, would be remedied through the creation of public banks to capture domestic and foreign savings and to invest them in new sectors such as manufacturing. Likewise, the failure of market forces to allocate resources to technologically dynamic sectors could be corrected through the establishment of planning agencies, public banks, and state-owned enterprises (SOEs).

The upshot of such a view of development was that the public sector should both occupy the 'commanding heights' of developing economies and be involved in the production of key inputs for the economy, from financial services to steel or energy. In other words, the public sector had to be the dominant actor in the governance of these economies, to which private interests would be subordinated, including the interests of MNCs. The implications for MNCs soon became clear: they were welcomed into developing countries as long as they were willing to reach an accommodation with the public interest, as represented by public sector agencies and firms. In some cases, such as the production of steel in South Korea or computers in Brazil, accommodation meant at best sharing technology and know-how with local SOEs, but not the ability to establish local production facilities (Amsden, 1989; Evans, 1995). In other cases, like the automobile industry in Argentina, MNCs were allowed to set up local plants with the expectation that local sourcing and know-how would be built up over time (Shapiro, 1994).

Naturally, this approach led to bargaining and conflict between MNCs and host governments. MNC entry into many developing countries was preceded by protracted negotiation with the host government with a view to creating mutually acceptable conditions. Conflict was abundant because the fixed investments of MNCs produced sharp changes in relative bargaining power once the investment had taken place – the 'obsolescing bargain' phenomenon described by Vernon (1971).

Energy and infrastructure not only fit this pattern, but were in fact at the very core of state-centered development policy. Their natural monopoly characteristics, capital requirements, and importance for economic and social development, created a very strong public interest in their control, leading in fact to their nationalization in most of the world after 1945. Those MNCs that owned utilities in developing countries, such as Stone & Webster or EBASCO, found themselves facing major obsolescing bargains

as their assets were gradually expropriated through adverse price regulation (Gómez-Ibáñez, 2003).

At the time, the multilateral banks contributed enthusiastically to the state-centered model. Energy and infrastructure were one of the cornerstones of the World Bank's lending activity from the beginning of the Bank's existence, for the same reasons that governments paid particular attention to these sectors, as already mentioned. Under the leadership of Robert McNamara (1967–81), the World Bank encouraged the growth of state-owned utilities by providing loans for the construction of massive hydroelectric dams and the creation of national transmission networks.

The debt crisis of the 1980s, in conjunction with the changing worldview of economists, led to a major reappraisal of past policies during that decade, resulting in the emergence of a new paradigm for the economic governance of developing economies. In the specific case of infrastructures, the debt crisis exposed the massive inefficiency and corruption associated with the state-centered model of governance. State-owned companies had pursued large-scale projects that suffered from significant cost overruns and completion delays, in part because the contracts for the construction of these projects were awarded through corrupt practices. Public ownership led to the manipulation of utilities for political gain in other ways too: employment levels were inflated for patronage purposes; collection efforts were dropped and theft was allowed as a way of cultivating consumers for their votes or campaign contributions; rates were held down to avoid political heat; and powerful unions were able to obtain high salaries and better working conditions as governments sought to avoid confrontations that could lead to blackouts and consequent disruptions in public order (World Bank, 1994, 1995).

In response, the reform programs advocated by economists and espoused by the multilateral banks were no longer limited to the attainment of fiscal and foreign account balance. It was necessary to restore the primacy of markets as mechanisms of economic governance. Market forces would be given new prominence through the elimination of restrictive regulations, particularly on foreign trade and investment, and through the retreat of the public sector from the 'commanding heights' and from the production or control of goods and services that could be supplied privately. Planning agencies and economic plans were to be eliminated or radically scaled down; privatization programs would transfer ownership of SOEs to the private sector. In the new framework, the public sector would cease, in large measure, to direct the development of productive resources, as this would be undertaken by market forces guided by profit opportunities relative to those in other countries. Instead, the public sector would focus its efforts on the supply of public goods and the regulation of markets, leading to

a system of regulated market governance. Regulation would facilitate the operation of markets, for instance through the prudential regulation of financial institutions; it would also correct market imperfections, such as environmental externalities. Thus, market reform entailed not merely a shift in governance of economic transactions from administrative to market mechanisms; it also involved a shift in the locus of the administrative action of the state from the production of goods and services to the arbitration between the interests of sellers, consumers, and other social groups (Majone, 1997). As a result, alongside the privatization of SOEs and the elimination of planning agencies, public sector reforms led to the creation of new regulatory agencies. For instance, during the 1990s antitrust agencies were created or expanded throughout Latin America to foster competition (Owen, 2003).

This paradigm shift also had significant implications for relations between MNCs and host governments. Consistent with the concept of the regulatory state, governments would treat MNCs like any other private firms, and only impose general conditions for MNC activity, relating to issues such as environmental impacts and land use, taxation of profits, or working conditions. One-on-one bargaining would be replaced by freedom to invest subject to general business regulations. In infrastructure sectors, one example was electricity generation, where foreign investment was invited to participate in competitive bids for existing or new plants, or in increasing cases to build new plants at the risk of the developer, just like any other type of manufacturing plant. The public sector would cease to intervene directly in this type of decision, leaving it to buyers and sellers to freely negotiate contracts; and any disputes arising from commercial transactions between buyers and sellers would be resolved through the courts or private arbitration.

As with the previous model of development, infrastructure sectors were not only affected by the changing vision of the development process, but became in many ways the lynchpin of reform programs. Guided by academic proposals and policy experimentation in a few countries, the new paradigm sought to extend the reach of market mechanisms to infrastructures. Demsetz (1968), in a now classic paper, proposed competing 'for the market', that is by auctioning off concession contracts, if competition 'in the market' was not possible. Littlechild (1983) proposed a new regulatory scheme that would replicate, for regulated monopolies, the incentives of markets to improve efficiency. Meanwhile, a bold experiment began in 1982 in Chile with the vertical separation of the state-owned utility in the central part of the country, the creation of a mechanism for trading electricity, and the privatization of the electric power industry (Rufín, 2003a). By the early 1990s, these trends had crystallized in the ambitious 'private provision of

infrastructure' (PPI) initiative at the World Bank. The PPI program would encourage the introduction of market forces and private ownership in the infrastructure sectors of developing countries, with the aim of making private investment the driver of growth in these sectors, just as in activities, such as consumer goods, where competitive private investment had been much more the norm. Instead of lending to state-owned monopolies, the Bank would facilitate access of privately-owned utilities to capital markets through its investment banking arm, the International Finance Corporation (IFC). As a result of the programs pursued by multilateral banks and donor countries, and the spread of the pro-market ideology, the new paradigm was implemented in a large number of countries during the 1990s, helped by the happy coincidence of the fall of communism. In electricity, for instance, market-oriented reforms spread rapidly during the 1990s (see Figure 4.1).

THE NEW GOVERNANCE IN PRACTICE

From the vantage point of more than a decade of reforms, it appears that the reforms have failed to effect the transformation in the governance of MNC–host relations in infrastructures, as will be discussed below (Doh and Ramamurti, 2003). Instead, the introduction of private ownership in infrastructure sectors appears to have merely extended the preceding pattern of MNC–host relations into these sectors.[2] The irony here is that history seems to be repeating itself, for MNC–host conflict in these sectors was intense in the period following the end of World War II (1945) and which culminated in the widespread nationalization of utilities.

The first remarkable characteristic of the reform of infrastructure sectors in developing countries is the fact that the introduction of private ownership looked to a large extent to direct foreign investment rather than to domestic sources of capital. In Latin America, with the exception of the early reformer, Chile, virtually all other countries relied extensively on inviting foreign companies to purchase existing assets, build new projects, or take over concessions.[3] Although domestic companies often joined consortia including foreign firms, the latter typically controlled the privatized company, and the domestic companies sold their participation to the foreign investor once the latter had gained some familiarity with the domestic context. A similar story can be told about energy,[4] water, telecoms, and transport in Asia or Africa (World Bank, n.d.:11, Table 1.4). The only partial exception may be Eastern Europe, where governments chose to a greater extent to distribute shares to the population and to foster the creation of locally-owned companies. In telecoms, foreign companies could

1982	1989	1990	1991	1992	1994	1995	1996	1997
							Bangladesh	
							Denmark	
							Ecuador	
							El Salvador	
				Peru	Bolivia		Guatemala	
				Sweden	Colombia	Brazil	Israel	
				Thailand	Czech Republic	China	Jamaica	Armenia
				United States	Honduras	Finland	Japan	Korea, Rep.
				New Zealand	Hungary	Ireland	Jordan	Panama
				Nepal	Morocco	Philippines	Kazakhstan	Romania
				Mexico	Pakistan	Portugal	Poland	Russian Federation
	United Kingdom	Norway	Australia	Malaysia	Spain	Singapore	Sri Lanka	Uruguay
Chile	Netherlands	Costa Rica	Argentina	India	Turkey	Ukraine	Trinidad and Tobago	Venezuela

Source: Elaborated by author from various sources.

Figure 4.1 Distribution of countries undertaking reform of the electricity sector up to 1997

bring new technologies that might not be available to local entrepreneurs. Another possible reason for the reliance on foreign capital was that domestic capital markets lacked the liquidity to absorb the privatization of large assets such as power plants, although the experience of Chile and other countries belies this claim: assets could be transferred, for instance, to pension funds in order to capitalize the funds and keep ownership local. The shallowness of domestic financial markets could also be invoked where large greenfield investment was needed: for instance, to upgrade decaying water distribution networks. Foreign investors enjoyed access to major international capital markets, which had the liquidity to fund such investment.

Whatever the reasons for the almost total reliance on MNCs, the result was that MNCs became the main providers of infrastructure services wherever reform took place. Inevitably, 'obsolescing bargain' dynamics began to appear. Infrastructure sectors are particularly susceptible to obsolescing bargains because they supply products that are widely consumed and thus have very high salience, whereas a large share of costs is sunk in the form of plant and equipment. MNCs quickly became the targets of accusations of corruption in the award of concessions or the terms of privatization, such as paying too little for the assets they acquired, or charging excessive prices for their products.[5] The recognition that many of the countries undertaking reforms had a great need for infrastructure investment led MNCs and their backers in the private and multilateral financial institutions to the understandable but erroneous assumption that these countries would do whatever it took to rectify supply–demand imbalances. In making this assumption, they forgot, ignored, or were insensitive to several uncomfortable facts. First, the infrastructure deficits that existed in these countries were often not of recent making, so users had adapted to functioning in those circumstances, for instance by purchasing back-up electricity generation equipment, or relying on independent water carriers. Many consumers were only willing to tolerate moderate increases in the prices of infrastructure services in order to obtain a better quality of service. In the second place, even where it was obvious that infrastructure deficits had to be alleviated, there was often no consensus as to how this was to be done, particularly about the extent of private sector involvement and the role of market forces. And thirdly, ambivalence towards foreign direct investment still prevailed in many emerging economies, a result of the colonial experiences of many of these countries. Any perception that a project benefited MNCs more than the local populace would invite considerable and unavoidable criticism.

Faced with widespread protest or backlash against reform, governments resisted playing a purely neutral role between the MNCs and consumers. Instead, they sought to renegotiate the terms originally agreed with the

MNCs, particularly with regard to prices, but also with regard to other important clauses such as quality of service or service coverage obligations. The bargains had indeed obsolesced within a few years of reform in countries as diverse as India, the Dominican Republic or Hungary.

The original terms of the reforms often aggravated the potential for obsolescing bargains. Risks were allocated to consumers in ways that created additional incentives to renege on contractual terms, as became painfully evident with regard to foreign exchange risk. Unlike extractive industries, suppliers in infrastructure sectors collect their revenue in domestic currency, while many of their costs are in foreign currency. Power plants often run on imported fuels; plant and equipment are too sophisticated to be produced locally; loans come from foreign sources; and in the case of MNCs, shareholders are abroad. This means that investors in these sectors, and especially MNCs, are highly exposed to foreign exchange risk. Mindful of such an exposure, MNCs generally sought protection from it by requiring that the prices of their products be fully indexed against foreign exchange rates. This meant, however, that the prices of widely consumed products such as piped water or electricity would rise substantially in the case of a major devaluation, which normally produces significant hardship for consumers as the prices of imported goods rise. In other words, utility prices would rise most at the least propitious time. Not surprisingly, foreign exchange indexation clauses have been among the first ones to be ignored by host governments. When the convertibility of the peso into dollars was suspended in Argentina in 2002, for example, the government simultaneously froze utility rates in pesos, breaking the terms of the concession contracts to the detriment of MNCs.

CIVIL SOCIETY ACTIVISM AND MARKET REFORMS

Of perhaps even greater significance for their fate, the reforms failed to pay sufficient attention to the impact of another massive transformation that occurred more or less simultaneously: the spread of democracy. During the 1980s and 1990s, democracy – at least in its formal components of competitive elections for representative government institutions – was enacted in an unprecedented number of countries around the world, in a veritable ‘third wave’ (Huntington, 1991) of democratization that extended democracy to developing and communist countries. In Latin America, for instance, by 1990 most of the countries in the region were democracies, whereas the opposite was true in 1980. A remarkable feature of the ‘third wave’ was the simultaneity of economic and political reforms, which even led Fukuyama

(1992) to claim that it represented the definitive triumph of the 'Western' values of market capitalism and democratic government. This simultaneity was probably not just a coincidence. Many of the authoritarian governments that fell had pursued socialist or interventionist economic policies that had become asphyxiating constraints on economic activity; the failure of such policies often led to the demise of their authors. But it is notable that democracy also reached countries like Chile, whose governments had pursued pro-market policies. Our understanding of the reasons for the coincidence of pro-market reform and democratization is still quite imperfect.

Whatever its causes, democratization expanded the channels for civil society activism and the accountability of governments to their citizens. At the very least, governments now faced the possibility of being ousted at election time. In Latin America's recent experience, voter dissatisfaction has resulted in the formation of populist or even personalistic movements that in many cases have managed to gain wide voter support very rapidly. This has been the case in Venezuela with Chávez, or in Peru with Fujimori (in his upset defeat of Vargas Llosa in 1990), and even in Bolivia, for example, where Evo Morales (a supporter of coca growers) came close to winning the last presidential election in 2002. But in general, the effects of democracy have gone beyond electoral contests. Greater freedom of expression and association have created new spaces for civil society activism, such as for instance the 'Madres de la Plaza de Mayo' in Argentina, who seek fuller disclosure and prosecution of the crimes perpetrated by the country's previous military regime.

However, in the context of a weak institutional fabric that characterizes most developing and transition economies, increased citizen mobilization and civil society activism also created new pressures for the manipulation of the regulatory role of the state. The previously mentioned populist and ideological accusations against MNCs may have found greater resonance as political entrepreneurs have sought issues that could gain voter support. Civic groups have arisen to protest increases in the price of utility services or the deterioration in the quality or coverage of these services. In the Dominican Republic, Father Rogelio Cruz, a dedicated and popular parish priest in a poor neighborhood of Santo Domingo, successfully mobilized the people of his parish to protest against the alleged abuses of Spanish utility Unión Fenosa (interview with Father Rogelio Cruz, Santo Domingo, December 2002). Faced with the potential impact of such messages on electoral competition, governments have often opted to reassert control over the activities of MNCs in infrastructure sectors, especially the prices charged by these companies. In countries with a strong set of political institutions, such as an independent judiciary, attempts of this kind would be curtailed by the presence of other institutions that could uphold

the terms of the original bargain. Unfortunately, in many developing countries the presidency wields a disproportionate share of power over other institutions. Judges can be pressured to resign if considered inconvenient for the government; weak political parties allow presidents to lean on individual legislators to trade their votes for governmental favors; and provincial authorities are either appointed by the central government or dependent on budget allocations from the center (Ramamurti and Doh, 2004). This setup makes it much harder for the public sector to play the role of a neutral arbiter between private interests. The arbiter is inevitably influenced by short-term electoral considerations, given the power of the government over all political institutions.

Despite the breadth of democratization over the past two decades, and the challenges it posed to the attempts to restructure the governance of the economy, the design of pro-market reforms paid little heed to the phenomenon of democratization. In fact, reforms were in many cases made in ways that actually undermined democratic processes. A comparative study of electricity reforms across several countries sponsored by the World Resources Institute (Dubash, 2002) found that reforms were generally made with little participation of legislatures, and even less consultation of stakeholders through mechanisms of democratic participation such as public hearings or periods for public notice and comment. In fact, the reforms were often designed by government technocrats and foreign entities, particularly the multilateral banks plus investment bankers and lawyers from the major international financial markets. This resulted in significant problems of both content and form. On the content side, reform packages tended to follow standard recipes that ignored local considerations. When the Brazilian government asked a London-based team from Coopers & Lybrand (now PriceWaterhouseCoopers) to design a blueprint for the reform of the Brazilian electricity sector, the consultants initially produced a replica of the reform carried out in England and Wales, including the competitive wholesale market implemented there. The proposal completely disregarded the fact that, unlike England and Wales, Brazil produced practically all of its electricity by means of large dams concatenated along a few river basins, which introduced a much greater level of complexity in the Brazilian case. Luckily for Brazil, this shortcoming was strongly criticized by the technocrats involved in the operation of the Brazilian electricity sector, which led the Brazilian government to require Coopers & Lybrand to revamp the proposal completely, in close consultation with Brazilian experts (Rufín, 2003a). Other countries were not so fortunate. In El Salvador, the attempt to introduce a minimally regulated electricity market in a small economy led to the apparent manipulation of market prices and subsequent political backlash against the reform (United Nations, 2002).

The undemocratic form in which reforms were designed and implemented also affected their sustainability even where the reforms fit well with local conditions. The reforms were born with little democratic legitimacy, making public opinion more prone to blame the reforms for any problems regardless of actual responsibility, and even opposing reform where it delivered clear benefits for all. The impact of the lack of legitimacy became very clear as a result of the need, in many cases, to raise the prices of infrastructure services to fund the necessary investment and compensate private suppliers adequately. In the absence of effective communication between the reformers and consumers of infrastructure services about the justification for such price increases, it was easy for consumers to interpret the measures as a scheme for the new private owners to enrich themselves at the expense of the local population, in connivance with corrupt politicians who had sold off the state-owned companies for hefty bribes.

Thus we have the paradox that in Latin America, for instance, public opinion throughout the continent appears to have a dim view of utility privatization (*The Economist*, 2003), even where it has brought better coverage and quality of service. The Argentine case, albeit perhaps extreme, is a salutary story about the perils of neglecting legitimacy during the reform process. Despite compensating labor unions and provincial governments for the adverse impact of reform on these actors, improvements in quality and decreases in prices, the use of public hearings by the regulators, and a successful deal to help poor consumers of electricity, the public could not forget the fact that reforms were rushed by the corrupt government of President Menem. When the convertibility of the peso and the dollar was suspended after several years of deepening economic malaise, public opinion was quick to lay the blame on the privatized utilities, among other actors, and to support the government's decisions to freeze utility rates in pesos.

CAN GOVERNANCE BE TRANSFORMED?

We can conclude that the governance of MNC–host relations in developing countries continues to be characterized by a significant level of conflict. Disputes may have been curtailed in the industries where MNCs have traditionally operated, such as natural resource extraction, but conflict has plagued the infrastructure sectors newly opened to private participation. In retrospect, the efforts by the multilateral banks to change the nature of economic governance have been undercut by the insufficient attention that the design and implementation of the reforms paid to their political viability.

The exclusive reliance on foreign investors, and the generous terms on which they were courted, opened the door for populist accusations of exploitation, and failed to give a stake in the reforms to domestic business firms, which could be expected to have a longer-term commitment to their country and greater savvy to manage political threats. The use of standard blueprints for reform ignored local conditions, such as market size and concentration, that had the potential to negate the potential benefits of reform. Secretive and technocratic approaches to the design and implementation of reforms undermined the legitimacy of the reforms in newly democratizing societies, leaving reforms exposed to subsequent reversals given the institutional fragility of most developing countries.

The analysis of these shortcomings in the preceding section also suggests potential remedies. It is clear that the participation of domestic investors and firms in the reforms must be greater than it has been so far. In many developing countries, there are already domestic business groups equipped with the financial and managerial capabilities to successfully manage infrastructure companies (Khanna and Palepu, 1997) and which can often operate at lower costs; in fact, in countries like India, major groups like Tata and Reliance are already doing so, and in Chile, the experience of Enersis/Endesa Chile shows that it is possible to develop capabilities that are not limited to the domestic market, but can be regionally successful too. Another lesson of the Chilean experience is that greater reliance on domestic firms can also help develop domestic financial markets, which can then reinforce the shift in economic governance from the state to the market. And as already mentioned, domestic ownership creates pro-reform stakeholders that have the capacity to vote or solid knowledge and contacts in the domestic political system. In his review of the nationalization of electric utilities in Latin America after 1945, Gómez-Ibáñez (2003) shows that Electricidad de Caracas avoided nationalization by selling shares to a wide segment of Venezuelans, which deflected charges of foreign exploitation and created a domestic constituency opposed to nationalization. In Guatemala, some of the key defenders of reforms in the electricity sector have been the owners of sugar mills, as they have also become electricity co-generators that earn additional profits by selling electricity in the wholesale market (Rufín and Romero, 2003).

Adapting reforms to local conditions seems, at first blush, a very obvious idea, particularly in light of the problems that were mentioned above about the use of a standardized approach. Yet the real problem is not dichotomous; it is about the extent and determinants of adaptation: in fact, it is conceptually no different from the well-known problem faced by MNCs of adaptation of their business practices across countries. Too much inflexibility may fail in the face of hostile conditions, but too much

adaptation may dilute reform beyond recognition. Fortunately, in the case of pro-market reforms, there is a well developed set of conditions that determine the viability of market processes of resource allocation. First and foremost are the conditions for competition in the market. Markets that are excessively small, or excessively concentrated, are unlikely to yield benefits for all participants. Adaptation must therefore begin here. If conditions are poor, reforms may need to be preceded by the dispersal of ownership, or administrative mechanisms may need to remain in place in order to correct market outcomes.

A more complex challenge concerns the institutional shortcomings of developing countries. Markets require a minimum of security about the rights exchanged in the marketplace. Normally, such security is provided by the arbitral role of the public sector through its enforcement of property rights. If the possibility of making the state an arbiter remains remote owing to the combination of democratization and weak political institutions, then the prospects for the success of the reform effort may be quite dim. Relations between the public sector and the private sector, especially MNCs, can only be expected to be adversarial, and in politically salient sectors such as infrastructures, private ownership may simply be subject to too much regulatory risk to be viable. Market-oriented reform, at least in infrastructures, may be contingent upon the existence of a number of institutional requirements.

It is easy, however, to take such an assessment too far. The problem of political opportunism may be mitigated by attempts to confer greater legitimacy on market-oriented reforms.[6] Legitimacy can be a solution for opportunism because it has the potential to make opportunism less attractive politically. If the design and the outcomes of reform can be made more acceptable to voters, the populist appeal of proposals to reverse the reforms will be reduced and hence the possibility of obsolescing bargains that continues to plague the aftermath of reform (Rufín, 2002).

This raises, of course, the question of how to legitimize pro-market reforms. Reformers must start by acknowledging the concerns of all the major stakeholders and not just investors and MNCs. The main stakeholders in the reform of infrastructure sectors include not only the potential private suppliers and their financial backers, but also subnational governments and consumers, both large and small. Engaging small consumers may have to proceed through intermediary organizations that, with the spread of democracy, have sprung from civil society, such as non-governmental organizations of environmentalists and human rights activists (Rufín, 2003b). The next step is to demonstrate a commitment to address the concerns of the recognized stakeholders during the reform process. This means that there should be a timely, accurate and

meaningful exchange of information among the parties, and that the reformers must be prepared for the possibility of an extended period of interaction as part of a bona fide effort to reconcile differences across stakeholders. As Suchman (1995) remarks, 'the surest indication of ongoing commitment to constituent well-being is the organization's willingness to relinquish some measure of authority to the affected audience'. Participation and information exchange will help create the perception among various stakeholders that the reform process is fair. Perceptions of fairness or procedural justice are critical in shaping stakeholder satisfaction (Thibaut, Friedland and Walker, 1974; Alexander and Ruderman, 1987; Lind and Tyler, 1988; Kim and Mauborgne, 1993, 1997; Strong, Ringer and Taylor, 2001).

Consider the issue of rate increases. Small consumers, even those with limited levels of education, can understand very well the need for prices to bear some relationship to costs and quality of service. What matters, therefore, is consumer perceptions about the fairness of their transactions with infrastructure service providers: the perception that the value derived by consumers from the services bears some 'reasonable' relation to the opportunity cost for the consumers in terms of other products that may have to be given up to purchase these ones. Consumers may not be able to determine the appropriateness of the costs incurred by the provider, as this is usually a complex technical matter; but they are more likely to accept the resulting prices if they believe the *process* used to determine the prices was 'fair'. In turn, the perception of fairness can be attained by informing consumers that the rate-setting process includes full disclosure of the utility's costs as well as the participation of consumer representatives.

To conclude, the shortcomings of the reform programs undertaken in recent years can be remedied. In particular, institutional deficiencies need not be an insurmountable obstacle for the implementation of market reforms. The pessimism that often follows from institutionalist explanations – that poor institutions vitiate attempts at institutional reform – is not fully justified.

DISCUSSION

Before exploring the implications of the preceding analysis, it is worth restating that the aim of this chapter is not to defend or to question the validity of the efforts by multilateral banks and other agencies to alter the framework of economic governance in developing countries. This chapter's more modest aim is to offer a critical review of the reform efforts.

Nevertheless, even a more limited exercise like this has a number of implications for the design and implementation of reforms of this nature, ranging from well-known critiques of multilateral banks to issues that have only been gaining currency more recently.

One implication that is hardly new or surprising is that multilateral banks and other development organizations need to be significantly more flexible in the adaptation of reform blueprints to different countries. It is unfortunate to say so, but an institution like the World Bank still appears to be driven by a culture of economic dogmatism and organizational rigidities that, at least in the case of the programs examined here, greatly hampers its effectiveness. Although introducing greater flexibility is easier said than done, some suggestions do come to mind: decentralizing authority for program design to field offices; employing multidisciplinary teams of social scientists without giving primacy to economists; incorporating possible variations into program design; and implementing a stronger mechanism of knowledge management for the rapid accumulation and diffusion of lessons from the field.[7]

Another familiar implication of the foregoing analysis is the desirability of separating more strictly the lending and policy advice functions at the multilateral banks. One explanation for the excessive reliance of the banks' pro-market reform programs on MNCs and international investors may have been the desire to maintain the banks' credit ratings by lending to reliable companies. As shown above, this had the negative consequences of making reforms less sustainable, and of forgoing excellent opportunities to deepen financial markets in the reforming countries.

An implication that reinforces more recent efforts by the World Bank and other institutions is the need to consider much more carefully the links between pro-market reforms and initiatives regarding the political governance of developing countries. Faced with increasing research evidence (for example Acemoglu *et al*., 2003) about the importance of governance, as well as their own experiences, the multilateral banks are increasingly aware of the need for better governance, but governance programs appear to be developed without coordination with pro-market reforms. As we have seen, not only is the probability of success of reforms dependent on the quality of political institutions, but efforts to legitimize reform will necessarily have a broader impact on governance, by stimulating the formation of entities to represent stakeholder interests and the development of more transparent processes of decision making in the public sector.

To the extent changes in political governance are difficult to attain, it is also important to continue to strengthen multilateral dispute resolution mechanisms, which can offer an alternative to relying on defective host country courts of law. The dispute resolution mechanism established by

the World Bank, for instance, is being used to settle the conflict between the Argentine government and Argentina's foreign-owned utilities, which have suffered from a rate freeze since the abandonment of convertibility in 2002. McGuire and Lawton (this volume) argue that the World Trade Organization's dispute settlement body is having a significant impact on the relationships between MNCs and governments,[8] while Levy and Newell (also in this volume) argue that many MNCs are indeed already seeking to influence the development of such global governance mechanisms, as they realize the increasing impact of these mechanisms on business activities.

Most of these implications are also applicable to MNCs and private-sector firms in general. MNCs, at least those in infrastructure sectors, which may be less experienced than those in industries that globalized earlier, like mining, need to be more adaptable to different institutional environments instead of relying on mechanisms like judicial redress that are often defective. As argued above, an effective alternative to judicial redress in developing countries, where property rights and the rule of law are usually very imperfect, is to actively seek legitimacy, not only for the company itself, but for the reforms. Building legitimacy for the reforms will fend off political attacks against the reforms and thus ensure a greater stability of the rules under which the company entered the country. The development of local alliances can be very helpful for obtaining knowledge of, and access to, influential actors in the country, and even for organizing coalitions of stakeholders favorable to reform. Since much of the contestation of MNC activity is coming from groups in civil society, the search for alliances cannot be confined to local business firms and business associations; the most effective alliances may be those crafted with civil society organizations and NGOs (Doh, this volume; Rufín, 2003b). Legitimacy can also be built up by lobbying for the creation of open and transparent decision-making processes for public agencies, especially the regulatory agencies that are supposed to embody the new arbitral role of the public sector.[9] Too often, private firms prefer an opaque system, in which they expect to gain individual advantages through one-on-one bargaining, to an open system where clear rules are applied uniformly and transparently, and thus there are few opportunities for cutting special deals. Such deals, and the environments in which they take place, may provide short-term gains, but their lack of legitimacy makes them unstable and often unsustainable, as Enron found to its disadvantage with its Dabhol project in India.[10] Lastly, there may be room for enhancing legitimacy through the development of, and adherence to, international standards of conduct by MNCs, for example regarding environmental performance (Christmann and Taylor, this volume).

From a research standpoint, the analysis presented above suggests that how MNCs gain legitimacy in developing countries is an important research question. At a time of renewed interest in corporate social responsibility and an emerging literature on nonmarket strategy (see, for instance, Bonardi, 2004), it makes sense to add this issue to the research agenda on the business environment in developing countries. Recent research has shown that MNCs pay careful attention to the stability of policymaking, preferring countries where the division of powers guarantees greater stability and hence a lower risk of direct or indirect expropriation (Henisz, 2000). But this may entail not investing in countries that offer profitable opportunities, such as China. Clearly, MNCs are entering some of these countries as the benefits appear to outweigh the risks. In such cases, MNCs may still have the potential to reduce risks through efforts to gain legitimacy. Precisely how legitimacy is acquired thus remains an important question that needs further consideration.

On the other hand, this chapter has important limitations that should be borne in mind. It represents only an initial attempt at evaluating the programs of reform of economic governance pursued by the multilateral banks. The evaluation has drawn on anecdotal data rather than on a systematic, quantitative assessment. This means that the conclusions of the present analysis must be regarded as tentative, before more thorough assessments are carried out.

In addition, as already mentioned, this chapter does not question the wisdom of the reforms per se. Interestingly, more than a decade after the demise of most Communist regimes, the pursuit of pro-market reforms is still surrounded by great controversy, at least at the 'street level' of public opinion, the media, and non-governmental organizations. Pro-market reform therefore remains 'contested terrain'. Hopefully, this chapter has shown that such controversy is not to be taken lightly. Even if there is broad consensus at the academic level about the benefits of pro-market reforms, the concerns of the 'street' have great potential to derail reforms by withdrawing political support from reform projects in the current context, where democracy is present in many parts of the world. If this is the case, then another important limitation of this chapter is that it does not provide a direct answer to those who protest against increases in the scope of market forces. Instead, on this issue it only suggests the need to engage the critics in a debate about the appropriate form of economic governance for developing countries, and even to acknowledge that public ownership and reliance on administrative processes may be the most viable arrangement, depending on a country's specific circumstances. A key corollary of the perspective presented above is therefore to determine what such circumstances may be, as well as the appropriate

scope for market forces and private ownership as a function of such circumstances.[11]

CONCLUSIONS

Over the last two decades, multilateral banks and related agencies have made a significant effort to change the governance of developing economies by extending the scope of market forces and private ownership. Among other effects, this effort had the potential to cause major alterations in the relations between MNCs and governments in host developing countries. The increased scope of markets and private ownership could significantly improve the business environment for MNCs and is opening up important new business opportunities.

After more than a decade of reform, the initial review presented here reveals, however, that they have been hampered by important defects in design and by increased civil society activism. Looking at the specific case of infrastructure services as a litmus test of the reforms, it seems clear that MNCs and foreign investors were expected to bear an excessive burden. Conferring so much protagonism on MNCs opened the door to nationalist and populist accusations against these actors and the reforms themselves. In addition, the reforms were applied in an excessively rigid way, foreclosing adaptations to local conditions that would have enhanced their benefits and diminished their costs. Lastly, design and implementation took place without much open debate and participation of all major stakeholders, which further diminished the legitimacy of the reforms and of the companies. This last aspect was especially relevant, because the reforms took place in parallel with the democratization of many developing countries. Democratization created new opportunities for civil society activists to mobilize consumers of utility services and forced elected policymakers to pay greater attention to the demands of these actors. The relative neglect of this type of stakeholder during the design and implementation of pro-market reforms did little to endear the reforms to the electorate. Given the institutional weaknesses of developing countries, voter dissatisfaction with the reforms is already leading to the indirect expropriation of MNC investment in some countries as few safeguards exist. If the opportunities for MNCs arising from pro-market reforms are to be more fully realized, MNCs must be ready to seek local partners even more than they have so far; reform packages must be more carefully adapted to local conditions; and both policymakers and MNCs must invest in legitimizing the reforms, by inviting other stakeholders to participate in the reform process in a meaningful way.

NOTES

1. For a recent contribution, see Mahmood and Rufín (2005).
2. By contrast, Ahlquist and Prakash (this volume) find that an increase in FDI leads to a reduction in contracting costs among private parties, probably because political pressure against the reduction of such costs is less potent than the pressures concerning infrastructure prices and service conditions, thereby making MNC influence stronger.
3. See the various issues of the *International Private Power Quarterly*, which provide detailed information about privatization and greenfield transactions.
4. Ibid.
5. According to data from 954 concession contracts awarded in Latin America and the Caribbean between the mid-1980s and 2000, one in three contracts were renegotiated, and on average renegotiation took place only after two years from the date of the original award (Estache, Guasch and Trujillo, 2003).
6. 'Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate by some socially constructed system of norms, values, beliefs, and definitions' (Suchman, 1995).
7. To be sure, these measures have been suggested by many reform proposals in the past. I can hardly claim originality here, but the stakes are high enough to make repetition valuable.
8. But this approach also has limitations which must be corrected if it is not to break down too.
9. Post and Carroll (this volume) make a strong case for the importance of legitimizing corporate governance through trust-enhancing behavior such as transparency, accountability, and stakeholder engagement.
10. For the Dabhol project, Enron was willing to negotiate power purchase contracts directly with the state government of Majarashtra without open tendering or transparency. Enron obtained very favorable terms, but the plant was shut down shortly after completion owing to disputes with the state government and the unpopularity of the contract.
11. Ghauri and Cao (this volume) also argue for the need to better manage the interdependence between MNCs and developing countries, and suggest a number of measures to do so.

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5. Business strategy in a changing nonmarket environment

John Ahlquist and Aseem Prakash

In this chapter we argue that, in the context of transnational value chains and increasingly interconnected citizen pressure groups, the multinational enterprise (MNE) should view its market and nonmarket strategies as being interdependent and multi-tiered.[1] In particular, we propose a framework in which firms develop locally appropriate strategies for multiple political jurisdictions that both inform and are conditioned by the firm's supra-national strategy. Conceptually, we generalize the idea of the 'two-level game' (Putnam, 1988) by incorporating Baron's idea of the 'multi-domestic strategy' in both market and nonmarket environments.

BACKGROUND

Economic exchanges mediated though market mechanisms require clearly laid out rules that are enforced at low costs. Embedded in social, political, economic, and legal institutions, such rules are established, monitored, and often enforced in the nonmarket arena. By impacting both the market and nonmarket environments, globalization is often viewed as empowering multinational enterprises (MNEs) at the expense of other actors. While MNEs' influence has certainly increased, so have their nonmarket vulnerabilities, particularly vis-à-vis non-governmental organizations (Sell and Prakash, 2004; Doh, Teegen and Vachani, 2004). Drawing on international business and international political economy literatures, this chapter seeks to advance the understanding about how globalization impacts MNEs' nonmarket environments, thereby both empowering and enfeebling them, and how MNEs can be expected to respond to these changes.

In recent years, political scientists have noted that there are important turbulences in world politics with the arrival of NGOs (or the civil society or the third sector) as important political actors on the world stage. While NGOs have been lobbying both the state and firms for the last two hundred years (Vogel, 1978; Friedman, 1999) scholars such as Wapner (1995) claim

that the activities of such groups have heralded an era of 'politics beyond state'. He notes:

> activist organizations are not simply transnational pressure groups, but rather are political actors in their own right. The main argument is that the best way to think about transnational activist societal efforts is through the concept of 'world civic politics'. When activists work to change conditions without directly pressuring states, their activities take place in the civil dimension of world collective life or what is sometimes called global civil society . . . The interpenetration of markets, the intermeshing of symbolic meaning systems, and the proliferation of transnational collective endeavors signal the formation of a thin, but nevertheless present, public sphere where private individuals and groups interact for common purposes. Global civil society as such is that slice of associational life which exists above the individual and below the state, but also across national boundaries. When transnational activists direct their efforts beyond the state, they are politicizing global civil society. (1995: 312)

Without doubt, protests by transnationally networked groups have forced governments to change domestic policies (Keck and Sikkink, 1998) and, in some instances, influenced the evolution of new intergovernmental regimes to manage increasing levels of globalization. In fact, some scholars have predicted the emergence of some sort of global corporatism model where a coalition of NGOs and businesses, along with a prominent international intergovernmental organization, will work together to develop a mechanism of global governance. The Global Compact outlined by UN Secretary-General Kofi Annan in January 1999 and the World Commission on Dams are touted as examples in this regard (Ottaway, 2001).

But what exactly are NGOs? In addition to carrying normative baggage, the term 'NGO' suffers from descriptive inaccuracies. After all, firms are also NGOs. Although several activist organizations are termed 'non-governmental', many of them rely on governments (instead of members or private donors) for much of their funding. This funding accounts for 47 to 78 percent of their incomes in Ireland, Germany, Israel, the Netherlands, and the United Kingdom. On average, private philanthropy provides only 11 percent of their revenues (Then and Walkenhorst, 1999). The terminological confusion (Vakil, 1997) is accentuated because several literatures study the advocacy and public good provision functions of organizations that are often subsumed under the term 'NGO'. These are the NGO politics literature in political science, the non-profit (NP) literature in public policy, and the social movement literature in sociology. In this chapter, we employ a neutral term, 'citizen group', to refer to those activist groups that seek to influence firms' market and nonmarket environments. We agree with Burstein that, in the ultimate analysis, these NGOs or NPOs or social movements are interest group organizations (Sell and Prakash, 2004).[2] For

the purpose of this chapter, we are most interested in understanding how the increasing domestic and international political salience of citizen groups is influencing firms' nonmarket environment and how firms should respond to these dynamics.

The Seattle protests coinciding with the World Trade Organization's ministerial meeting (November 1999) epitomized the growing political salience of citizen groups in influencing domestic and transnational governance structures. Under pressure from citizen groups that were demonstrating outside the meeting venue, (former) President Clinton made a plea for including labor and environmental standards in WTO negotiations, and he even suggested sanctions (which he subsequently retracted) against countries that do not meet such standards. Not surprisingly, Clinton's proposal was opposed by developing countries that enjoy a comparative advantage in the export of labor-intensive goods. Free traders saw Clinton's proposal as protectionist. Countries also differed on other issues such as agricultural subsidies (the United States and the Cairns group versus the European Union – EU) and antidumping laws (the United States versus the rest of the world).

The derailment in Seattle had two messages. First, notwithstanding transnational production, governments continue to champion domestic interests, many times under the guise of new 'international' standards. Second, demonstrations outside the meeting's venue characterized the growing backlash against so-called 'globalization'. It highlighted that many citizen groups believe that intergovernmental regimes suffer from 'accountability deficits' and 'democratic deficits' and view them as hellbent on laying out nonmarket architecture of globalization that favors MNEs over other societal actors (Levi and Olson, 2000).

In particular, the subject of environmental standards has enraged many groups. The WTO judgments on the sea turtles case (against the United States' ban on imports of shrimp), the beef hormone case (against the EU's policy to prohibit imports of hormone-treated beef and to allow the United States to impose penalties equivalent to the damage suffered by its firms), and the gasoline case (in favor of Venezuelan refiners regarding their exports of gasoline to the United States which were banned under the 1990 amendments to the Clean Air Act) are identified as examples in this regard. This is over and above previous cases including the Tuna–Dolphin case that held the US Marine Mammals Protection Act of 1972 to be inconsistent with the General Agreement on Tariffs and Trade (GATT). The WTO rulings are not alone in stoking the anger of citizen groups. Under Chapter 11, Article 1103 of the North American Free Trade Agreement (NAFTA), each party is expected to accord national treatment to the investors from other signatories. Claiming expropriation, US-based MMT

manufacturer Ethyl Corporation sued the Canadian government for $250 million in damages due to Canada's ban (emanating from Bill C-29 passed in 1997) on MMT imports. The Canadian government capitulated and settled the suit for $13 million. Citizen groups viewed this as yet another instance where supranational trade agreements have undermined governments' abilities to protect the environment and the health of their citizens.[3]

The Seattle episode was preceded by a similar one (with citizen groups employing similar tactics) at the Multilateral Agreement on Investment (MAI) meeting in April 1997. Organized under the aegis of the Organization for Economic Cooperation and Development (OECD), the key features of the proposed MAI regime were national treatment for foreign firms, a ban on performance requirements, limits on the expropriation clause (akin to NAFTA's Chapter 11) and rights for private investors to sue national governments (OECD, 1998). If enacted, this regime would have strengthened MNEs' bargaining power vis-à-vis national governments. Human rights groups were irked by the most favored nation (MFN) clause because it could prohibit boycotts of countries that violate citizens' rights. As Kobrin (1998: 104) noted: 'if the MAI had been in force, apartheid would still be with us, Nelson Mandela would still be in jail, and it would be impossible to single out future South Africas for sanctions'.

Akin to Seattle, there were inter-country differences as well. France opposed the MAI, fearing that it could enable Hollywood to swamp the French entertainment industry. Excluded from the negotiations process since they were not OECD members, developing countries opposed limits on their rights to regulate foreign investment.[4] In February 1997, the MAI draft was leaked to Nader's *Public Citizen* and was published on the web. This draft was quickly disseminated around the world and a massive backlash followed. MAI negotiators were forced to meet citizen groups in October 1997. After failing to revive the talks, the OECD announced in December 1998 that the MAI negotiations were indefinitely halted.

In summary, four lessons emerge from studying the changes in the nonmarket environments facing MNEs. First, interested groups differentially affected by increasing levels of cross-border flows will demand new supranational institutions and the strengthening of extant ones. These institutions will constitute the critical nonmarket arenas where the rules for market exchanges are established, monitored, interpreted, and enforced. Second, citizen groups will continue to actively oppose MNEs in the market environment (through, for example, consumer boycotts of sports apparel manufactured in 'sweat shops') and in the nonmarket environment, both in domestic and supranational contexts. Third, citizen groups realize that their impact on MNEs, governments, and supranational organizations would be greater if it brought pressure from several directions (Keck and Sikkink,

1998). Transnationally networked groups will seek to affect MNEs' domestic as well as supranational nonmarket environments. Fourth, inter-country differences at the WTO (and previously at the MAI) indicate that, unsurprisingly, national governments continue to answer to domestic interests and attempt to engineer outcomes to their benefit. Thus, along with supranational nonmarket environments, MNEs will need to manage multidomestic nonmarket environments as well. In effect, MNEs face a more complicated version of the 'two-level games' (Putnam, 1988). What they do in one political jurisdiction impacts the other one. This holds across countries as well as from the domestic to supranational levels (more below).

Building on the above themes, this chapter proceeds as follows. The next section briefly defines the often gelatinous concept of 'globalization'. The second examines why some groups oppose globalization. The third section discusses the notion of the nonmarket environment and how it is changing. The fourth links the nature of opposition to globalization with multinational production and argues that firms will need to build contingent strategies across various domestic and supranational arenas. Conclusions are presented in the last section.

CONCEPTUALIZING GLOBALIZATION

Globalization is either a multifaceted phenomenon having economic, political, cultural, and social dimensions (Appadurai, 1996), or a much abused buzzword. For our purposes, we conceptualize economic globalization (henceforth 'globalization') as the set of processes leading to increased integration of factor, intermediate, and final product markets, coupled with the increasing salience of MNEs' value-chains in cross-border economic flows (Prakash and Hart, 2000). Cross-boundary economic integration is not a new phenomenon. Complex webs of economic linkages have existed among ancient civilizations (Wallerstein, 1979). If globalization were to be measured in terms of trade and capital flows, the world economy was perhaps more integrated on the eve of World War I than it is today (Rodrik, 1997). However, the breadth and the depth of the current phase of economic integration is significantly greater. Further, unlike the case of previous phases of integration, MNEs have a very high salience in cross-border flows.[5]

We pointed out that country representatives disagreed in Seattle over the agenda for the 9th WTO quasi-round, leading to refocused scholarly attention on issues such as the relationship between governments and MNEs. How globalized are MNEs? How salient is domestic policy? Who is 'us' and who is 'them' (Reich, 1992)? There is a theoretical and empirical literature that examines the levels of MNEs' transnationality (Sullivan, 1994;

Makhija, Kim and Williamson, 1997; UNCTAD, 1998). Pauly and Reich (1997) argue that MNEs locate the critical functions – R&D, systems of innovation and corporate finance – in the parent country. Therefore, it seems that MNEs still remain rooted in their home economies. Not surprisingly, then, governments have incentives to defend and to promote domestic firms and home-based MNEs to the extent firms wield domestic political influence (for an opposite view, see Ohmae, 1991). Thus, the evolution of new supranational regimes and transnationalization of citizen groups coexists with the continuing salience of governments in promoting the interest of at least some MNEs. This creates incentives for MNEs to play modified two-level games, simultaneously managing their domestic and supranational nonmarket environments.

OPPOSITION TO GLOBALIZATION

Although foreign trade and investment may increase aggregate welfare, they impact countries (Prebisch, 1959; Hymer, 1976), factors of production (Rogowski, 1989), sectors (Midford, 1993) and firms asymmetrically (Milner, 1988). Consequently, economic integration is perceived to create 'winners' and 'losers'. Often the gains from integration are diffuse and in the long term, while the losses are concentrated and in the short term. Losers have incentives collectively to oppose globalization and the presence of organized groups could mitigate collective action dilemmas (Olson, 1965).[6]

What explains this opposition? One reason could be that globalization is accelerating 'creative destruction'. Restructuring of domestic economies entails job loss, retraining, and demographic shifts. Worker mobility across industries may in fact be quite sticky, as least in the short to medium term, especially as growth industries increasingly require specialized knowledge. Even if the laid-off workers find new jobs easily, arguably the very act of being laid off causes uncertainty that people dislike. Thus, opposition to globalization is not rooted in imaginary causes (Scheve and Slaughter, 2001, 2004; but see Krugman, 1994a). Between 1950 and 1998, international trade grew 17-fold. Why did people not protest then? As the compensation hypothesis enunciated in the 'embedded liberalism' (Ruggie, 1982) argument suggests, this was because a liberal international trade order was embedded in a domestic interventionist state. By expanding and strengthening social safety nets that were first established in the mid-nineteenth century, governments sought to compensate losers from free trade. Financed by taxes, such policies constituted a species of collective insurance. As is well known, welfare policies have come under attack since the 1980s, most likely because of some combination of supply shocks,

demographic shifts, and a changed ideological climate. While several states have managed to preserve their social welfare support, especially when left parties and labor unions are strong in domestic politics (Garrett, 1998), the rhetoric of globalization and race-to-the-bottom (Kahler, 1998) has created fear about the retreat of the social welfare state.[7] With declining union membership, displaced labor is less powerful in relation to mobile capital, at least in many traditional industries (Levi and Ahlquist, 2005). In many countries, labor may have become less mobile across industries in recent decades (Hiscox, 2001). Combining these trends, workers are bearing more risk in the global economy while governments are providing less insurance. Labor has incentives to play the political card in firms' non-market environment by opposing visible targets, such as the WTO, that provide architecture for globalization.

Importantly, many labor organizations in developing countries also oppose globalization, at least in the liberalization of trade.[8] This may seem counterintuitive as the relocation of labor-intensive manufacturing industries from developed countries to low-wage developing countries should pit labor unions in these countries against each other. Further, most manufacturing labor in developing countries is unionized; thus, the influx of new jobs potentially expands unions' membership. Then why might unions in developing countries oppose MNEs' entry? First, many unions are in some way 'official' or attached to government and thereby de facto precluded from taking positions in opposition to the state. Second, unions that do exist are typically in manufacturing and arose in the decades of import-substitution development models in which local industries were heavily protected and subsidized. Union leaders fear both the loss of existing union jobs as uncompetitive domestic firms are exposed to world markets and that foreign-owned firms will be difficult to organize.

Arguably, citizen groups fear that globalization processes provide cover for MNEs to work towards establishing new supranational regimes or strengthening extant ones which are beset with 'accountability deficits' and 'democratic deficits'. The distrust is compounded because governmental delegations at these intergovernmental forums often seem to represent business interests. Some supranational organizations work in secrecy, not offering opportunities for public input. The WTO's dispute resolution proceedings are held in-camera, thereby denying access to citizen groups to participate or even to file briefs. In contrast, the U.S. Administrative Procedure Act requires federal agencies to seek public input on new regulations.

However, blanket claims about MNEs (citizen groups) favoring (opposing) supranational regimes require careful examination (Levy and Prakash, 2003). Based on two attributes, regime purpose (regulation versus market

creation) and the location of monitoring and enforcement authority (domestic versus supranational levels), four broad types of supranational regimes can be identified: international market facilitating, domestic market facilitating, domestic regulatory, and international regulatory. Most citizen groups can be expected to support (and MNEs expected to oppose) establishing regulatory regimes which tend to reduce corporate autonomy. However, some MNEs may support specific regulations because of strategic, political, and competitive considerations. The domestic political economy literature provides several reasons. First, firms that are able to 'capture' (Stigler, 1971) the regulators have often supported new laws and regulations. Regulations provide a sort of entry barrier protecting existing firms. Firms can also use strong third party players to 'organize competition' (Bowman, 1989; Swenson, 2002); that is, to enforce cartelist arrangements that would otherwise fall victim to free rider problems. Further, MNEs that can shape new regulations because of their technological competencies and reap first-mover advantages (Porter and van der Linde, 1995), may favor new regulatory regimes. It seems, therefore, that MNEs may not oppose regulatory regimes per se, but only specific kinds that put them at competitive disadvantage. Conceivably, citizen groups and some MNEs could form 'Baptist–Bootlegger' alliances (Vogel, 1995) in support of some such regulatory regimes.

Claims about citizen groups' and MNEs' preferences for locating enforcement and monitoring mechanisms at domestic versus supranational levels also require examination. At a broad level, actors' preferences for locating authority in a given arena are influenced by the degree of power and access they enjoy in this arena. MNEs are frequently portrayed as favoring supranational arenas because nationally organized groups such as unions and environmentalists are more powerful in domestic politics. MNEs may not want to be regulated by domestic regulators with whom they have had a history of adversarial relations (Kollman and Prakash, 2001). However, given their domestic rootedness, MNEs could be in a better position to influence domestic regulators rather than international ones. In addition, for regulatory regimes requiring significant scientific input, MNEs may not have influence over international 'epistemic communities' (Haas, 1990).

The issue of access to regulatory institutions also influences actors' preferences about them. Marks and McAdam (1996) argue that labor and anti-nuclear groups have been less inclined to support the strengthening of the European Union (EU) because of the less formal access they have to the EU structure, and the constraints they face in establishing a pan-European identity. On the other hand, environmental groups have welcomed European integration partially because the EU structures provided

them with ample institutional access and their abilities to forge a pan-European identity. Thus, environmental groups perceive themselves as enjoying greater influence with the transfer of authority to a supranational level. Clearly, citizen groups and/or MNEs may exhibit varying preferences for various regulatory arenas.[9]

In sum, the opposition to globalization is being articulated at both the domestic and the supranational levels. Arguably, the Seattle episode suggests that politics is local because governments continue to champion domestic interests. While this may be true, Seattle (and the MAI) also signifies the growing importance of supranational regimes in shaping cross-border flows, thereby creating incentives for citizen groups to network in order to influence them. Preferences of MNEs/ citizen groups for national versus supranational, and regulatory versus market enabling regimes depend on multiple factors such as power and access they enjoy in different institutional arenas. As will be argued subsequently, this will create incentives for MNEs to develop and to integrate multi-domestic and supranational nonmarket strategies.

GLOBALIZATION AND THE NONMARKET ENVIRONMENT

Market-based economies function effectively if property rights are clearly delineated, monitored, and enforced at low cost (North, 1990). Typically, governments (executive, legislature, and judiciary) are the main agencies that perform these functions. At a broader level, because governments set most (but not all) rules within which market actors function and private contracts are negotiated (Lindblom, 1977), firms have incentives to influence policy processes (Stigler, 1971; Buchanan, Tollison and Tullock, 1980; Mitnick, 1993). Firms' access to nonmarket actors, processes, and institutions varies within and across countries. The literature on MNE–government relationships (governments being the most important nonmarket actors) is vast, focusing on how governmental policies impact MNEs' strategies, processes and performance, and vice versa (Vernon, 1971; Porter, 1990; Lenway and Murtha, 1994; Caves, 1996; Hoskisson, Eden, Lau and Wright, 2000). Scholars (Preston and Windsor, 1992; Hillman and Keim, 1995) have also examined how institutions, both domestic and supranational, impact MNEs' structures (such as locating their government relations department) and strategies (lobbying, contributing to political action committees, working individually or through industry-level associations). There is also a body of research on how MNEs influence supranational intergovernmental and private institutions

(Braithwaite and Drahos, 2000; Cutler, Haufler and Porter, 1999) and how, and to what extent, citizen groups influence international trade and environmental policy debates (Wapner, 1995; Vogel, 1995). This chapter does not survey these literatures. Instead, it examines how globalization is impacting MNEs' nonmarket environments and how MNEs can be expected to respond to these changes.

Globalization impacts MNEs' nonmarket environments in the following ways: by creating new incentives for governments to influence economic activity; by creating conditions for the emergence of new supranational regimes or for the strengthening of extant ones; by inducing opposition from transnationally networked citizen groups; by providing new channels of information flows; and by consolidating the media industry whereby local events are quickly transformed into transnational ones.

Governmental Interventions and Regimes

Globalization is creating incentives for governments to privatize, liberalize, and deregulate (Ramamurthi and Vernon, 1991). How these processes take place – what to privatize, liberalize, deregulate; and how, when, and so on – is decided primarily in nonmarket environments, both domestic and supranational (Feigenbaum, Henig and Hamnett, 1999). Domestic politics and ideological climate create political space for these changes. At the supranational level, international organizations such as the IMF and the World Bank have required borrowing countries to adopt market-friendly policies.

Further, in response to the emergence of new products and new modes of transactions (the Internet), as well as to correct the failures of ill planned and/or badly executed market-facilitating policies, one expects to see a demand for new regulations (California electricity market being a recent example). Although some have argued that such regulatory mechanisms (particularly, the Internet) should remain in the private domain (Spar, 1999), self-governance by market actors may not always be feasible or desirable (Polanyi, 1957). Private governance also may not be self-enforcing and may require the coercive apparatus of public law. The upshot then is that deregulation and reregulation go hand-in-hand (S. Vogel, 1998). And policies regarding what, when, and how to deregulate or to regulate – all decided in nonmarket arenas – have a crucial bearing on MNEs' market strategies.[10]

Baron (1995a, 1995b) suggests that nonmarket strategies are more important in sectors where opportunities are influenced by governments. In the 1990s, surges in cross-border mergers and acquisitions (M&A) – an integral component of globalization – created oligopolies in many industries.[11] For perspective, M&As increased from $49 billion in 1991 to

$163 billion in 1996, and to $411 billion in 1998 (UNCTAD, 1999). Major industries (such as automobiles, petroleum exploration, semiconductors, consumer electronics, insurance, and banking) now have from eight to ten key players that account for 70–80 percent of the global output (Zachary, 1999). Not surprisingly, then, there is an increased level of antitrust scrutiny, especially in the United States and the EU, the scrutiny of the Boeing–McDonnell Douglas merger, British Airways–American Airlines alliance, MCIWorldCom–Sprint merger, and recently, GE–Honeywell merger being notable examples of regulators restraining the emergence of (potential or actual) cross-border oligopolies. The number of transactions reported to the Federal Trade Commission and the Justice Department under the Hart-Scott-Rodino Act tripled in the 1990s: from 1529 to 4642 in fiscal 1999 (Parker, 2000). Lest antitrust actions become non-tariff barriers or cartel-sponsored private barriers become obstacles to trade and investment flows, key issues are whether, when, and how to establish an international regime (or modify an extant one) on competition policy.[12] This has an immense bearing on MNEs' nonmarket environments.

Globalization also creates incentives for governments to intervene in favor of domestic MNEs in terms of 'macroeconomic' and 'macrostructural' policies (Dunning, 1993). In the 1980s, strategic trade theorists (STT) argued that, in industries marked by imperfect competition, high positive externalities, and supernormal profits (characteristics of the new oligopolies as well), firms are often locked in a zero-sum game, and governments have incentives to intervene in favor of domestic firms (Krugman, 1994b). Boundaries between domestic and international are blurred because domestic interventions (such as tariff and non-tariff protection, R&D subsidies) can tilt the scale in favor of domestic firms in global markets. In emerging technology industries, the competition over standard setting is intense as the owner of the winning standard is often guaranteed near-monopoly rents for a significant period. Arguably, given the fast pace of product obsolescence, a winner-takes-all situation is developing in many industries. Consequently, MNEs have incentives to emerge as winners, if not through market processes then through nonmarket strategies.[13] Thus, globalization processes create incentives for MNEs to enlist support from their home governments and create an obligation for governments to support them (Stopford and Strange, 1991).

Citizen Groups and the Media

Although domestic governments may be willing to support MNEs, a major threat has emerged from transnationally networked citizen groups,

many of which believe that MNEs are their common 'enemy'. Florini (2000: 216) notes:

> Businesses, increasingly the direct target of transnational civil society activities, find it even harder than governments do to keep civil society at arm's length. . . . Although businesses that market directly to consumers have been most affected by transnational civil society campaigns, other types of businesses are increasingly finding themselves forced to change their practices.

The *Yearbook of International Organizations* estimates the number of international NGOs (operating in more than one country) in 1999 at 26 000, up from 6000 in 1990 and 3000 in 1960 (*Economist*, 1999: 19). These groups may operate within the traditional state-centric system by influencing governments, or independently of it by directly influencing MNEs (Vogel, 1978), consumers, and policy discourses. In recent years the latter perspective has gained currency with many scholars, suggesting that global civil society and global politics – organized social life and politics that are independent of the state and outside the state-centric system – have emerged (Wapner, 1995).

Berry (1999) suggests that citizen lobbies now focus predominantly on postmaterial issues (consumer issues, environmentalism, and minority rights) rather than economic issues (import duties, manpower training, and farm price support). This is also reflected in the changes in the US Congress's agenda over last four decades: in the 1960s, about two-thirds of the proposals were economic, while by 1991 about 70 percent were postmaterial.

Realizing that their strength lies in numbers, citizen groups have incentives to coordinate their strategies across borders. The Internet has reduced the costs of organizing collective action, the mobilization against the MAI meeting (Kobrin, 1998) and the Seattle meeting being notable examples. Many citizen groups are quite media savvy, often managing to outmaneuver their corporate opponents.[14] A telling example is the controversy over the dumping of the Brent Spar buoy (often incorrectly described as an oil platform) in the North Sea in 1995. The main actors were Greenpeace and Royal Dutch/Shell (third largest MNE in terms of assets; with 1997 sales of $128 billion). Shell used the Brent Spar buoy as a storage and tanker loading facility for its Brent oil field in the North Sea. In 1991, the buoy was decommissioned, and after extensive internal scientific evaluation, discussions with British governmental agencies, and consultation with British stakeholders regarding the environmental and safety aspects of various disposal options, Shell decided to dump it in the North Sea rather than to bring it onshore for dismantling. However, Greenpeace opposed dumping.

One of its key claims was that the buoy contained hundreds of tons of toxic petroleum waste, some of it radioactive. Greenpeace launched a massive media campaign and eventually Shell was forced to bring the buoy ashore for disassembly. Eventually, independent investigations revealed that the buoy did not contain the petroleum waste, certainly not any radioactive ones, as Greenpeace had alleged. Embarrassed by this development, Greenpeace wrote to Shell apologizing for the factual error (Moore, 2000). Nevertheless, in the heat of the controversy, the media gave prominence to Greenpeace over Shell.

An important implication is that because the media industry is now increasingly globalized (in terms both of ownership and of content), local events such as Brent Spar quickly impact market and nonmarket environments in other parts. Thus, MNEs are losing their ability to localize damage from adverse media coverage (Prakash and Kollman, 2003) even if their actions are defensible on scientific and technical grounds. Their response time has also been reduced. These trends suggest that MNEs now require supranational nonmarket strategies on issues that can potentially spill over borders, and most issues seem to be developing this potential.

Because globalization leads to a high degree of cross-border economic linkages, MNEs become vulnerable to political developments in their home and host countries. Citizen groups in home/host countries can impact MNEs' strategies in yet another country. US citizen groups, notably the Natural Resources Defense Council, in alliance with Mexican groups, forced Mitsubishi to shelve a $100 million investment in a salt plant on the shores of Laguna San Ignacio where gray whales breed: 'And as Mexico received $11.6 billion last year in long-term investments from abroad, it also discovered that it cannot ignore the other forces, like the environmental movement, that are criss-crossing borders and making politics into a global game' (Preston, 2000: 9). The message is clear: if MNEs invest in multiple markets, they need to deal with citizen groups in multiple countries. And this would require MNEs to integrate their supranational and multi-domestic nonmarket strategies.

A lack of such integration can impose significant costs, Royal Dutch/Shell's experience in the global warming debate being a notable example. There is wide divergence within and among countries on the existence, causes, and consequences of global warming. MNEs with FDI in multiple countries could be faced with tricky situations where only some governments wish to ratify the Kyoto protocol. Thus, relying on multi-domestic nonmarket strategies may make MNEs appear inconsistent. Royal Dutch/Shell faced this predicament recently. Owing to the varying domestic political economies, Shell's UK and Dutch parents have consistently supported the Kyoto protocol while Shell USA opposed it. Being

a visible member of the anti-treaty US-based Global Climate Change (GCC) coalition, Shell USA criticized the Kyoto protocol in the main text of its 1998 annual report. Shell's inconsistency was quickly seized upon by environmental groups. Sensing a damaging political fallout, the European parent forced its US subsidiary to repudiate its opposition in an addendum of the *same report* (Kolk, 2000: 72). This 'flip-flop' took a toll on Royal Dutch/Shell's credibility with environmental groups. To mollify this important actor in its nonmarket environment, Royal Dutch forced its US subsidiary to withdraw from the GCC coalition in April 1998. Thus, relying on multi-domestic nonmarket strategies alone will not work for MNEs because both economics and politics now have important global dimensions.

It some ways globalization also empowers MNEs to better influence their nonmarket environments through their cross-border 'rent chains' (Baron, 1995a). Rents are returns on resources above their opportunity costs. Rents manifest themselves in many forms: supernormal profits for industries protected from imports or high wages for labor whose unions have forced governments to restrict imports from low-wage countries. Because of extensive forward and backward linkages, MNEs often create rent chain networks across jurisdictions. MNEs can be expected to organize these networks for nonmarket action.[15] Thus, along with the increased supranational reach of citizen groups and the media that potentially disadvantage MNEs in nonmarket arenas, transnational rent chain networks can be expected to serve as useful resources for MNEs' nonmarket activities, particularly their global strategies.

To summarize, this section suggests that globalization is changing MNEs' nonmarket environments in four ways. First, it is leading to deregulation as well as reregulation. Because cross-border consolidations are creating global oligopoly industries, there is increased antitrust scrutiny. Instead of a national orientation, competition policy is moving toward a regional and global focus. Second, since MNEs retain national identities and first-movers appropriate significant profits, governments have incentives to influence nonmarket environments in favor of home-based MNEs. Third, many citizen groups that oppose MNEs have acquired a broad array of cross-border competencies (not merely country-specific). Exercising both 'structural' and 'relational' power (Strange, 1999), these groups seek to change the existing rules of global commerce and investment and to prevent new ones that empower MNEs over other societal actors. Their collective opposition is significantly aided by the Internet and their abilities to manage the media. Fourth, since the media is now significantly globalized, local nonmarket issues quickly acquire supranational dimensions. We now turn to the way firms can respond to this changing environment

strategically. We will argue that MNEs can be expected to develop multi-domestic and supranational nonmarket strategies (including mobilizing their rent chains).

THE MNE AND MULTI-TIERED STRATEGY

Baron (1995a, 1995b, 2000) emphasizes the role of nonmarket environments in influencing market outcomes. Nonmarket environments consist of the 'social, political, and legal arrangements that structure the firms' interactions outside of, and in conjunction with, markets' (Baron, 1995a: 48). They differ from market environments in terms of decisionmaking processes (majority rule, due process, and broad enfranchisement in nonmarket environments), firms' control over the processes (market processes are voluntary, nonmarket ones may be involuntary as well), who participates in these processes (stakeholders having economic and non-economic interests in nonmarket environments), and levels of the 'free-rider' problem (high in nonmarket environments). Since strategies to deal with nonmarket and market environments differ, Baron emphasizes that firms should integrate their market and nonmarket strategies.

Bartlett and Ghoshal (1989) identify three mentalities/strategies (global, international, multi-domestic) that MNEs adopt to deal with the opposing pressures of globalization (tapping economies of scale) and localization (tailoring strategies to serve country-specific needs). Global strategies are predicated on an integrated world market and require firms to adopt a given strategy across countries. If political boundaries significantly impact the nature of markets, then global strategies are less useful. International strategies require transferring parents' expertise to foreign markets while multi-domestic strategies are developed to respond to country-specific needs.

Baron suggests that nonmarket strategies should be examined in the context of institutions, actors, and issues. Since these often vary across countries, he calls for MNEs to adopt multi-domestic strategies, as opposed to global or international ones:

> A comprehensive global or international nonmarket strategy seems unlikely to be successful, however, because strategies must take into account the institutions in whose context nonmarket issues are addressed, the configuration of interests in a country, and other country-specific factors. Many nonmarket issues have a strong domestic orientation and are more likely than market strategies to require multi-domestic strategies. The successful implementation of a multi-domestic strategy involves issue-specific action plans that are tailored to the configuration of institutions and interests in individual countries. (1995a: 62–3)

This chapter argues that, with the accelerating pace of economic globalization, in addition to multi-domestic strategies, MNEs can be expected to adopt supranational strategies. Although globalization processes are causing many interests (especially the ones that oppose MNEs) and institutions (where rules are established, monitored, and enforced) to assume a supranational character, the domestic nonmarket environment (particularly, the power of and incentives for governments to influence market processes) remains important. National governments continue to play important roles in shaping the evolution of supranational regimes, and domestic politics matters in influencing what governments do or do not do. Therefore, the nonmarket challenge facing MNEs would lead them simultaneously to develop multi-domestic policies that fit into their supranational nonmarket strategies as well as to develop supranational strategies (in relation to supranational institutions and actors) that are consistent with their multi-domestic ones. In other words, MNEs will be playing 'games' in each jurisdiction in which they have a financial interest; the other players could include governments, other firms, and the citizen groups we identified above. These games, by their very nature, involve asymmetric information, mutual benefits to players and incentives to oppose one another. Each game is not independent and isolated, however. Firms will learn from experiences against one set of opponents and attempt to adapt the strategies they employ elsewhere. Similarly, the firm's opponents can be expected to (at least partially) observe how the firm plays against others in similar games. Both the firm and its opponents will play simultaneously in the supranational arena, attempting to impose structure and consistency in the domestic level games across jurisdictions.

This is a challenging task given an increasing divergence among countries on how globalization processes need to be managed, Seattle and MAI being telling examples. A need for domestic focus in shaping nonmarket strategies and yet ensuring that there is global coherence raises important issues for MNEs in devising their organizational goals, structures, and processes. Firms will need to consider several variables.

First, is the firm, on (weighted) average, in an advantageous position in playing the game in a decentralized manner? If so, it may be worthwhile to avoid supranational influence in some areas. If, however, the firm is in a threatened position, it may pay to attempt to constrain domestic actors via supranational venues.

Second, what are the informational costs and burdens imposed on the firm by having to maintain not only separate strategies in different markets but also an apparatus for monitoring outcomes and synthesizing information across 'games'? As the literature on bounded rationality has long

recognized, these burdens could be overwhelming. Firms may be able to economize on attention and processing (that is, informational costs) by standardizing the game across jurisdictions via a supranational strategy. Alternatively, if decisionmaking can be effectively decentralized then more parallel processing can occur within the firm and playing the multi-domestic games may make sense.

Third, what is the firm's long-term position? A particular firm may have relatively short-term interests in some jurisdictions but longer-term concerns in others. One way to reconcile the two is to pursue a long-term strategy on the supranational level and devolve short-term game play to the domestic level. If a binding supranational institution is unlikely to emerge the converse could also work: identify long-term multi-domestic interests and play the supranational game for the short term only.

Finally, these games are clearly iterated in the sense that they do not disappear after one play. Players, however, may change in either their interests or their identities. To maintain this multi-tiered strategy appropriately, the firm must be forward-looking in terms of new entrants, beyond just other firms in the industry. New players could take many guises, as we have illustrated.

CONCLUSIONS

MNEs are impacted by globalization in ways they cannot completely control. As economics begins to have important global dimensions, so does politics. MNEs increasingly confront supranational actors who oppose them, supranational regimes that govern their behavior, and global media that scrutinize them. At the same time, however, domestic politics of home/host countries remain critical for MNEs' operations. This chapter therefore argues that pressures to manage domestic and supranational nonmarket issues, actors, and institutions simultaneously would create incentives for MNEs to play two-level games (Putnam, 1988).[16]

In response to an important debate in international relations on how best to explain countries' foreign policies (in terms of domestic imperatives, the 'second-image'; or international structures, the 'third-image'), Putnam argued that domestic and international imperatives need to be considered simultaneously:

> The politics of many international negotiations can usefully be conceived as a two-level game. At the national level, domestic groups pursue their interests by pressuring the governments to adopt favorable policies, and politicians seek power by constructing coalitions among those groups. At the international level, national governments seek to maximize their own ability to satisfy domestic

> pressures, while minimizing the adverse consequences of foreign developments. (Putnam, 1988: 434)

Read the above quotation by substituting MNEs for national governments. The salience of domestic and supranational arenas for MNEs would differ across issue areas, depending on, inter alia, the actors that are engaging MNEs, the institutional context, and the trans-border appeal of the issue. The impact of home/host countries on MNEs' strategies would also vary because developing countries typically have much less bargaining power vis-à-vis MNEs. Thus, in playing a two-level game, MNEs may be aware of conflicting pressures from both levels: crafting multi-domestic strategies could sacrifice their global applicability but supranational strategies may not fit perfectly well in every domestic context.

This chapter suggests that citizen groups have emerged as key actors that MNEs need to take into account. MNEs' strategies to confront, coopt, and/or collaborate with these groups can be expected to be nuanced because significant differences exist within citizen groups regarding their aims, capabilities, and orientations. For example, citizen groups from the North and South differ in fundamental ways (Malhotra, 2000). This would clearly pose a challenge for MNEs operating in both developed and developing countries because working with one set of stakeholders may offend some others. In this regard, the criteria of power, legitimacy, and urgency that Mitchell, Agle and Wood (1997) offer to managers in classifying stakeholders merit attention. Because giving equal salience to all stakeholders is difficult, managers are advised to identify which stakeholders have the power and legitimacy and which managerial responses require urgency. On the basis of these attributes, managers could decide which stakeholders' concerns will be addressed, when, and how. Such decisions will be challenging if different stakeholders in the domestic and supranational arenas are powerful and/or legitimate and different sets of managerial actions are deemed urgent by them. Further, as discussed above, stakeholders from the South may be disadvantaged if managers were to adopt the decision criteria suggested by these authors.

To conclude, globalization is impacting various societal actors in multiple ways. While MNEs' influence has increased in some areas, so have their vulnerabilities. A key challenge for scholars of international business and international political economy is to examine how globalization is impacting various actors and social relationships, and how these actors have (or could have) responded to these changes. This chapter has contributed to this endeavor by examining how globalization impacts the nonmarket environment, and how MNEs can be expected to respond to these changes.

NOTES

1. This chapter draws on Prakash (2002). We thank Sushil Vachani for his comments.
2. The Tocquevillian romanticism with the civil society (Putnam, 1995) may not hold for all societies (Sabine,1952) . Even in the American context, citizen groups have also come under criticism. Mathews (1997: 64) notes:

   > For all their strengths, NGOs are special interests . . . The best of them, the ablest and the most passionate, often suffer most from tunnel vision . . . A society in which the piling up of special interests replaces a single strong voice for the common good is unlikely to fare well. Single-issue voters, as Americans know all too well, polarize and freeze public debates.

3. The MMT case, unfortunately, has not been adequately understood, and perhaps has even been misrepresented. Bill C-29 prohibited imports and interprovincial trade in MMT. It *did not* prohibit Canadian firms from manufacturing MMT. Thus, the Canadian government was in weak legal standing as Bill-29 discriminated against foreign manufacturers, thereby violating NAFTA's 'national treatment' clause (Hufbauer, Esty, Orejas, Rubio and Schott, 2000). Arguably, had the Canadian government prohibited MMT's domestic production as well, the final outcome would have been different.
4. Developing countries have, however, fallen all over themselves in recent years in the rush to sign Bilateral Investment Treaties (BITs) with capital exporting countries. BITs provide for MFN or national treatment of investors from signatory countries. BITs also typically provide for third party arbitration of disputes between investors and governments (UNCTAD, 1998).
5. Multiple indicators reflect the MNEs' key economic role in the contemporary world economy (UNCTAD, 2000): inward FDI stock has surged from $1 trillion in 1987 to $4.8 trillion in 1999, and MNEs' value chains account for about 10 percent of world GDP (5 percent in the mid-1980s). Data suggest that the so-called 'Triad' accounts for 60 percent of FDI inflows. Rugman and D'Cruz (2000) point out that most manufacturing sectors are regionally, not globally integrated. Though this is not examined in the chapter, if regional integration leads to the establishment of regional level regulatory institutions, MNEs may then have incentives to develop regional nonmarket strategies in addition to domestic and global ones.
6. This is not to suggest that the resistance to globalization/neoliberal policies began only in the 1990s. In the 1980s, citizen groups in developing countries actively opposed the IMF's structural adjustment policies.
7. The literature on this subject is rather huge and sophisticated. Rudra (2002) points out that Garrett's arguments cannot be generalized to developing countries that have large surplus pools of unorganized labor. Iverson and Cusak (2000) suggest that the resilience of the welfare state has little to do with globalization; it is explained by the demographic changes taking place in OECD economies.
8. Most labor in developing countries is not unionized (Rudra, 2002) and frequently employed in the informal sector (De Soto, 1990). In many countries, a sizeable section of the labor force works in the agriculture sector. Because the informal and agricultural sectors are not organized, it is difficult to assess labor's preferences regarding economic globalization. Organized labor is often incorrectly portrayed as the voice of all labor.
9. Citizen groups may also not speak in one voice owing to their clashing interests, economic or non-economic: the American Federation of Labor and Congress of Industrial Organizations (AFL–CIO) opposes the ratification of the Kyoto treaty but most environmental groups support it.
10. A vast majority of FDI reregulations favor MNEs: in the period 1991–9, 94 percent of 1035 changes in FDI laws favored MNEs (UNCTAD, 2000: xv). At the same time, there are trends towards reregulating key industries to rein in firms (Vogel, 1998).

11. The EU can investigate the merger of entities (and impose sanctions on them) whose combined sales exceed $4.5 million in the EU area, irrespective of where these entities are headquartered. Many industries, therefore, correspond to Yoffie's (1994) 'regulated competition' model. This is not to say that cross-border M&As always create oligopolies. In many cases, they may create contested markets. However, how such M&As impact levels of competition depends on competition policy, an area in which governments exercise a sizable influence.
12. The WTO does cover some issues pertaining to competition policy. Recently, it upheld the EUs complaint regarding a $1.4 billion tax break (an export subsidy) provided by the US government to its exporters under the Foreign Sales Corporation (FSC) law. FSC allows US companies to set up offshore subsidiaries that are partially exempted from US corporate taxes. US companies channeled some of their export profits through these subsidiaries and the WTO found this to be in violation of WTO rules.
13. Examples are numerous. Airbus invoked political help to ensure that the EU required Boeing to shed its exclusive supply contracts with three major American airlines in return for its approval for the merger with McDonnell Douglas. President Chirac was quite vociferous in this regard. The EU objections to MCIWorldCom-Sprint merger are attributed (partially) to lobbying by French and German governments who fear that France Télécom and Deutsche Telecom will be locked out of the Internet backbone market.
14. The media are also giving more coverage to citizen groups, in both network TV news and the printed press. For details, see Berry (1999). The media industry is getting more concentrated and, arguably, it is not a disinterested player in the various globalization debates. Further, as media companies come to rely more on advertisement revenues (rather than user fees or governmental budgetary support), they become vulnerable to pressures from their advertisers (rather than politicians and bureaucrats). To increase their viewership/readership, these companies are also under pressure to be the first to report news (thereby perhaps upsetting their advertisers).
15. The Clinton Administration's decision to levy a punitive import tariff on Japanese luxury cars led Japanese auto companies to mobilize their dealer networks in the United States against this policy, including a demonstration at Capitol Hill.
16. The two-level game approach would be equally helpful for citizen groups in developing their strategies to oppose MNEs.

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6. Governance and the stakeholder corporation: new challenges for global business

James E. Post and Tanja D. Carroll

INTRODUCTION: THE GOVERNANCE OF GLOBAL BUSINESS

Corporate governance has become an axial theme in discussions of the modern capitalism. We live in an era of corporate and managerial misdeeds and, to an extent not evident in the past 70 years, there is a widespread recognition of the institutional and societal need for improved corporate governance. Sound corporate governance is both a 'private good', whose benefits redound to shareholders, employees, customers, and other stakeholders, and a 'public good' (that is, collective good) that benefits society as a whole.

In a famous article, published more than 70 years ago, Harvard law Professor E. Merrick Dodd asked, '*For whom are corporate managers trustees?*' His answer was that managers are trustees 'for the *institution* (rather) than for its *members*', and further, 'that society may properly demand that [business] be carried on in such a way as to safeguard the interests of those who deal with it . . . *even if the proprietary rights of its owners are thereby curtailed*' (Dodd, 1932, reprinted in Clarkson, 1998; quotations are from Clarkson, p. 46, italics added). This position was considered quite controversial at the time, and still is in some circles, but most contemporary analysis equates the interests of the corporate *institution* with the interests of some or all of its multiple stakeholders, nonowners as well as owners.

As Charles Handy wrote in a 'Looking Ahead' symposium commissioned to mark the 75th anniversary of the Harvard Business Review,

> The old language of property and ownership no longer serves us in modern society because it no longer describes what a company really is. . . . The idea of a corporation as the property of the current holders of its shares is confusing because it does not make clear where power lies. . . . A public corporation should now be regarded not as a piece of property but as a community . . . created by a common purpose. (Handy, 1997, pp. 7–8)

In spite of broad agreement about the existence and importance of stakeholders within the corporate system, the troublesome questions raised by Dodd are still at the center of the current debate. Which stakeholders are to be recognized, and in what ways? How are the interests of multiple stakeholders, whoever they are, to be incorporated into corporate governance and decision-making processes? The first of these questions is easy to deal with in general, although difficult to resolve in specific cases. The second is easy to deal with in specific circumstances, but hard to resolve in general.

These questions are of special importance in the context of global business, where an effective system of governance is limited by the absence of institutions (for example, national governments) capable of exercising countervailing influence. Global businesses, by their nature, are built on relationships with very large numbers of stakeholders across national borders, some of whom may well be in conflict with one another. To suggest that the effective governance of global businesses requires *public trust* is to suggest that the global enterprise cannot survive without institutional and noninstitutional mechanisms designed to foster public trust in the modern world. Transparency, accountability, dialogue, and engagement are among the trust-producing mechanisms that are essential to the successful enterprise of the twenty-first century.

THE EXTENDED ENTERPRISE

The global business of the 21st century is an extended enterprise. The 'extended enterprise' metaphor, which has its origins in manufacturing-logistics management, refers to the full range of constituencies that are vital to the survival and success of the modern corporation. The contemporary global business is the nodal element in a network of actors and interests often referred to as 'stakeholders' who, as the term implies, share the benefits and risks arising from the firm's operations. The firm creates value through relational, as well as transactional, interactions – both voluntary and involuntary – with stakeholders in its social and political environment, as well as those constituting its resource base and industry setting.

This 'stakeholder view' (SHV) of the firm holds that stakeholder relationships are the ultimate sources of the firm's wealth-creating capacity. According to this view, long-term business success requires a firm to develop and integrate relationships with its multiple stakeholders within a comprehensive management strategy. *Redefining the Corporation* illustrates this approach by describing and analyzing the evolution and impact of comprehensive stakeholder management policies in three major firms,

Cummins, Motorola and Royal Dutch Shell, over the course of several decades. (See, Post *et al.*, 2002.)

The critical dependencies among the firm, its employees, customers, investors, communities and other constituencies cannot be described in terms of simple contractual exchange. Indeed, early in the last century, and just as the mechanistic idea of 'scientific management' was gaining acceptance, Mary Parker Follett discussed the central contribution of 'interconnectedness' among diverse actors to business success (Schilling, 2000). Chester Barnard later described the business firm as a 'cooperative' organization based on rational principles, and this characterization continued to attract scholarly endorsement over the following decades (Barnard, 1938). Nearly a half-century later, Freeman (1984) argued that the central challenge of strategic management was creating a satisfactory balance of interests among the diverse constituencies that contribute to, or place something at risk in, the running of a business. Freeman's writing popularized the term 'stakeholders' to describe the entities and interests that are involved, either voluntarily or involuntarily, in the operations of the firm. The 'stakeholder model' subsequently became a familiar and widely accepted characterization of the contemporary business organization.

The term 'extended enterprise' appears to have originated at Chrysler Corporation, where it was used to describe information exchange and cost reduction challenges within the company's vast supply chain. The concept was later generalized as a distinctive approach to manufacturing-logistics management. Contemporaneously, a more detailed model of the firm operating within a network of relationships mediated through both market and nonmarket processes was also developed by academicians (Dyer and Singh, 1998). In a 'Survey of the Near Future', *The Economist* (3 November 2001, pp. 1–20), Peter Drucker described such a network organization as 'a confederation or syndicate'; and Michael Hammer and James Champy (1993) moved beyond reengineering and recognized the 'extended enterprise' as a comprehensive metaphor for the contemporary large corporation.

In our analysis, the 'extended enterprise' concept includes not only the focal firm's interactions with other businesses, but also its relationships with other stakeholders, both internal and external. The 'extended enterprise' is a node within a network of interrelated stakeholders that create, sustain and enhance its value-creating capacity; and we argue that the long-term survival and success of a firm is determined by its ability to establish and maintain relationships within its entire network of stakeholders.

Strategic management theory has long been dominated by a controversy over whether the primary determinant of a firm's successful performance was (a) its access to resources or (b) its position within its industry structure. The editors of a Special Issue of the *Strategic Management Journal* devoted

to this debate eventually concluded that the attempt to choose one of these explanations over the other is fruitless because there are continuous 'reciprocal interactions' between the firm and its environment, with competition shaping capabilities, and capabilities in turn shaping competitive positions (Henderson and Mitchell, 1997). But even this benign conclusion fails to take into account the third dimension of strategic activity, the social–political environment. Schendel's (1997) critique of strategic management research as failing to study path-dependencies and contingencies foreshadowed the need for focusing on the stakeholder corporation as an axial theme that unites the interests of corporations, governments, nation-states, and the entire international community. The transformation of corporate governance, the subject of the conference on which this book is based, inevitably deals with the central questions stated above. Which stakeholders are to be recognized, and in what ways? How are the interests of multiple stakeholders, whoever they are, to be incorporated into corporate governance and decision-making processes?

To answer these questions, we must integrate all three dimensions – resources, industry structure, and social–political setting – to discuss a redefinition of the corporation and the governance framework that theory and reality call forth.

The New Stakeholder View

Contemporary analysis of the stakeholder model has evolved from mere descriptive accuracy to exploration of its instrumental and normative implications (Donaldson and Preston, 1995). Following the argument that managers have a responsibility to meet the legitimate claims of all stakeholders, Jones and Hill (1992) developed a 'stakeholder agency' model and argued that managers should act as 'agents' for stakeholders (the relevant 'principals'). Although the specific instrumental impact of a stakeholder orientation on financial performance has been difficult to quantify, Michael Jensen, a well-known finance scholar, reflects a widespread consensus in the remark that 'a firm cannot maximize value if it ignores the interests of its stakeholders' (Jensen, 2001).

In spite of its widespread use, the term 'stakeholder' is rarely given a precise definition. To correct this deficiency, we propose the following:

> The stakeholders in a firm are individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and who are therefore its potential beneficiaries and/or risk bearers. (Post *et al.*, 2002, p. 19)

This definition is consistent with the criteria for stakeholder identification suggested by Kochan and Rubenstein (2000) in their study of Saturn, Inc.

They note that stakeholders (a) supply critical resources; (b) place something of value 'at risk' and are dependent on 'the fate of the enterprise'; and (c) have sufficient power to affect the performance of the enterprise. It should be noted that competitors, often erroneously included in general lists of corporate stakeholders, are explicitly – and correctly – excluded by this set of criteria. (Of course, erstwhile competitors sometimes join in collaborative activities, in which case collaboration, rather than rivalry, determines their stakeholder status.)

The capacity of a firm to generate sustainable wealth over time, and hence its long-term value, is determined by its relationships with critical stakeholders. According to this view, recognition of mutual interests among the firm and its stakeholders, leading to the development of consistent and supportive policies for dealing with them, is the critical challenge for contemporary management. It is a challenge that involves policy, practice, and corporate governance.

Governance and the Stakeholder View

The recognition of, and response to, stakeholders has governance implications. The commitment to stakeholder management, manifested in actual corporate policy and practice, addresses the root meaning of governance: how are power and authority understood and enacted in the corporation?

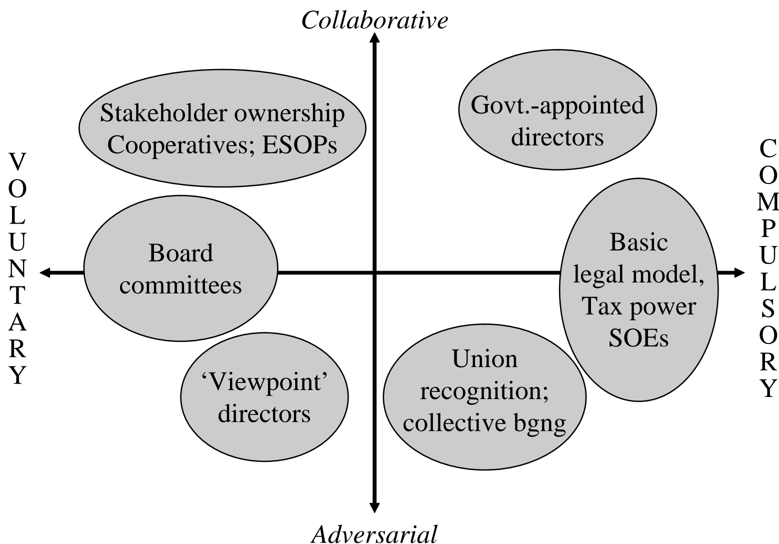

Figure 6.1 Corporate governance mechanisms

Figure 6.1 illustrates a typology of corporate governance mechanisms. This typology of governance arrangements reflects the social and political realities of the modern extended enterprise. The mechanisms vary in detail, but universally acknowledge the legitimacy of a constituency and involve commitments to specific forms of behavior. These arrangements also involve significant choices regarding the degree to which participation is mandated (voluntary to compulsory) and the essential nature of the interaction process (collaborative to adversarial).

REDEFINING THE CORPORATION

From the time of Adam Smith, through the age of industrialization, the trauma of the Great Depression, and the recent half-century of globalization and prosperity, the purpose and role of the business enterprise, and particularly the large corporation, has been the focus of debate. Whatever the specific terms of the debate, the fundamental questions remain the same: to whom, and for what, are the corporation and its managers responsible?

The persistence of these questions is, in part, a tribute to the corporation's success. For more than two centuries, the business corporation has evolved as a highly adaptable and successful form of human enterprise. As a result, its structures and processes have been emulated throughout the private sector all over the world, and in public and nonprofit institutions as well. And the global scope of the private sector, and therefore of corporate activity, has been gradually enlarged, even in those parts of the world where it had been severely restricted. But even as the global corporate system evolves, questions about its nature and purpose become more complex and challenging, and the public debate about the corporation in society grows more intense.

The modern corporation as we observe it is the center of a network of interdependent interests and constituents, each contributing (voluntarily or involuntarily) to its performance, and each anticipating benefits (or at least no uncompensated harms) as a result of the corporation's activities. The purpose of the business enterprise is to create wealth. Corporations create wealth in many different forms: earnings for investors, compensation for employees, benefits in excess of costs for customers, and so on. The attraction of the corporate form of enterprise, as it has emerged in advanced industrial countries, lies in its capacity to amass capital from multiple sources and to spread financial risks, always for an ultimate wealth-creating purpose.

Although the ultimate justification for the existence of the corporation is its ability to create wealth, the *legitimacy* of the contemporary corporation

as an institution within society, its 'social charter' or 'license to operate', is contingent on its ability to meet the expectations of an increasingly numerous and diverse array of constituents. The modern, large, professionally managed corporation is expected to create wealth for its constituents in a *responsible* manner. The connection between *wealth* and *responsibility* has been stressed by both business leaders and by critics for more than a century, and continued affirmation of this connection is required for the corporation's survival and continued success. It is in this context that United Nations Secretary-General Kofi Annan (1999) challenged multinational corporations to form a new 'global compact' expressing their responsibility for human rights and environmental protection throughout the world. As he stated,

> . . . I want to challenge you to join me in taking our relationship to a still higher level. I propose that you, the business leaders . . . and we, the United Nations, initiate a global compact to shared values and principles, which will give a human face to the global market.
>
> Globalization is a fact of life. But I believe we have underestimated its fragility. The problem is this. The spread of markets outpaces the ability of societies and their political systems to adjust to them, let alone guide the course they take. *History teaches us that such an imbalance between the economic, social, and political realms can never be sustained for very long*. (Annan, 1999; original emphasis)

The corporation needs to be 'redefined' in the minds of its managers and constituents, and ultimately in law and public policy, in order to reflect its observable characteristics. Appropriate redefinition will help to clarify the role and purpose of the corporation within the evolving global social and economic system. Governance of the global extended enterprise must recognize the legitimacy of stakeholders who ask the questions: to whom, and for what, is the corporation responsible?

There are reasons to believe that many of the inequitable or harmful impacts of corporate activity could be more cheaply, and probably more effectively, reduced through adaptive behavior by managers, *if* (and this is a big 'if') they were motivated to do so. Hence, one of the goals of 'redefining the corporation' is to bring the concerns of both voluntary corporate constituents and involuntary, noncontractual parties – as well as those of the larger community as a whole – more clearly within the purview of managers.

The stimulus for our proposed 'redefinition' is that, at least in the Anglo-American tradition, the legal framework of the corporation and the great bulk of legal and managerial rhetoric are cast in terms of an 'ownership' model, in which the corporation is seen as an extension of a basic human right to own property. If citizens individually possess such a right, and they

voluntarily collaborate to own property in common, then the corporation is simply another form of personal property ownership. Some societies severely limit their citizens' rights of property ownership, and even the most property-oriented European and Asian traditions emphasize the fact that critical features of the corporate form (legal status, unlimited life and limited liability) are *not* natural attributes of the individual, but extraordinary privileges granted by the state on behalf of the larger host society.

As far back as 1946, Peter Drucker dismissed the argument that the corporation is 'nothing but the sum of the property rights of the individual shareholders' as a '*crude old legal fiction*' (Drucker, 1946: 30; emphasis added). In spite of the relative ease with which corporations are formed, dissolved and reorganized in many countries of the world, the core image of the corporation has to include the fact that the corporate form is socially created, and not a natural phenomenon. Therefore, conforming with broad social norms and values is an inherent requirement for the corporate system as a whole.

Adherence to the ownership model is often associated with imprecise reference to a managerial goal of 'maximization', whether of 'profit', 'value' or some other magnitude. In spite of the prevalence of 'maximization' rhetoric, comprehensive 'maximization' practices are rarely observed. As Michael Jensen has written: 'Value maximization is not a vision or a strategy or even a purpose; it is the scorecard for the organization . . . It just tells [managers] how the score will be kept' (Jensen, 2001). Jensen states that a better description of what corporations do, and what they can and should do, is *value seeking*. That is, within the limitations of their knowledge and skills, and within limited and often ill-defined time horizons, they attempt to make and implement individual decisions that will increase their value over the long run.

In the modern theory of the firm, 'ownership' is seen in cognitive and behavioral terms, as well as physical and legal terms. An individual 'owns' his or her knowledge and capabilities, and groups of people 'own' the common understandings and routines that they have learned to rely on over time. Commitments to working within and among specific organizations, and development of situation-specific capabilities that serve organizational purpose, involve 'investments' comparable to – and possibly rarer and more valuable than – the financial investments of shareowners (Blair and Stout, 1999).

A New Definition

The conventional concept of the corporation is descriptively inaccurate and ethically unacceptable. The corporation requires and receives inputs,

some of them involuntary, from multiple sources, and generates impacts, both favorable and unfavorable, on multiple constituents. The corporation cannot and, in our view, should not survive as a social institution if it does not take greater responsibility for the welfare of all of its constituents, both voluntary and involuntary, and for the well-being of the larger society within which it operates, than its contractual agreements and formal government regulations ordinarily require or could effectively enforce. Fortunately, in spite of the prevalence of 'shareholder value' rhetoric, many large corporations are actually managed (as all should be) so as to serve the interests of a broad range of stakeholders, both internal and external. (See below and Figure 6.1.)

Following the maxim that 'Corporations are what they do', we believe that a new definition, a new 'concept of the corporation', is needed. Further, we believe that this new conception (a) should be based on the obvious fact that corporate activity involves the collaboration, both voluntary and involuntary, active and passive, of numerous and diverse constituents; and (b) should acknowledge that these constituents have good reason to expect benefits, and not harms, from their association with the corporation. Hence, we express the *stakeholder* view of the corporation in this definition:

> The corporation is an organization engaged in mobilizing resources for productive uses in order to create wealth and other benefits (and not to destroy wealth, increase risk, or cause harm) for its multiple constituents, or stakeholders. (Post *et al.*, 2002, p. 17)

This definition of the corporation is intended both to provide a more accurate description of reality and to offer better guidance for managers and directors in the discharge of their responsibilities. This definition is also the foundation for a theory of governance that is suited – and suitable – to the modern realities of global business. Our definition is also congruent with the ideas presented in the OECD publication on corporate governance, which includes the following statement:

> The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises. (OECD, 1999: 18)

This document offers no formal definition of the term 'corporate governance' and formal definitions are hard to find in the voluminous literature that has recently appeared on this subject. Williamson, writing within the context of transactions-cost economics which recognizes the dual principles of conflict and mutuality in every transaction, defines 'governance' as

'the means by which order is accomplished', so that conflict can be reduced and mutual gains realized (Williamson, 1998: 76). Preston suggests a broad concept of 'governance', defined as 'the set of institutional arrangements that legitimates and directs the corporation in the performance of its functions'. He describes the diverse ways in which various classes of stakeholders actually participate in 'governance' in this broad sense, and in both collaborative and adversarial ways, in the varied types of corporate structures that are currently operating all over the world (Preston, 2002).

The OECD document also offers no formal definition of the term 'stakeholders' and, in fact, a definition congruent with the most frequent use of this term in the management literature has proved elusive. The term 'stakeholder' was first popularized in the strategic management literature by Freeman in 1984; he subsequently emphasized that a stakeholder perspective required a redefinition of the firm itself, emphasizing that its purpose is 'to serve as a vehicle for coordinating stakeholder interests' (Evan and Freeman, 1993: 102–3).

Most subsequent analysts have paraphrased Freeman's loose statement that a 'stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the activities of an organization' (1984: 46). However, this broad definition would include entities such as competitors, whose interests are directly *opposed* to those of the focal corporation (but who nevertheless can affect or be affected by it). This inclusiveness would make the usual use of the term in the management literature inappropriate, and would turn the OECD statement that corporations and their stakeholders should 'cooperate in creating wealth, jobs, and so on' into an absurdity. It is clear that the notion that corporations should aim for mutually beneficial (and certainly not harmful) relationships with their stakeholders requires a definition with narrower scope. Toward this end, we have offered a precise clarification of the sense in which this term is used:

> The stakeholders in a corporation are individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and that are therefore its potential beneficiaries and/or risk bearers. (Post *et al.*, 2002, p. 19)

The fundamental idea is that stakeholders have a 'stake' in the operation of the firm, in the same sense that business partners have a common 'stake' in their venture, or players on a team a common 'stake' in the outcome of a game. Stakeholders have a common risk, a possibility of gaining benefits or experiencing losses or harms, as a result of corporate operations. Their common desire is that the corporation should be run in such a way as to

make them better off, or at least no worse off, than they would be otherwise. Our definition of the term 'stakeholders' emphasizes both benefits and risks, and is congruent with the most frequent use of the term in the management literature, including the OECD document.

Investors, employees, and customers associate themselves voluntarily with the corporation in the hope of obtaining benefits. Other stakeholder individuals and groups adversely affected by pollution or congestion may be involuntarily involved with the firm, and may seek to minimize its negative impact on their welfare. However, their tacit acceptance of the firm's license to operate is nevertheless a significant contribution to its welfare.

Comprehensive stakeholder management requires recognition of stakeholders who voluntarily associate themselves with the corporation in pursuit of their own interests, and other persons and entities that are involuntarily impacted by corporate activity. With respect to the voluntary constituents of the corporation, the key managerial concept is obviously mutual benefit. Their continued voluntary involvement with the firm, including their cooperation as it adapts to change, rests on their perception that they do, in fact, benefit as a result. With respect to individuals and groups involuntarily impacted by corporate activity, in particular those subject to externalities such as pollution, congestion, or unwelcome cultural influences, the critical management goals have to be *avoidance of harm, reduction of risk and/or creation of offsetting benefits*, so that the continued operation of the individual enterprise (its 'license to operate') remains acceptable to all parties. In democratic political systems, which are uniquely hospitable to market-oriented economic arrangements, no business activity that causes a substantial *negative* impact on any significant group of people or interests can be expected to survive, unless it offers conspicuous and broadly distributed offsetting benefits.

THE STAKEHOLDER CORPORATION

The stakeholder concept of the corporation argues that favorable relationships and linkages with stakeholders, both internal and external, are assets of the firm, constituting part of its current wealth and forming part of its future wealth-creating capacity. The fact that there may be sources of corporate value other than physical and financial assets is well known. Know-how, core competencies, tacit knowledge, information bases, operating routines, brand names, market contacts, reputation, image and other intangibles can increase the value of a successful 'going concern', as compared to a start-up or less experienced firm with the same physical and financial resources. Interest in the value of intangible assets has been stimulated by

the high market valuations of many technology and knowledge-based companies and by contemporary mergers, acquisitions and corporate restructuring in which acquiring firms have paid premiums far in excess of the value of the physical and financial assets changing hands. The role of intangible assets in determining the overall value of a firm is now attracting worldwide attention, and the financial press is currently filled with commentary on the subject (*Economist*, 1999; Condon, 1999; Fombrun, 1996, refers to the 'reputational capital' of the firm; see also Rindova and Fombrun, 1999).

The 'balanced scorecard' concept developed by Kaplan and Norton (1996) was inspired by a belief that the ability of a company to mobilize and exploit its intangible or invisible assets has become a decisive factor in competitive success. These authors think that it would be highly desirable to expand financial accounting systems to include intangibles, but they acknowledge the difficulties of doing so. To illustrate the importance of the wide range of intangibles that may be significant, they quote a client who insisted that 'outstanding environmental and community performance' was a critical element in overall company strategy. He argued that, in the face of changing circumstances, 'we expect to have earned the right to continue operations'. Kaplan and Norton believe that 'all stakeholder interests, when they are vital for the success of the business unit's strategy', can, and should, be incorporated into their flexible 'balanced scorecard' analysis (Kaplan and Norton, 1996: 35).

Relational Assets

The difficulties associated with attempts to estimate the impact of intangible factors on the overall wealth of a firm have led some analysts to take an opposite approach. Rather than focus on measurement issues, they focus on the arrangements and processes by which the value-generating capacity of a firm can be increased. Some of these techniques involve the development of 'human capital' through training, job assignment and other individual-focused programs; others emphasize the importance of accumulated knowledge and know-how. But the more original current approach, which we wish to emphasize here, is on *relationships*, both among individuals and units within an organization, and between any focal entity or organization, on one hand, and other entities, groups, and organizations, on the other hand. Leana and Rousseau begin their analysis of 'relational wealth' as follows:

> Work – and how it is carried out in organizations – is fundamentally about relationships: relationships between a firm and its employees; relationships of

> employees with one another; relationships between a firm and its investors, suppliers, partners, regulators and customers. (Leana and Rousseau, 2000: 3)

Blair and Stout (1999) describe the purpose of corporate law as an attempt to deal with the relationships involved in 'team production'; that is, to provide a vehicle through which shareowners, creditors, executives, employees and other stakeholders can gain individual benefits for themselves by jointly producing a 'nonseparable output'. Dyer and Singh (1998) stress the value of inter-firm relationships, focusing particularly on the supply chain, as viewed from the perspective of a particular 'nodal' firm. Donaldson and Dunfee (1999) argue that implicit normative agreements ('microsocial contracts') reduce opportunism and shirking among stakeholders, thus enhancing a firm's economic performance. All of these contributions view the firm as operating within a *network of relationships*, both internal and external, that can have a positive or negative impact on its overall performance and value, depending upon the way in which they are structured, managed, and mediated.

Anecdotal evidence supports the view that relationships with internal and external stakeholders may be of critical importance for the success of the corporation. This argument is developed in detail by Coff and Rousseau, who write:

> By its very nature, relational wealth *mediates* among the attributes and capacities of people, groups, and firms (including firms' human and financial capital) and affects successful work coordination, task performance, and goal achievement. For inimitable benefits to accrue from inputs, they must be bound together in an inimitable way. (Coff and Rousseau, 2000: 29; italics in original)

As for the role of relationships as sources of competitive advantage, they note that, even if competitors know that a firm's strategic capability is built on stakeholder linkages, 'such ties are so complex and idiosyncratic that they cannot be readily copied' (Coff and Rousseau, 2000: 27).

Organizational Wealth

Sveiby (1997) has developed a conception of 'organizational wealth' that combines the value of both tangible assets (less liabilities) and intangible elements to determine the total value of an organization. He classifies intangibles into three categories: (1) competence of personnel, reflected, for example, in skill levels, job satisfaction and retention; (2) internal structure, such as arrangements for information handling and decision making; and (3) external structure, such as customer and supplier relations.

Both of Sveiby's 'structure' categories are essentially 'relational', and there is also a clear connection between the competence of individuals and their ability to function within organizational units and teams. He analyses the ability of each set of intangible factors to contribute to the overall value of the organization in terms of three criteria: stability, growth/renewal, and efficiency. He proposes specific measures and indicators for each of these, and illustrates his approach in a case study of WM-Data, the largest publicly owned computer software and consulting company in Sweden. Building on the large current literature dealing with the importance and valuation of intangible and relational assets, including Sveiby's work, organizational wealth must be understood as the 'summary measure of the capacity of an organization to create benefits for any and all of its stakeholders over the long term' (Post *et al.*, 2002: 45).

The principal components of organizational wealth are: (1) the market value of physical and financial assets (less liabilities); (2) the value of individually separable intangible assets, such as specific human capital, patents, licenses; and (3) the value of relational assets, both internal and external, involving stakeholder linkages, processes, collaborations, and reputation factors.

Organizational wealth is enhanced whenever the value of output from operations is increased without comparable increases in resources or risks, or when resource use and/or risks are reduced without comparable reductions in the value of the output. In its relationships with stakeholders, the corporation may achieve these results directly – as when favorable customer relations increase brand loyalty (reducing market risk) – or indirectly, as when improved collaboration and trust within the operating environment increases productivity. We believe that both specific and general effects can be achieved when the firm bases its relationships with stakeholders on mutually supportive contributions and benefits.

Stakeholder Relations and Organizational Wealth: The New Governance

Favorable relations with each major class of stakeholder can contribute to the superior performance and reputation of the modern corporation. The sources of organizational wealth arising from relationships which each major stakeholder group are summarized in Table 6.1.

Taken as a whole, this network of relationships constitutes a 'governance system' (*de facto*, if not *de jure*) for the modern corporation. The failure to recognize and account for the many benefits and risks that are generated every day through commercial and non-commercial activity would be a managerial mistake of the first order. To the extent managers recognize the 'real power' of stakeholders through these relationships, an emergent form of governance

Table 6.1 Stakeholder contributions to organizational wealth

Stakeholders	Contributions
Investors: shareowners/lenders	Provision of capital, equity and/or debt Financial market recognition and status (reducing borrowing costs and risks)
Employees	Development of specific human capital Team production and routines based on understanding and trust Collaborative relations in the workplace
Unions	Workforce stability and conflict resolution
Customers/users	Brand loyalty and reputation Repeated/related purchases Collaborative design, development and problem solving
Supply chain associates	Network and value chain efficiencies Collaborative cost-reducing routines and technologies
Joint venture partners and alliances	Strategic resources and capabilities Options for future development (R&D, technology, and so on)
Local communities and citizens	Mutual support and accommodation Planning, municipal services 'License to operate'
Governments	Macroeconomic and social policies Supportive relationships with policymakers
Regulatory authorities	Validation of specific product/service characteristics and quality levels Reputation for compliance, integrity and best practice
Private organizations	Constructive collaboration with individual organizations and groups Favorable public opinion environment

arises. On both the economic and the legal fronts, the social and managerial understanding of what constitutes 'legitimate' authority and power, and how it is to be used, is evolving. This is, at the end of the day, the best answer to the governance questions posed by Professor Dodd 70 years ago.

The 'stakeholder view' of the corporation as a creator of wealth stands in both theoretical and practical contrast to other views of the firm. Empirical observation and logical analysis reveal limitations of the contemporary

'resource-based view' (RBV) and 'industry structure view' (ISV) of the corporation, both of which are derived from economic analysis. The 'stakeholder view' (SHV) is intended to integrate and supplement these received ideas of the sources of organizational wealth, both derived from economic analysis.

There is a continuing and vigorous debate between adherents of the resource-based and industry structure views. Penrose (1959) is generally credited with formalizing the RBV in the management literature, although the idea that the unique resources and capabilities of the firm determine its market success has long been familiar. Porter (1980) introduced the ISV as a challenge to this perspective, arguing that the firm's ability to generate wealth depends upon its position within its industry, including relations with competitors, suppliers and customers and the impact of government regulation. Wernerfelt (1984) responded that a resource-based analysis including access to capital, labor, locations, and technologies would lead to different insights than an analysis focused on industry structure. Barney (1991) concluded that a firm's success was ultimately determined by the value, rarity, inimitability and substitutability of its resources – in other words, by their economic scarcity. The validity of the RBV as a 'theory' of the firm has recently been seriously challenged by Priem and Butler, drawing an equally forceful response from Barney (Priem and Butler, 2001; Barney, 2001).

Some scholars have sought to synthesize these views. Peteraf (1993), for example, offered a partial integration of RBV and ISV perspectives, combining resource characteristics and competitive conditions. Henderson and Mitchell (1997) concluded that attempts to choose one explanation over the other would prove fruitless because there are continuous 'reciprocal interactions' between the firm and its environment, with competition shaping capabilities, and capabilities in turn shaping competitive positions. Teece, Pisano and Shuen (1997) moved the analysis into a dynamic framework, emphasizing that the *processes* of developing and utilizing the firm's resources were probably more important to its long-term success than competitive activities and entry barriers. Hatten and Rosenthal (1999, 2001) suggest that it is a firm's capacities and capabilities, rooted in knowledge acquired through its business processes, that are central to long-term success. These contributions suggest some ways to overcome criticism that most strategic management research has been 'static rather than dynamic, cross-sectional rather than longitudinal' and has paid inadequate attention to 'path dependence' and 'complex contingencies' (Schendel, 1997: 1–2).

The stakeholder view (SHV) embraces elements of both the RBV and ISV within a framework that is dynamic and emphasizes path dependencies. All of the firm's resources are represented in some way by various stakeholders, and it is the firm's relationships with its relevant stakeholders that make resources available and functional for the organization. Similarly, actors

Table 6.2 Comparing the resource-based, industry structure and stakeholder views of the sources of organizational wealth

Dimensions	Resource-based view (RBV)	Industry structure view (ISV)	Stakeholder view (SHV)
Unit of analysis	Firm	Industry	Network of a firm's stakeholders
Primary sources of organizational wealth	• Physical assets • Human resources • Knowledge • Technology • Financial resources • Intangibles	• Bargaining power vis-à-vis suppliers and customers • Market power vis-à-vis competitors • Collusion	• Relationships leading to increased revenues and/or reduced costs and risks • Relational benefits leading to increased capacity to generate wealth
Means to preserve organizational wealth	Firm-level barriers to imitation	Industry-level barriers to entry • Production economies/sunk costs • Government regulations	Firm-specific stakeholder linkages and implicit agreements leading to increased revenues and/or reduced costs and risks

Source: Adapted from Dyer and Singh (1998).

within the industry structure – customers, suppliers, regulators – will be more (or less) collaborative, supportive, reliable, and so on, in their dealings with the firm, depending upon the kind of stakeholder relations that the firm has developed with them. It is not simply the firm's 'stock' of resources, nor its static 'position' in the industry structure that determines its long-term success. Rather it is the dynamic *interaction* with stakeholders that generates the organizational capacity to generate wealth over time. That is the central implication of the stakeholder view for strategic management. The failure to establish and/or maintain productive relationships with all of the firm's stakeholders is a failure to manage effectively the organization's capacity to generate wealth over time.

The distinctive features of the three views are summarized in Table 6.2, which broadens the 'relational view' of the firm presented by Dyer and Singh (1998) to include all relevant stakeholders. Dyer and Singh stress that

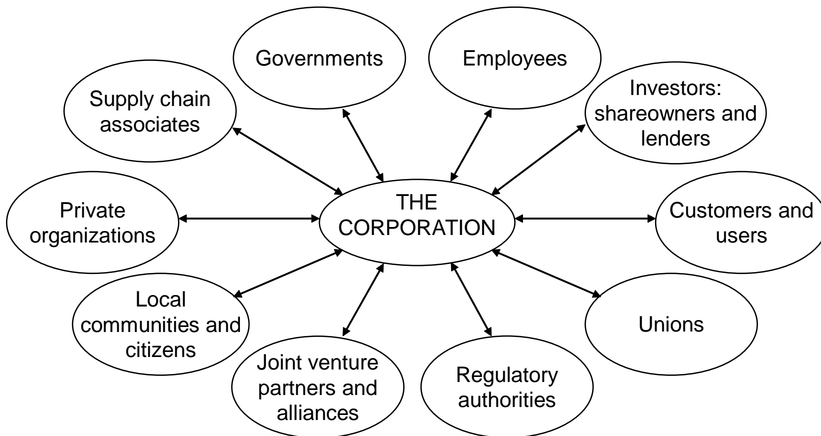

Figure 6.2 The corporation and its stakeholders

'relational' values are created by mutually beneficial collaboration among firms, and cannot be achieved by an individual firm acting alone (as implied by the RBV) or by one firm attempting to gain at the expense of others (as implied by the ISV). They also note that both the RBV and ISV suggest that a firm should attempt to protect, rather than share, information and know-how. By contrast, firms linked in supply chain and alliance relationships often gain by collaborative product and process development and by continuous and interactive exchange of data. It is also important to note that the SHV (like the analyses of Teece, Pisano and Shuen, 1997; Hatten and Rosenthal, 1999, 2001) places greater emphasis on managerial skills and processes than either of the other perspectives.

In Figure 6.2, the important groups of stakeholders identified in the conventional 'hub and spoke' stakeholder map (corporation at the center with lines radiating outward to each stakeholder) are shown. In Figure 6.3, however, these stakeholders exist throughout the 'stakeholder view' diagram. Investors and employees are sources of critical inputs for the firm's operations, and are therefore part of its resource base. Customers, supply chain associates, JV partners and alliances, and regulators are elements of its industry structure. Governments, local communities and citizens, and relevant private and voluntary organizations (along with unions, in their broader role), operate in the firm's social–political arena. It should be emphasized that relative closeness to the center of the diagram does not indicate anything about the level of importance of any group of stakeholders; the 'license to operate' from the firm's host environment is certainly as important as its financial resources.

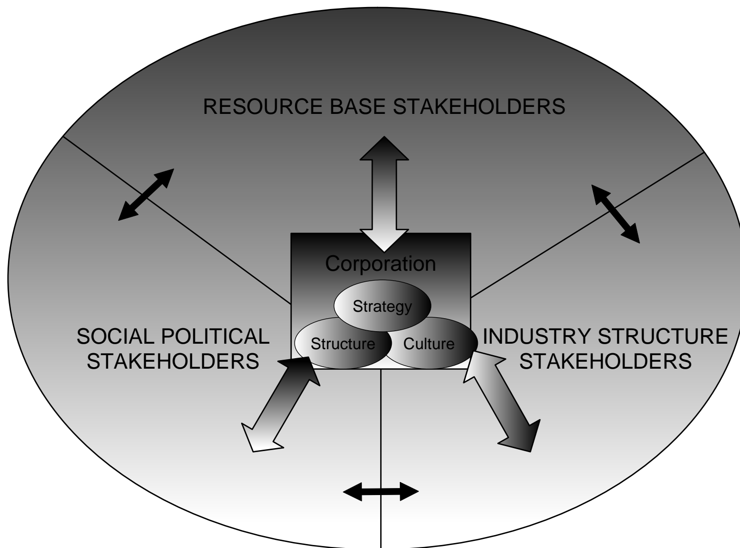

Figure 6.3 The stakeholder view: strategic perspective

GOVERNANCE AND TRUST IN A GLOBAL ECONOMY

Contemporary corporations encounter challenges and make decisions that can be understood, and evaluated, only within an interactive, multiple-stakeholder context. Trust plays a central role in achieving business success under such conditions. Both internal and external relations are often so complex and dynamic that formal bargaining and contracting is infeasible. Individuals working within organizations need to trust each other, and to trust the organization itself to live up to its responsibilities. And corporations need to trust one another as well to carry out collaborative activities for mutual benefit. Trust is the 'glue' that holds together relationships that cannot be fully defined in contractual terms. For the modern corporation, the trust of its stakeholders is an important component of its capacity to create value over the long term.

Trust also plays a central role in a society's success. When communities do not trust important institutions, including business and government, the capacity to build social capital is impaired. As Fukayama (1996) and others have argued, the fortunes of nations often correlate with the capacity of social, economic, and political institutions to inspire trust. On a global scale, the United Nations Global Compact initiative is a clear statement of the

critical importance of trust and governance to the future of globalization and, ultimately, peace and international security. Moreover, the UNGC draws attention to the pivotal connection between social and economic progress, the human condition, and the activities of multinational business.

In a longitudinal study of economic structure from 1840 to 1920, Zucker (1986) determined that trust is a defining factor in the evolution of organizational structure at the macro and micro levels. Zucker's analysis suggests that failing to meet legitimate stakeholder expectations is a governance failure as well as a business failure. It is well understood that the modern corporation competes in the economic market, the political market, and the market of public opinion. When image and reputation are important assets, as they so often are in corporations, the disruption of trust in commercial and noncommercial relations can be costly. For these reasons, managing 'trust gaps' is a critical management responsibility.

Trust is a factor to be considered in the design of any system of corporate governance, authority, and power. Zucker identifies three central modes of trust production, each associated with measures:

1. *process-based*, where trust is tied to past or expected exchange such as in reputation or gift exchange;
2. *characteristic-based*, where trust is tied to the person, depending on characteristics such as family background or ethnicity; and
3. *institutional-based*, where trust is tied to formal societal structures, depending on individual or firm-specific attributes (for example, certification as an accountant) or on intermediary mechanisms (for example, use of escrow accounts).

Each of these modes of trust production contributes to stakeholder confidence in the institution.

The presence or absence of trust within and between organizations presents a serious challenge to economic analysis and to conventional contractual–transactional approaches to management (Ghoshal and Moran, 1996). These analytical traditions tend to treat trust as an aspect of the 'principal–agent problem', which focuses on the development of explicit or implicit contractual relationships to ensure that the trustee (that is, the agent) behaves in a fashion consistent with the goals and intentions of the trustor (that is, the principal). By contrast, according to Mayer *et al.* (1995), trustworthiness depends upon three characteristics of the trustee: ability, benevolence and integrity.

It is easy to see that mutual trust is a desirable attribute of stakeholder relationships. The more reliance can be placed upon common understandings and shared benefits, as opposed to detailed negotiations and formal

contracting, the less costly, time-consuming and restrictive the interactions between a corporation and its stakeholders will be. Hence, the development of 'social capital' through trustworthy behavior, both vis-à-vis individual stakeholder groups and in relation to all actual and potential stakeholders, and to society at large, is an obvious way of enhancing organizational wealth over the long term.

This is the challenge of corporate governance: *how can governance be legitimized in the stakeholder corporation?* The answer surely requires attention to trust-enhancing activities. The development of new and expanded forms of transparency, accountability, disclosure, and stakeholder engagement suggests how corporations are recognizing, in deeds as well as words, the reality of stakeholder governance. Corporations are what they do, and in these times of global social, economic, and political challenge, they are experimenting with new trust-producing processes and mechanisms.

Stakeholder Engagement: The Ceres Coalition

Growing numbers of companies, both large and small, acknowledge the need to address the so-called 'triple bottom line' – economic, social and environmental – performance of their business, not just with its shareholders, but with other stakeholders, especially employees, customers, and communities. The term 'triple bottom line' is used synonymously with the idea of 'sustainability' among corporations and stakeholders; that is, addressing the needs and opportunities of the present without compromising the ability of future generations to meet their needs. Others use 'corporate social responsibility' or 'citizenship' to describe this type of accountability.

Stakeholder engagement, at its best, involves two-way communication, generates mutual benefits, reduces costs, builds markets, strengthens shareholder value, and helps companies manage change. It is not just a new name for the traditional function of community or public relations, or a means to avoid negative publicity. Stakeholder engagement is not just having an external advisory board of professional or technical NGOs or academic experts identified *by the company* as influential. While these can be useful for the groups that are invited to participate, less powerful community-based stakeholders are excluded. The best stakeholder engagement programs are inclusive and help mixed groups of stakeholders build technical and communication skills with each other and the company so that concerns can be expressed in problem-solving dialogues.

In the United States, a coalition of environmental, investor, labor, and public interest groups called 'Ceres' has been successfully advocating corporate transparency and implementing stakeholder engagement since 1989. The Ceres coalition, which began to form after the *Exxon Valdez* oil

spill in Alaska, has grown to include over 85 diverse organizations, including National Wildlife Federation, Friends of the Earth, the Union of Concerned Scientists, the Interfaith Center on Corporate Responsibility, Calvert Group, Trillium Asset Management and the AFL-CIO.

Ceres started by developing the Ceres Principles, a 10-point code of environmental conduct, to be publicly endorsed by companies as an environmental mission statement or ethic (for full text see www.ceres.org). The code addresses (1) Protection of the Biosphere, (2) Sustainable Use of Natural Resources, (3) Reduction and Disposal of Wastes, (4) Energy Conservation, (5) Risk Reduction, (6) Safe Products and Services, (7) Environmental Restoration, (8) Informing the Public, (9) Management Commitment, and (10) Audits and Reports. The initial corporate reaction to the Principles and their reporting mandate was negative, with much resistance to the release of environmental performance data. In the early years, the Ceres Principles were adopted primarily by smaller 'green' companies, such as Aveda, Ben & Jerry's and The Body Shop. But in the 1990s, the tide began to shift. Stakeholder engagement, environmental ethics, voluntary initiatives promoted by the government and annual environmental reporting – all hallmarks of Ceres – became more widely accepted by influential members of the mainstream business community. In 1993, following lengthy negotiations, Sunoco, an oil refining and chemical company, became the first Fortune 500 firm to endorse the Ceres Principles. Sunoco's leadership triggered a round of discussions leading to endorsements by other large companies including American Airlines, Bank of America, Catholic Healthcare West, Ford Motor Company, General Motors and Northeast Utilities.

To date, Ceres has persuaded more than 70 companies to endorse the Principles, and has worked with numerous other companies to adopt environmental policies and issue performance reports. Endorsing companies are actively involved with Ceres in reporting annually on their environmental performance, which since 2002 has involved using the Global Reporting Initiative's *Sustainability Reporting Guidelines*. They are also engaging with stakeholders, both from within the Ceres coalition and with others appropriate to their industry and geography, and seeking continual improvement of environmental performance.

Ceres has historically called on a 'Report Working Group' of 15–20 representatives of coalition organizations and endorsing companies to conduct annual pre-publication reviews of corporate environmental and/or sustainability reports. Recently, Ceres has reached deeper and wider into the coalition to organize a dedicated 'stakeholder team' for each major company or cluster of small and medium-sized companies, based on the mutual preferences of companies and stakeholders. These stakeholder

teams, which now actively involve more than 100 coalition members, are charged with this reporting and review function, as well as providing lasting engagement with the company for discussion of priority or emerging issues, future plans for reporting, or particular stakeholder engagement challenges (such as handling a localized incident). Many companies have used Ceres staff and particular stakeholders this way over the years, but now all Ceres companies and a majority of our coalition organizations have a more intentional commitment to this enhanced level of engagement.

Ceres has also developed expertise in facilitating dialogues regarding specific issues or policies specific to an industry sector or individual company. These discussions typically occur in a private setting out of the glare of public scrutiny. This encourages an honest exchange and learning by all, resulting in a deeper understanding of environmental issues by companies and a greater appreciation by stakeholders of the cultural and technical obstacles to rapid change. Some of these dialogues eventually lead to public workshops at the annual Ceres conference, so that the issues raised and best practices identified in these conversations can be a platform for others to learn and improve performance. Ceres has also established a groundbreaking multi-year dialogue with several electric power companies, investors and environmental NGOs about climate change and its risks, which eventually led to public reports on their findings, so that the broader communities represented by participants could benefit from their deliberations.

One of Ceres' most important successes in stakeholder engagement was working in partnership with the United Nations Environment Programme (UNEP) to lead a multi-year, multi-stakeholder effort to create a global standard for corporate sustainability reporting – the GRI *Sustainability Reporting Guidelines* – as well as the institutional structure for continued administration and improvement of this guidance. In 2003, after five years of leadership, Ceres spun off the GRI as a separate, non-governmental organization that is now based in Amsterdam. Today, over 600 corporations around the world are issuing sustainability reports using the GRI *Guidelines*.

To build the credibility of reported sustainability performance information, some companies are pursuing data assurance or verification statements similar to the auditing of data in a financial report. Still in its infancy, the emerging market for 'assurance' has so far been dominated by the 'big four' accountancy firms. A survey carried out by KPMG in 2002 found that 65 percent of verification statements in environmental and/or sustainability reports produced by the largest global corporations originated from these four accountancy firms (KPMG, 2002). These firms bring much traditional verification expertise to the table, but it remains unclear what value an assurance statement by such an organization provides for the varied stakeholder audience that a sustainability report is meant to reach.

Some companies are exploring 'stakeholder assurance' – statements from key stakeholders that the reported information covers the key performance metrics that stakeholders find material, and that the company has engaged a balanced mix of stakeholders in a productive two-way dialogue. Ceres is uniquely positioned to provide in-depth, authentic stakeholder-based reporting assurance and is working with two Ceres-endorser companies to move from the stakeholder team model to develop a more systematic engagement process that will lead to inclusion of a stakeholder statement in their next corporate report.

Effective stakeholder engagement can be costly and filled with setbacks. The multi-year experiences of Ceres companies indicate that sticking with the process does reduce risks and build trust. When companies want to expand, or environmental incidents occur, the companies have found it useful to consult with familiar Ceres stakeholders who know their documented environmental progress and management practices designed to avoid environmental problems. In countries where NGOs may have limited resources to build capacity and collaborate in ways that Ceres has facilitated, companies should support capacity building among NGOs. The collaborative model has shown the potential to empower stakeholders and build trust in ways that lead to more creative, expansive and, ultimately, sustainable outcomes for businesses, communities and the environment.

CONCLUSION

The modern corporation faces two types of governance problem: the legitimate acquisition and use of authority and power in its quest to create wealth, and its impact on the societies and communities in which it resides and operates. The diverse governance mechanisms that are emerging to address these challenges rest on an understanding that the corporation is a network of stakeholders whose presence and interests must be taken into account by business managers. The transformation of corporate governance in the twenty-first century will depend on the acceptance of this principle by businesses and society.

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7. Multinationals in global governance

David L. Levy and Peter Newell

From regional trade agreements to international environmental treaties, we are witnessing the emergence of multilateral institutions and sources of authority that affect the operations of multinational corporations (MNCs). Even in the absence of a supranational authority with the coercive power of a state, negotiations among governments, firms and non-governmental organizations (NGOs) are leading to the establishment of structures of governance – rules, norms, codes of conduct, and standards – that constrain, facilitate, and shape MNCs' market behavior (Haggard & Simmons, 1987; Keohane, 1983). MNCs need to respond to these new sources of authority, and are increasingly engaged in their development. Despite recent contributions to literatures on global governance and international political economy (IPE) (Braithwaite & Drahos, 2000; Prakash & Hart, 1999), we lack adequate understandings of the diverse ways in which MNCs respond and contribute to the architecture of global governance. The International Business literature has tended to take a somewhat narrow view of the political dimensions of MNCs, focusing on relations with host and home governments (for example, Boddewyn & Brewer, 1994; Eden, 1993). Here, we take a broader view, grounded in political economy, that accounts for the multiple roles MNCs play, the diverse set of actors with which they interact, and the textured nature of power and authority in global governance systems. From this perspective, MNCs do not just interact with governance structures; rather, they constitute an integral part of the fabric of global governance.

MNCs, in their role as investors, innovators, experts, manufacturers, lobbyists, and employers, are critical players in developing the architecture of global governance. They are increasingly prominent in negotiating formal intergovernmental regimes, such as the Kyoto Protocol, and in scientific advisory panels to these regimes. They participate in quasi-private policy bodies such as the Trans-Atlantic Business Dialogue, which are becoming increasingly influential in trade and investment policy (Coen, 1999). In collaboration with private and public partners, they establish standards and codes of conduct that govern not just products but also environmental practices and labor conditions.

The broad notion of governance advanced here looks beyond corporate engagement with external institutions, rules and standards. The day-to-day production, research and marketing practices of large MNCs are decisive in shaping environmental impacts, trade patterns, labor market practices, and consumer identities. Pricing strategies, in the context of particular structures of industry competition, affect income distribution and developing country growth prospects. The significance and pervasiveness of these impacts suggest that market structures and corporate strategies 'govern' many aspects of life; an understanding of governance thus needs to encompass market as well as nonmarket activities (Baron, 1995). For example, the widespread deregulation of electric power markets and the privatization of water supply systems has changed the nature of governance in these sectors, shifting the burden of governance from the public to the private sphere, often with significant consequences for water quality, access, and pricing. Similarly, the technological strategies of leading chemical companies helped shape the content, timeline and implementation of the Montreal protocol for ozone-depleting gases. In many ways, large firms are the 'street-level bureaucrats' of policy, Lipsky's (1980) term to describe the role of frontline employees in shaping policy through its implementation on the ground.

While corporate impacts in social, environmental, and labor arenas have traditionally been viewed as problems to be regulated, there is increasing recognition that large firms can also serve as powerful engines of change, with the potential to redirect their substantial financial, technological and organizational resources toward addressing societal concerns. Business is increasingly aggressive in asserting a role as a legitimate actor in global governance. The International Chamber of Commerce, an influential umbrella industry association, has forcefully asserted industry's significance in the case of climate change, though these words would apply equally well to many other issues:

> Industry's involvement is a critical factor in the policy deliberations relating to climate change. It is industry that will meet the growing demands of consumers for goods and services. It is industry that develops and disseminates most of the world's technology . . . It is industry, therefore, that will be called upon to implement and finance a substantial part of governments' climate change policies. (International Chamber of Commerce, 1995)

These words demonstrate a remarkable acknowledgment that market activities constitute an important aspect of governance, and of the linkage between these activities and more overtly 'political' engagement with public policy. This active corporate role is increasingly welcomed by governments and international organizations, which are enticed by the resources and expertise offered by MNCs (Dunning, 1993, O'Brien, Goetz, Scholte

& Williams, 2000). The role is legitimated through the rising prevalence of neoliberal discourses of market-based solutions and competitiveness, complemented by (though sometimes in tension with) the discourse of corporate social responsibility (CSR) and stakeholder dialogue (Bendell, 2004). There has also been a notable shift in the relationship between business and non-governmental organizations (NGOs) around regulatory issues. From a position of clearly defined antagonism, there is increasing emphasis on partnerships and institutionalized forms of collaboration (Newell, 2001). Contemporary MNCs are thus increasingly embedded in webs of relationships that provide varied forms of governance across wide areas of economic and social life. They are political actors, in the broad meaning of the term, blurring distinctions between market and nonmarket activities.

This chapter examines the evolving role of multinational corporations (MNCs) in global governance, drawing in particular on a series of studies of business and international environmental issues (Levy & Newell, 2005). After reviewing the current literature on global governance, we suggest that the bargaining theory of foreign direct investment (FDI) can be extended to account for multiple bases of power and multiple actors. The chapter then examines some contemporary patterns and trends, exploring how structures and processes of governance vary across countries and sectors, and highlighting a shift toward the privatization of governance.

THE NATURE OF GLOBAL GOVERNANCE

The use of the term 'global governance' itself constitutes a reorientation of perspective regarding the political economy of MNCs; instead of the traditional focus on relations between business and host/home governments, the burgeoning literature on global governance presumes that it is meaningful to conceptualize governance at the multilateral, if not global or supranational, levels. Governance structures take many different forms. Multilateral institutions have long provided governance mechanisms for 'market-enabling' (Levy & Prakesh, 2003) or 'constitutive' (Lipschutz, 2005) regimes, such as those for international trade, investment, and finance, which provide the structure, stability, and secure property rights required for markets to function. It is only quite recently, however, that international governance structures are emerging around more 'regulatory' or 'distributive' regimes, which constrain MNC behavior and address social concerns about the impact of market operations on the environment and labor. Some governance regimes, such as the World Trade Organization (WTO) and the Kyoto Protocol for controlling emissions of greenhouse gases, are truly global, encompassing a majority of countries in the world. Others, such as

NAFTA and the Convention for the Protection of the Mediterranean Sea, are regional in scope. Some governance structures are centered upon formal agreements and protocols, while others are constituted within a looser set of standards, norms, and market practices. Dauvergne (2005) describes the emergent informal governance structure for tropical forests, noting how the mixture of local politics, industry structures, and certification standards provides a very weak system of protection.

Global governance refers to the multiple channels through which economic activity and its impacts are ordered and regulated. It implies rule creation, institution building, monitoring and enforcement. But it also implies a soft infrastructure of norms, and expectations in processes that engage the participation of a broad range of stakeholders. This conception of governance displaces government from its traditional, sovereign role in establishing and securing order (Rosenau, 1992). Instead, governance is viewed as a more diffuse form of authority and control operating through a network of actors, at multiple levels, national, regional, and international. Global governance does not therefore require a supranational body with formal authority over states; rather, it represents a looser system of structures and processes, in which multiple actors employ a range of strategies and sources of power. While the term 'global governance' points to the extensiveness of these structures across multiple jurisdictions, global governance can penetrate in an intensive way into the everyday activity of firms and individuals (Hewson & Sinclair, 1999). The discipline of credit ratings, the operation of labor markets, and the permeation of consumerist advertising constitute powerful mechanisms for ordering economic and social life (Gill, 1995).

This conception of governance extends our understanding of 'regimes', a concept already well developed in International Relations literature (Krasner, 1983; Young, 1994). Regime theory concerns itself with 'norms, rules, principles and decision-making procedures around which actors' expectations converge in a given area of international relations' (Krasner, 1983: 2), and grew out of a concern that, with the decline in the hegemonic power of the United States, the prospects of international cooperation would be detrimentally affected (Keohane, 1984). The main limitation of the regime concept is that, while it increasingly recognizes the significance of private actors and informal, normative structures, it is still primarily concerned with official inter-state arrangements. Moreover, regime theory has tended to portray regimes as rational, technical solutions that successfully overcome problems of collective action among states. Much of the regime literature is concerned with identifying the factors associated with success in establishing formal regimes and measuring their 'effectiveness', in terms of lower emissions of greenhouse gases, for example. In doing so, it tends to neglect linkages across issue arenas and underplays the

significance of global structures and discourses that lie outside the particular institutional arrangement under scrutiny.

The term 'global governance', by contrast, suggests a broader system of order and structure, in which various issues and arrangements are nested (Levy & Newell, 2002). A particular international agreement might form an important aspect of such a system, but remains only one part. Moreover, governance structures can serve many motives outside of the stated purpose of a particular international agreement, and induce significant side-effects, intended and otherwise. A narrow approach to interpreting effectiveness is therefore misplaced. Processes of ordering economic activity effect asymmetrical distributional outcomes, not just for states, but also for various industrial sectors and other social groups. Indeed, an observer of many complex, protracted negotiations could easily be forgiven for concluding that these distributional impacts are far more important to participants than, for example, the liberalization of trade or the amelioration of climate change. The Kyoto Protocol is likely to fail dismally as a mechanism for slowing greenhouse gas emissions, but does provide significant funding for technology transfers to developing countries, as well as valuable emission credits for countries of the former Soviet Union.

A global governance perspective thus needs to emphasize the linkages between particular issue arenas, as well as an appreciation for the larger political and economic context. The outcomes from any particular set of negotiations over a particular issue area become part of the global infrastructure of norms, practices, and institutions that, in turn, will affect other issues. Corporate engagement with the ozone case, for example, gave rise to processes for inclusion of business in technical and scientific issues that set the stage for climate change and, more broadly, for the interaction of institutions such as the World Bank with business and civil society. To give another example, MNCs have advocated and helped to implement the 'Europeanization' of regulatory structures and processes, in order to standardize reporting requirements and product regulations across countries, and avoid the national fragmentation of markets. In turn, firms are responding to the new regional power structures by setting up offices in Brussels to influence policy, reflecting the shift from state-centered to regional decision-making structures (Coen, 1997). As part of this dynamic process, firms shift conceptions of their interests. For example, through their interactions with other actors during the process of negotiating a regime, US-based MNCs in the oil and automobile industries have come to view emission limits as much less of a threat to their core competencies and profitability (Levy, 2005). The relationship between issue-level governance and the global political economy is thus dialectical; individual regimes are shaped by, yet constitutive of, wider political and economic structures of governance.

The global governance perspective has perhaps been most valuable in raising awareness of the importance of non-state actors (Higgott, Underhill & Bieler, 2000; Teegen, Doh & Vachani, 2004). Organizations representing elements of civil society such as labor, environmentalists and scientists have been particularly active in negotiations over environmental regimes and industry codes of conduct (Haas, 1992; Litfin, 1994). Even when not engaged directly in negotiations, activist groups have exerted considerable influence through the strategic use of information and creative forms of protest; the derailing of the Multilateral Agreement on Investment has been attributed to the use of the Internet by activist NGOs for disseminating embarrassing information and the coordination of opposition (Kobrin, 1998). Even the original Bretton Woods institutions, the World Bank and the International Monetary Fund, have gradually been opening themselves to non-state influences (Scholte, 2000; Williams & Ford, 1999).

MNCs are, of course, a type of non-state actor, but have received relatively little attention in the global governance literature. The neo-Gramscian stream of international relations has developed a theoretically sophisticated critique of corporate power in the global polity, though it tends toward the abstract; the target is capital rather than corporations (Cox, 1987; Sklair, 1997). In so doing, the agency of MNCs within particular industry structures and issue arenas is underplayed. A number of studies have focused on the role of MNCs in establishing private regimes based on industry codes and standards (Clapp, 1998; Cutler, Haufler & Porter, 1999) or influencing particular policy issues, such as intellectual property rights (Sell, 2002). The contestation between MNCs, NGOs, and state agencies has been explored in some recent case studies on coffee production (Kolk, 2005), prices for AIDS drugs (Vachani & Smith, 2004) and biotechnology (Andree, 2005). Conceptual frameworks for considering the role of MNCs in structures of global governance remain underdeveloped, however. Here we suggest that the bargaining model of MNC–host relations might prove a valuable platform for developing a conceptual framework that incorporates some of the insights of the global governance literature regarding the multipolar, multi-level aspects of governance.

EXTENDING BARGAINING THEORY TO MNCs AND GLOBAL GOVERNANCE

The bargaining model of the 1970s proposed that MNCs and host countries bargain over the distribution of benefits from each instance of foreign direct investment (FDI), and the bargaining power of each side was

determined by the possession of rare or unique assets (Fagre & Wells, 1982; Kobrin, 1987; Vernon, 1971). Extending this model to encompass contemporary notions of global governance presents a considerable challenge, as there is a need to reflect the emergence of a broader terrain of contestation, one that relates to the very structures and processes of international governance. Strange's (1988) model of 'triangular diplomacy' applied the bargaining framework to issues beyond FDI, and described three forms of state–market relations: among states, between states and firms, and among firms. Similarly, Ramamurti (2001) proposed a two-level model in which states negotiate, often within the framework of multilateral institutions, over the rules of investment regimes; firms then negotiate with states within the confines of the macro-regime.

Here, we extend the bargaining framework to locate MNCs in the complex and dynamic fabric of global governance systems. We offer a bottom-up approach in which governance structures and processes represent the negotiated outcome of bargaining amongst MNCs, states, NGOs, and other actors. Simultaneously, these structures are located in the broader context of political contests between different groups of social actors in the global polity (Levy & Egan, 2003). Regime structures and processes therefore reflect the varying power, resources, and strategies of the various actors in these contests. Despite the substantial material resources possessed by MNCs, other actors also have considerable influence. Moreover, MNCs from different sectors and with different competitive positions rarely speak in one voice on issues of global governance, thereby creating political space for other societal actors to exploit these differences and push their agendas. The outcomes of these negotiations among host and home governments, business, and civil society, over a series of specific issue arenas, are constrained by, as well as constitutive of, the emerging international system of governance, accounting for its untidy and uneven form.

Our approach differs from the traditional bargaining model in several respects. In the traditional bargaining model, negotiations were typically bilateral, between the MNC and the host government; civil society was nowhere to be seen. The state was presumed to be a unitary actor with a single set of interests. Bargaining over forms of global governance involves multiple actors, including NGOs, states, firms, and international organizations. Even states may be represented by multiple authorities, such as departments of environment and state, with conflicting interests.

Global governance structures generally comprise interrelating institutions and processes at multiple levels. MNCs have the opportunity to engage with issues at the national level, in regional blocs such as the European Union, as well as in the international arena. In the United States,

subnational structures are important, such as the initiative by 10 northeastern states to establish a carbon trading mechanism. While these multiple levels pose costs and complexity for MNCs, they also provide an opportunity for strategic forum selection. Levy and Egan (1998), in a study of the climate change negotiations, showed how US energy-related businesses attempted to keep any regulation at the national level because of their powerful domestic influence. US industry considered itself relatively weak in the international negotiations, which involved more than 140 countries and a set of international institutions, particularly those responsible for scientific assessments, with a degree of autonomy and legitimacy that provided some insulation from the interests of particular countries or industry sectors. This corporate preference for political engagement at the national level stands in contrast to the situation for market enabling regimes, such as those for foreign investment and intellectual property rights (IPRs), where the representation of civil society in international negotiations is relatively weak (Sell, 2002).

In the traditional bargaining model, which focuses narrowly on FDI, power derives from the possession of unique assets, market access, and technologies. Indeed, the possession of firm-specific advantages provides the raison d'être for MNCs to exist (Dunning, 1988). Similarly, a country's power derives from its ability to offer access to large markets or valuable mineral resources. In bargaining over the broad range of social and economic issues addressed by emerging forms of global governance, economic power is but one of several sources of leverage. Moreover, the power of MNCs now needs to be assessed relative to other actors, including NGOs and firms from other countries and sectors.

Technical expertise is still an important source of MNC power, but it is wielded in more diverse ways than was conceived in the original bargaining model. It is the recognition that large firms possess the financial, technical, and organizational resources to effect significant changes that explains the key role they increasingly assume in policy processes at the global level. The weak technical capacity of European regulatory agencies, in particular, gives firms substantial opportunity for engaging in policy development (Coen, 1997). Invited onto delegations, industry representatives can provide advice to governments, serve as a sounding board for ideas being discussed in negotiations and operate as crucial allies in building support for policies. At the same time, of course, they gain an insider's understanding of the process. Business frequently has a formal voice in advisory panels and in the process of authoring and reviewing scientific reports. In the climate change case, for example, the contribution of business to the scientific evaluation process was significantly expanded in the Third Assessment Report of the Intergovernmental Panel on Climate Change (Levy & Egan, 2003).

The power to frame debates within particular discursive and cultural contexts has increasingly been recognized as a key factor in the course of international negotiations (Litfin, 1994). Negotiations over environmental regulatory regimes often revolve around contested claims concerning science (Jasanoff, 1990). Industry has generally advocated a 'sound science' approach that requires a high burden of proof before regulatory action is taken, while environmental NGOs and some European governments have urged adoption of the 'precautionary principle'. Andree (2005) demonstrates the ways in which biotech firms have sought to deflect fears raised by environmentalists about environmental and health impacts from GM crops by emphasizing the precision and predictability of the technology and by portraying their products as solutions to hunger, in an effort to shift debate from risks to potential benefits. Keohane and Nye have used the term 'soft power' to describe:

> the ability to get desired outcomes because others want what you want. It is the ability to achieve goals through attraction rather than coercion. It works by convincing others to follow or getting them to agree to norms and institutions that produce the desired behavior. Soft power can rest on the appeal of one's ideas or culture or the ability to set the agenda through standards and institutions that shape the preferences of others. (Keohane & Nye, 1998, p. 86)

A key implication of the discursive aspect of power is that actors' interests and preferences are not fixed by structural circumstances, but can be shifted by framing issues in particular ways. MNCs have been largely successful in recent decades in mobilizing state managers to view their role as promoting 'competitiveness'. The emergence of the 'competition state' (Cerny, 1997) reflects the perceived structural dependence of the state on business for investment, employment, and tax revenue. In an effort to leverage this dependence, industry associations engaged with the climate change debate have funded a number of studies predicting dire economic outcomes if restrictive policies were adopted (Levy & Egan, 1998).

Organizational structures and capacity also serve as a critical resource. Murtha and Lenway (1994) have discussed how governments can deploy their organizational capabilities and political institutional structures in a strategic manner to influence MNC investment behavior. Where NGOs are lacking in material resources, they can sometimes compensate through innovative organizational linkages and sophisticated strategy. Leggett's efforts to develop relationships between environmental NGOs and the insurance industry over the climate issue provide a good example (Jagers, Paterson & Stripple, 2005). In another case, Greenpeace developed its own 'ozone-friendly' Greenfreeze refrigerator to combat industry claims that CFC-free refrigerators were a technological impossibility. Using methods

that are remarkably similar to those employed by business, NGOs pursue their goals by acquiring economic resources, building organizational capacity and alliances, developing formal and informal channels of access to policymakers, and by engaging in public debates concerning the science and economics of environmental issues. Indeed, many scholars have argued that an embryonic global civil society, which is somewhat autonomous from the state-centric system, is emerging as an effective counterweight to business power (Florini, 2000; Wapner, 1995). It would be a mistake, however, to portray global governance politics as a 'business versus NGOs' game. Horizontal issue-specific alliances frequently bring together business and NGOs. The Pew Center for Global Climate Change, for example, brings together firms from many industries with a commitment to emission reductions. Through these relationships, NGOs can offer business a measure of legitimacy, networks of contacts, and a degree of scientific expertise. Business can offer NGOs financial resources, global organizational reach, and the prospect of direct influence on industrial practices.

Outcomes of the bargaining process are critically influenced by bargaining strategies; actors need to be skillful in projecting their perspective in the media, in mobilizing scientific and economic research and influencing public opinion, in forging alliances, and in linking issues. MNCs need to develop local as well as global political competencies as they deal with challenges at multiple levels. The complex, dynamic nature of negotiations combined with strategic behavior by actors makes outcomes somewhat indeterminate (Braithwaite & Drahos, 2000); actors with less power in the traditional sense of material resources can sometimes outmaneuver their rivals.

The contested and contingent nature of business influence is illustrated by the case of biotechnology where, despite strong state backing, the industry has faced stringent regulation in Europe in the face of consumer concern, and a major multinational company was forced to back down on the use of the controversial 'terminator' technology that produced seeds capable of being used for one season only (Andree, 2005). In the climate case, industry efforts to challenge official scientific reports and to mobilize the appearance of grassroots citizen support backfired in the face of challenges from environmental NGOs (Levy, 2005). In the regime to control ozone-depleting substances, Falkner (2005) concludes that, despite the pervasive influence of large chemical multinationals, corporate actors were never in control; they only supported it as a second best strategy, and sought to shape its evolution and implementation. In demonstrating their ability to develop new chemicals and meet lower production targets for CFCs, they inadvertently set the stage for states and NGOs to push for a comprehensive elimination of ozone-depleting substances.

STABILITY AND CHANGE IN GLOBAL GOVERNANCE SYSTEMS

We have proposed that structures of global governance arise out of a bargaining process amongst groups of actors, including MNCs, states, and NGOs. The resulting arrangements need to ensure sufficient benefits for the various parties to induce them to cooperate in the governance system; this cooperation needs to extend to the informal and market mechanisms of governance. For a governance system to endure and achieve a degree of stability, various dimensions of the system need to function in a manner that can sustain the loose alliance of actors. Here we suggest that the neo-Gramscian concept of hegemony can usefully be applied to understand the nature of governance systems at the industry level, particularly where industries intersect with specific social and political issues, such as the fossil fuel industry and climate change, or biotechnology and genetically modified foods (Levy & Egan, 2003; Levy & Newell, 2002). Hegemony refers to a state of relative order based on an alliance of dominant players and an alignment of political, economic, technological, and ideological forces. The stability of the governance system requires a combination of the coercive bargaining power of more powerful actors combined with economic incentives, in the context of sets of norms and cognitive frames that help to coordinate perceptions of interest. The notion of hegemony, in this sense, is similar to the concept of field stabilization in institutional theory. Figure 7.1, is a schematic representation of the various dimensions of a governance system.

For example, contemporary patterns of production and consumption associated with the fossil fuel industry reflect a largely informal and market-based system of governance, one that reflects a balance of forces among firms, environmentalist groups, and regulatory authorities responsible for the environment and energy. The market dimension of the governance system needs to 'work', in the sense that oil and transportation companies need to be able to operate business models that deliver sufficient profitability to secure their cooperation in the system. These business models reflect power structures within the industry's supply chain, in relation to potential entrants and labor (Bair & Gereffi, 2003), as well as relations with the state that provide a context of regulatory constraints and substantial subsidies for the oil, coal, and transportation industries. The system is also predicated on the dominance of specific technologies operating within particular performance parameters. The ideological dimension refers to the discursive forms that lend legitimacy to actors and institutions, and hence to a particular distribution of incomes and decision-making authority. Moreover, technologies are themselves socially

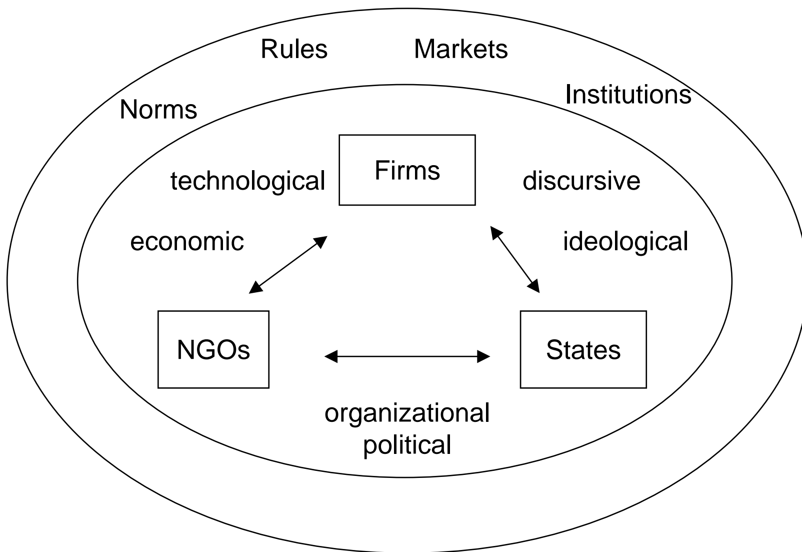

Figure 7.1 Global governance structures

embedded (Bijker, Hughes & Pinch, 1987; Garud & Karnoe, 2000). Consumer willingness (or lack thereof) to use energy-efficient products, such as hybrid-electric cars or public transportation, is constructed within a particular normative and ideological context (Callon, 1987).

The bargaining theory of FDI and the neo-Gramscian approach to governance both point to sources of dynamism and change. The traditional bargaining model proposed that bargaining power would shift over time from MNCs to host countries, once MNCs had invested in physical assets on the ground and local personnel in host countries gained expertise in the company's operations and a degree of control over its fate. The 'obsolescing' nature of the original bargain might thus set in train a dynamic process of renegotiation. In our extended conception of the bargaining framework, the direction in which power might shift over time is far less clear. Indeed, Gereffi (1985) argued that pharmaceutical MNCs in Mexico could retain their bargaining leverage through sophisticated technology strategies and alliances with local elites. His study foreshadowed more recent writing in the strategy field on dynamic capabilities, which emphasizes the advantages stemming from continuous enhancement of firm-specific capabilities, and their reconfiguration and redeployment in the face of a changing environment (Teece, Pisano & Shuen, 1997). Similarly, Gereffi's recognition that host countries are not unitary actors presaged current approaches to governance that stress the webs of relationships among multiple actors.

The shifting power of MNCs in global governance systems needs to take account of multiple bases of power in a complex, multi-actor world. Bargaining tends to be an ongoing, iterative, path-dependent process, sometimes extended over many years and covering multiple linked issues. The result is a greater space for potential conflict, yet simultaneously more opportunities to avoid zero-sum games and to find 'integrative' outcomes that provide widespread benefits (Young, 1994, p. 127).

The neo-Gramscian approach also highlights sources of tension and instability in systems of governance, but suggests they might change as a result of a shifting alignment of economic, technological, political, and ideological factors. In turn, of course, these affect the bargaining power of actors. In a study of the evolving climate change governance system, Levy and Egan (2003) argued US fossil fuel-related sectors have been pushed into a strategy of accommodation, despite their economic strength and aggressive resistance to controls on greenhouse gas emissions. Environmental groups have successfully deployed moral and scientific arguments, while mobilizing their own coalitions, including scientists, some state agencies, and elements of business that stand to benefit from low-carbon technologies. US-based MNCs have made some serious strategic miscalculations, and have been forced to respond to competitive challenges from Japanese and European firms, who have aggressively developed low-carbon technologies within a very different political–economic context. Overall, the oil and auto industries have moved toward accepting the scientific basis for emission controls and, in return, have won broad acceptance for a flexible, market-based implementation system that preserves corporate autonomy and profitability. The emerging governance system is predicated on a very weak international regime with flexible targets and lax enforcement. It reflects the continued political strength of the fossil fuel industry, the antagonism of the US administration toward the Kyoto Protocol, and the technological and market barriers facing more radical low-emission technologies such as fuel cells or solar energy.

PATTERNS AND TRENDS IN GLOBAL GOVERNANCE

The growth of global forms of governance does not imply a single locus of authority. Underlying the 'global' are layers of regional, country, and industry-specific patterns of business–government relations. Each issue also has its own specific set of actors, history, competitive dynamics, and regulatory and institutional context. The trajectory of global governance is shaped by the conflicts and compromises between the various actors in the

context of these particular institutional settings. Considerable heterogeneity exists across firms, sectors, and countries.

It is only relatively recently that small and medium-sized enterprises are becoming more multinational in scope and more engaged in policy debates. As actors in the supply chains of MNCs and as global traders in their own right, SMEs find themselves subject to a bewildering array of regulations and product specifications that they have to meet. Regulatory regimes carry significant implications for competitiveness as costs are imposed unevenly and new market opportunities are created. Regulated industries such as hazardous waste frequently have complex procedures for certifying new processes, thus stabilizing existing technologies and protecting market incumbents. Indeed, the erection of barriers to entry can constitute a strategic motive for larger corporations to support regulatory regimes (Reinhardt, 2000). The desire to keep smaller firms out of profitable markets by increasing the costs of compliance is arguably one of the drivers of private forms of regulation, such as ISO 14001 standards (Clapp, 1998). Larger firms remain better placed to perform multiple roles as expert, lobbyist, regulator and enforcer. MNCs sometimes initiate private, voluntary mechanisms, such as the US chemical industry's Responsible Care program, to raise public confidence and discipline poor performers who might attract regulatory pressure for the whole industry (Nash & Ehrenfeld, 1996). Financial limitations also prevent SMEs from securing a higher political profile for themselves by, for example, hiring lobbyists and tracking legislative activity related to their sector, in the way many larger multinationals do.

Firms at different stages of the value chain have relationships to technology and markets that affect their engagement with governance negotiations. Falkner (2005) demonstrates how producers of ozone-depleting chemicals, such as Dupont, were much more willing to shift to higher-margin substitutes than users of these chemicals in the refrigeration and electronics industries, who faced higher costs with few benefits. In the biotechnology industry, Monsanto and other technology providers at the input end were much more aggressive in securing a permissive international regime than grain traders and processors, such as Cargill, who were more concerned about consumer resistance and the costs of separation of genetically modified foods throughout the supply chain.

Locational factors remain important in explaining MNCs' stances toward global governance. Despite the globalization of supply chains and markets in recent decades, MNCs still tend to maintain ownership and management structures that reflect their country of origin (Pauly & Reich, 1997). Corporate political activity, which has traditionally been a function closely associated with headquarters, is therefore likely to be influenced by

home-country conventions and norms (Lin, 2001). Some significant trans-Atlantic differences have been observed in the lobbying styles and modes of access of firms. Business lobbying in the US is frequently far more adversarial in style and formalized in structure compared with Europe, where the approach is focused on dialogue, private meetings and corridor lobbying (Coen, 1999). US-based firms are more engaged in the generation of scientific and economic research data to support particular perspectives, and in the dissemination of these perspectives to policy elites and through the mass media to the public. Levy and Kolk (2002) have argued that corporate political strategies are premised on perceptions of interests that are constructed within particular institutional environments. In their study of the oil industry and climate change, they found that European MNCs were more accepting than their US counterparts of climate science, expected more stringent regulation of carbon emissions and were more optimistic regarding markets for low emission technologies.

At the same time, corporate political strategies generally need to respond to local political and cultural contexts in host countries to a greater extent than product market strategies (Hansen & Mitchell, 2001). Baron (1997) argues that 'Non-market strategies . . . tend to be less global and more multi-domestic, that is, tailored to the specific issues, institutions, and interests in a country.' There has been very little consideration, however, of MNCs' engagement with global governance structures that are negotiated and regulated in the context of unified multilateral arenas. For these, MNCs have little choice but to develop unified company-wide positions regarding the scientific, regulatory, and economic aspects of such regimes. The cost of failing to do so became evident for Shell in the mid-1990s, when Shell Europe moved toward acceptance of the need for internationally agreed greenhouse gas emission controls while Shell US was still a member of the Global Climate Coalition (GCC), the industry association which lobbied aggressively against any such measures. This inconsistency complicated the company's efforts to pursue a particular political strategy, and became a severe liability when it was publicized by environmental NGOs (Levy & Kolk, 2002). Clearly, implementation techniques, such as the channels of political access, might vary from country to country, but the broad terms of support or opposition to international emission controls need to be coherent and coordinated.

Recently there has been a notable trend towards convergence between the lobbying styles and practices of business in Europe and North America, though differences have not disappeared. This flows from the increasingly trans-Atlantic nature of capital integration in sectors such as biotechnology, and attempts by global coalitions to construct policy positions that bridge European–US differences. Coen (1999) shows how business

political activity in Europe has gradually shifted from the national to the European level, adapts to the growing mandates of EU institutions, and is increasingly influenced by the American style of aggressive lobbying. He also describes how international quasi policymaking organizations, such as the Trans-Atlantic Business Dialogue, are increasingly coordinating business positions and strategies on environmental and trade issues. Indeed, industry is increasingly forming issue-specific rather than sector or country specific associations for this purpose. In the case of climate change, Levy and Kolk (2002) argue that, while initial trans-Atlantic differences in the oil industry's responses were shaped by the home-country institutional environment, over time MNCs are more subject to common global institutional pressures, through participation in global industries and the new issue-specific institutions. As a result, there has been some degree of convergence of corporate perspectives, and hence strategic responses.

The growing role of MNCs in global governance suggests that there is a significant trend toward privatization of governance, which takes a number of forms. The most obvious manifestation of this trend is the dominance of corporate interests and lobbying in establishing and running formal regimes of governance. This is evident in the unprecedented influence of the fossil fuel lobby over US climate policy, in the power of chemical companies in shaping the timing and mechanisms of the Montreal Protocol regime for ozone depleting substances, and in the acquiescence of regulatory agencies such as the US Food and Drug Administration to the agenda of the biotechnology industry. Market-enabling regimes are even less subject to contestation from elements of civil society. Sell (2002) has amply documented the leading role of MNCs in the software, entertainment, and pharmaceutical industries in drafting of accords for Trade Related aspects of Intellectual Property Rights (TRIPS).

Recently, more attention has been paid to the emergence of international institutional mechanisms aimed at bringing order to an area of business activity, in which state authority is either not present at all, or not the predominant form of political authority (Cutler, Haufler & Porter, 1999; Haufler, 2001). Prominent examples in the environmental area would include the ISO (International Organisation for Standardisation), the FSC (Forestry Stewardship Council) and the MSC (Marine Stewardship Council). In many cases, enforcement takes place through reporting, auditing and inspection by other private authorities (Kolk, van Tulder & Welters, 1999). Sanctions include withdrawal of a product or facility from certification and, more importantly, loss of public reputation and the corresponding financial implications of damage to a brand name. Not bound by the same customs and expectations as state-based regimes, with their requirements for consultation with civil society, equal rights to representation and transparency of

proceedings, private regimes allow for faster decision making, some insulation against state regulation, favorable publicity for firms, reduced transaction costs and access to markets. States might favor self-regulation because it lowers the financial and political costs of forging policy, monitoring, and enforcement. In some cases, industry initiatives lead to the emergence of hybrid private–public governance systems. For example, private initiatives to develop trading systems for carbon emissions are likely to serve as templates for later regulatory structures. Industry-level codes of conduct such as the ISO 14001 environmental management standards, which started off as a private initiative, are being incorporated into various governmental trade and purchasing requirements (Clapp, 1998).

The privatization of entire sectors in many countries in recent years, such as water, energy, and railways, signifies a broad transfer of governance functions to the corporate sector. Despite this general trend toward deregulation and the 'outsourcing' by states of monitoring and reporting functions to private actors, the state is far from withering away; indeed, several scholars note a simultaneous increase in state regulatory capacity. The internationalization of production and the removal of trade barriers have themselves created the need for orchestrated institutional responses from states. For example, it is the global and transboundary nature of the trade in genetically modified seeds (GMOs) that gave rise to the need for a protocol on biosafety to ensure adequate attention to the environmental effects of transferring the technology across borders. The privatization of 'network' industries, particularly those with a common infrastructure, such as water, electricity, and railways, requires a whole slew of regulations to address competition, pricing, and security of supply. The establishment and enforcement of new forms of intellectual property rights, and the development of market mechanisms such as emission trading schemes, also require a complex administrative structure. State agencies stretched for expertise and resources by these new demands are increasingly turning to partnerships with NGOs, MNCs, and international organizations. Privatization of governance does not necessarily therefore signify a decline in the authority or regulatory expanse of the state; rather, the state's relationships with civil society and the corporate sector are being redefined in complex ways. This blurring of state boundaries is accompanied by the diffusion of ideologies through institutions such as the World Bank and Business Council for Sustainable Development that discredit 'command and control' forms of regulation as overly intrusive, while portraying business as socially responsible corporate citizens who are entitled to a role as partners in environmental governance, not just its subjects. If anything, states are expanding their overall regulatory scope, but in ways that are increasingly penetrated by expanding market relations and their associated

ideologies, and increasingly enmeshed in a web of relationships with firms, NGOs, and international organizations.

CONCLUSIONS

A political economy approach to global governance locates MNCs in the global economic and political system of which they are a part. This chapter has developed a framework in which MNCs engage in complex forms of bargaining over the structures and processes of global governance with a range of societal actors in diverse arenas. The outcomes of these bargains construct the edifice of the system of global governance. The complexity and dynamics of the bargaining process open up space for weaker groups, such as environmentalists and labor, to exert significant pressure on MNCs. Yet the relationship between macro-structures and individual regimes also signals the limitations of pluralist approaches that view regime negotiations as bargains amongst equals within isolated arenas. Businesses are clearly not always able to secure outcomes favorable to their interests, but they do appear to enjoy a privileged position that draws, not just from their material resources, but also from the power of international institutions governing trade and finance, a pervasive discourse supportive of markets and deregulation, and the support of states committed to 'business competitiveness'. Above all, business has gained legitimacy as a responsible partner in global governance structures and processes, willing to deploy financial resources and technological expertise to address a range of issues. Indeed, business cooperation has become an essential part of governance; the everyday marketing and innovation decisions of MNCs constitute an important dimension of global governance systems. Business is not just a subject of a regulatory system imposed by the state; rather, business is an intrinsic part of the fabric of governance.

A key implication of this perspective on MNC bargaining is the intertwining of governance and markets, and of corporate political and market strategies. MNCs do not play a passive role in this system of environmental governance, but exert their agency as political as well as economic actors. Global governance systems provide the structures within which trade, investment, and competition take place. As MNCs engage with global governance, they deploy a range of sources of power and leverage, from their possession of unique technologies to skillful dissemination of scientific information. The development of wider coalitions and alliances, with NGOs as well as other business sectors, is an important part of these strategies. These partnerships have market as well as political dimensions, for example, by creating industry standards. It is not just that companies

can benefit from coordinating market and nonmarket strategies (Baron, 1997); rather, this conception of governance points to a more profound linkage of the economic and political realms.

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8. Managing the interdependence between multinationals and developing countries

Pervez N. Ghauri and Xuefei Cao

INTRODUCTION

This chapter examines the relationship between multinational firms and governments of developing countries. In the period from the 1950s to the new millennium, there have been profound changes in this relationship. Governments and multinational firms have moved from a situation of conflict, to one where government policies were seen as a constraint on the activities of MNEs and then finally to an era of cooperation (Boddewyn, 1992). But now there is a situation of great uncertainty following '9–11' which this chapter seeks to illuminate. Since 2001, there have occurred numerous changes in world political economics. As a result, the conditions and the landscape for MNEs have changed as compared to earlier decades. The multinationals and developing countries (LDCs) relationship is manifested by the dominant theme of anxiety. The host governments are now uncertain of strategic implications of multinational decision making (Prasad and Ghauri, 2004). It is interesting to see whether the welcoming approach of LDCs towards MNEs will continue. Some of these issues are so old that the role of MNEs is seen both as contributing to a host country's technological modernization and as a hindrance to local firms' development and loss of jobs due to rent-extracting power of MNEs, loss of control over national resources and displacement of indigenous firms (Lopez and Miozzo, 2004).

A key issue determining the impact of globalization on developing economies and international business is the nature of the relationship between country governments and multinational firms. The contention of this chapter is that the conceptualization of this relationship has mirrored the changing balance of power between states and firms and between rich and poor nations. The current configuration of the global economy, including the impact of 9–11 has brought us to a point of inflexion in this relationship, which might lead to a totally new trajectory.

The most profound change in the world economy in the first postwar period is however, the emergence of successive waves of Asian 'newly industrializing countries' (NICs) as key players in the world economy, bringing new competition to Western nations and fostering the notion of a 'loss of competitiveness' in the developed countries. This had a number of effects. First, foreign direct investment (FDI) in these countries changed in nature and its conceptualization ceased to regard the host economy as a purely malleable object (Ramamurti, 2004). Second, as outward-oriented policies replaced protectionist ones, emerging country multinationals became salient and the analysis of their strategies became important (Ghauri and Buckley, 2002). Third, the policies of host governments towards inward investment have been shaped by the increasing interdependence of global economic activity (Buckley and Ghauri, 1999). Asian emerging countries went beyond NIC states to become full global competitors and the post-communist nations began to enter the world economy as new 'NICs'. The danger facing many economies was that of being left on the fringes as globalization drew countries together either through expanded world trade and FDI or through the creation of trading blocs (EU, NAFTA, ASEAN–AFTA). Some of these issues, such as privatization, the emergence of China, the Asian crisis and 9–11, have made scholars and policy-makers rethink their strategies.

This chapter traces the key writings on these issues and shows how these writings have influenced policies. The contrast between these key writings and the current situation highlights current problems.

THE CRITICAL LITERATURE

One of the very early pieces on foreign investment and the growth of the firm, by Edith Penrose, published in 1956, is a classic piece in the sense that it pointed out the controversial aspects of foreign investment, where in spite of the successful establishment of a subsidiary, local benefits may be low because excessive returns may be transmitted out of the host country. The paper discussed the implications of this form of foreign investment for the economic policies of less industrialized host countries. It revealed that, for the year ending 1954, GM earned a return of 590 percent on its original dollar investment in Australia. Later, Stephen Hymer (1971) looked specifically into what he termed 'two basic laws of development', namely the Law of Uneven Economic Development and the Law of Increasing Firm Size. He claimed that the multinationalization would continue through giant firms from both sides of the Atlantic. Using the Chandler-Redlich (1961) scheme, he suggested that MNEs would spread their day-to-day, that is

manufacturing, activities all over the globe, thus diffusing industrialization to developing countries and creating new centres of production. The other activities, that is coordination and communication, would stay closer to the head offices which would be completely centralized. As a result, 'the best' highly skilled and highly paid manpower would concentrate in the major cities of the US and Europe, while lower-level skills and manpower would remain in other parts and cities of the world. MNEs would thus be greatly interested in the markets of these less developed countries. Hymer's analysis seems to hold firm after three decades.

Whenever we discuss MNEs and developing countries, it becomes inevitable to enter a discussion of the determinants of development. Streeten (1974) started with the assumption that countries are poor and thus need large injections of foreign capital because they cannot raise their own savings. The low investment ratio was considered both the cause and effect of poverty. While discussing MNEs and developing countries it is suggested that the bulk of FDI in developing countries consisted of the reinvestment of local earnings. The analysis of Barnet and Muller (1975) addressed the myth of development, 'the struggle of human beings to realise their full potential' and an evaluation of FDI. By the end of the 1960s, the gap between the rich and the poor world was widening. Moreover, the gap within countries was also widening; a small minority was becoming affluent but for a large majority the miseries were increasing. Yet in absolute terms there has been growth in most countries. This can only be judged by understanding or defining 'development'. The positive impact of MNEs, as regards job opportunities, should be compared with the negative impact of maintaining and increasing poverty and having conflicting interests to those of developing countries. However, the primary objective of MNEs is profit maximization, thus MNEs use all their resources and power to achieve this, which has had an adverse effect on the distribution of income and employment levels in developing countries.

Bergsten, Horst and Moran (1978) took a different perspective and examined the impact of American FDI in developing countries on American interests. They claimed that there was no consensus on whether MNE–host-country alliances undermine the US industrial base. They believed that, as the conditions change, American policy must aim at preserving the advantages of the international transfer of resources and at striking a balance among its interests in domestic welfare, international efficiency and development in poorer countries. Raymond Vernon's 'Sovereignty at Bay' (1971), and his later analysis, 'Ten Years After' (1981), also analyzed the developments that took place in the field of MNE growth in the subsequent decade. In trying to predict the behavior of US-based MNEs, Vernon explained that, although his product life cycle hypothesis

(1966) has worked well over the years, it needs to be modified as the innovation lead of US firms is declining. The later study admits that MNEs from Europe and Japan have gained somewhat more in importance as compared to 10 years earlier. Moreover, there are a number of new MNEs based in Brazil, Mexico, Hong Kong, India and other developing countries that have also emerged. Developing countries have flexed their muscles, particularly in the raw material and extractive sectors, but, in manufacturing and the emerging service sector, control of the key competitive advantages (largely derived from knowledge) remained firmly under the control of innovative MNEs. A new stability was emerging, based on mutual recognition of goals and control of key resources.

Later studies by Dunning (1988, 1994, 2000) and Dunning and McKaig-Berliner (2002) re-evaluated the benefits of FDI and pointed out that both country and firm-specific factors have changed considerably. Countries have a more welcoming attitude towards foreign firms which they see as a positive means of enhancing the competitiveness of their local capabilities and firms. For firms, a more systematic and integrated approach combining production and marketing was becoming a strategic issue. Both of these issues are creating a new balance of benefits and costs for both parties.

More recently, Krugman's work has come to the forefront, starting with historical material and referring to the fact that only a short while ago a number of scholars and writers were warning that the biggest threat to US prosperity was competition from other developed nations. According to Krugman (1994), now that many economic writers have lost interest in the much-hyped threat of Japan to the USA's dominance, they have started seeing a new enemy: the emerging economies of the Third World. While the advanced nations had shown a disappointing performance over the past 20 years, Asia, especially South East Asia, had shown a remarkable and rapid growth. In Krugman's opinion, fears about the economic impact of Third World competition were entirely unjustified. Theoretically, there were some reasons for concern about the possible impact of Third World competition on the distribution of income in the West, but in practice there was almost no evidence that this was serious. The only effect of Third World growth was on the distribution of income between skilled and unskilled labor within the First World. Assuming that there was more skilled labor in the North and more unskilled labor in the South, the North will export skill-intensive products. Thus, the two parts in fact trade in skilled and unskilled labor. Northern skilled labor becoming scarcer will increase the wages of skilled labor and will reduce the wages of unskilled labor. The same type of mechanism will work in the Third World. This was the effect of North–South trade and it has very little to do with growth or performance, which is dependent on domestic productivity. On the other hand, if the

West creates barriers to imports from emerging markets, owing to a misguided belief that it will destroy home industries, it may destroy the most promising aspects of today's world economy: widespread economic development for the benefit of all. Buckley and Ghauri (2004) suggest that the consequences of globalization represent political challenges, and reaction against these changes has led to a questioning of the effects of global capitalism as well as its moral basis.

MULTINATIONALS IN DEVELOPING COUNTRIES

The role of developing countries in 'the South' has not been seen by academic authors as merely an inert recipient of FDI from 'the North'. Although Gereffi and Evans (1981) highlighted the dependence of developing countries like Mexico and Brazil on MNEs, and their policies to handle this dependence, they argued that countries like Mexico and Brazil should not be considered as typical developing countries as they are 'too industrialized' and have also developed sophisticated administrative apparatuses capable of protecting local interests. Hill and Johns (1985) discussed the role of FDI in developing East Asian countries. They claim that a lot of information is available to evaluate the role of FDI in the development of particular countries.

Buckley and Casson (1991) and Buckley (1997) analyzed MNEs in developing countries in terms of the interplay between two types of culture, a highly entrepreneurial culture in developed countries versus less entrepreneurial social groups in developing countries. It was claimed that the limited entrepreneurial culture in developing countries is one of the reasons for their underdevelopment. These two types of culture describe the values which stimulate the emergence of individual performances and competencies. The paper dealt with 'the poorest and most persistently' underdeveloped countries, such as sub-Saharan African countries. This extreme contrast was considered to reveal the sharper influence of culture. MNEs also differed from each other because of differences in their home countries. One condition for development was that there are resources with the potential to be exploited. Some countries, however, failed to realize their potential owing to lack of education and training, inefficient use of labor because of lack of transportation, and the absence of an entrepreneurial culture. This culture has two main aspects: technical and moral. The technical culture stimulates the study of laws and experimentation while the moral culture influences organization building, commitments, honesty, stewardship, and other values related to contractual arrangements. MNEs are considered to be a major instrument for transferring both the technology

and the entrepreneurial culture of DCs to LDCs, which, according to these cultural differences, are difficult to transfer (Buckley and Ghauri, 2002). This explains the limited spillovers of MNEs' operations in LDCs.

The noticeable shift in the past years from extreme liberalization and minimal state intervention to a more general disenchantment with globalization and emphasis on presentation of civil societies in LDCs is leading towards increasing tension between MNEs and LDCs (Lall and Tenbal, 1998; Buckley and Ghauri, 1999; Stiglitz, 2002; Yamin and Ghauri, 2004). This shift also has its roots in the increasing realization that industrialization in East Asia (in so-called NICs) was a governed process and was not market-led, which is apparent in many other LDCs and problems in their economies in spite of liberalization policies (Wade, 1990; Lall, 1994, 1998; Havila *et al.*, 2002; Yamin and Ghauri, 2004). The government policies in Korea, Singapore and Taiwan to govern market forces played a greater role in generating economic development than anything else (Wade, 1990; Yamin and Ghauri, 2004).

FACTORS INFLUENCING THE MNE–GOVERNMENT RELATIONSHIP

While discussing MNE–government relations and questions about whether MNEs have been causing stability or discontinuity in the Third World, Kaplinsky (1991) provided some statistical evidence that the world's largest 350 MNEs employed 25 million people and their liquid financial assets were three times larger than the total global assets of gold and foreign exchange. These 350 MNEs accounted for more than 40 percent of the total global trade of a number of the world's largest economies. The role of different developing countries in this globalization had been far from homogeneous. Those MNEs located their production in a limited number of countries and those developing countries where MNEs concentrated production for export generally achieved significant economic growth. This type of FDI contributed to the New International Division of Labour (NIDL). However, the basis of globalization began to change, as far back as the 1980s. The principles of optimal location and scale began to change. It is now no longer self-evident that NIDL-type strategies for FDI, which have been successful in the past, are likely to be fruitful in the coming years. Issues such as the transformation of the basic rules of competitiveness, the changing determinants of optimum location, unevenness in the world economy and the changing parameters of scale economies have all influenced the above changes. The changing patterns of production are considered to be directly related to the developing countries. The Third

World policy makers thus need to be aware of the significance of these changes in production patterns and efficiencies.

Stopford (1994) also dealt with the issue of growing interdependence between transnational corporations and governments. The starting point was the idea that the rapid growth of FDI has brought MNEs center-stage in the international political economy. This development challenges traditional comparative advantage and directs attention towards created assets instead of natural endowments in a greater degree of partnership between MNEs and governments. In this respect, both parties needed to understand each other's objectives and consider policy coordination as a positive-sum game and not as a zero-sum game. Four factors were considered to be central in this increasing interdependence.

1. The growth of MNEs; the output from assets located in one country was owned and controlled in another, which made it very hard for governments to control foreign investors.
2. The growth share of MNEs in exports, from both domestic and foreign countries, given that MNEs manage about three-quarters of world trade.
3. MNEs are primary sources of R&D in technology and thus dominate world trade in technology payments, often through transfer pricing. An understanding of MNE decisions on the location and transfer of R&D is of the utmost importance for governments.
4. The growth of strategic alliances and other forms of collaboration among MNEs and firms from emerging markets.

These collaborations have changed the structure of competition and challenge the power of governments. There is a triangular diplomacy model, government–government, company–company and government–company, to illustrate competing national and international resources. More recently, however, non-governmental organizations (NGOs) have been playing a major role in reshaping the global political–economic landscape. A number of studies are thus challenging the two-sector bargaining model (for example Teegen *et al.*, 2004). These studies claim that NGOs' many and varied interactions with MNEs and governments represent new challenges to both parties.

Understanding of globalization is crucial to an understanding of international political economy. Globalization is considered to be a term for varied phenomena, which suggests a multiple-level analysis in terms of economics, politics, culture and ideology. However, globalization is driven mostly by economic forces such as reorganization of production, international trade and the integration of financial markets (Sideri, 1997). It is not

uniform across countries and the strategies of multinationals are therefore crucial to its causes and consequences (Ghauri and Buckley, 2002; Buckley and Ghauri, 2004). While discussing production, the state and new social movements, we detect a series of relationships among (a) economic globalization and the state; (b) pressures on the state from below by subnationalism and from above by globalization; (c) globalization and democratization and, finally (d) resistance to globalization to prevent the eruption of social tension. Globalization thus encompasses contradictory trends (Mittelman, 1994). On the one hand, there are the unaccountable forces of globalization, which are largely beyond the control of effective state regulations. On the other hand, the state pulls in the opposite direction by using a variety of government intervention measures to create a competitive edge. Power is dispersed among more actors and interregional competition is heightened between the 'Triad' of Europe, North America and Asia.

The globalization of production has also led to a globalization of consumption which is threatening local cultures, tastes and buying behavior and is provoking nationalistic sentiments (Buckley and Ghauri, 2004). A recent emphasis on social responsibility and behavior of MNEs, pharmaceutical firms in particular, regarding pricing of drugs (for example AIDs drugs) in developing countries, has widened the rift between MNEs and developing countries (Vachani and Smith, 2004). All this is thus causing tensions at global, national and subnational levels (Dunning and Wallace, 1999; Oxelheim *et al.*, 2001).

THE CHANGING NATURE OF THE RELATIONSHIP

Privatization (the transfer of productive assets from public to private ownership) has been part of most structural adjustment policies in LDCs since the 1980s. It has been undertaken to achieve a variety of objectives, such as enhanced economic efficiency, reduction of financial deficits and reducing the role of the state. If we summarize experiences with privatization strategies showing that there is now a sufficient body of evidence to review their progress and to assess what works and what does not, we end up with the cautionary point that privatization alone is unlikely to ease significantly the burden of the state-owned sector in many less developed countries.

The emergence of China as a major player in the world economy and its full membership in WTO in 2001 has already had an impact equal to that of Japan in earlier decades of the postwar world. An initial, almost blanket, acceptance of FDI has now become more selective in terms of priority sectors and regions. China represents a non-uniform environment for the inward investor and there are currently difficulties in the

implementation and transparency of business law, contractual difficulties, regional differences and uncertainties about the direction of future economic policies. These challenges need to be addressed by careful adaptation of company strategies.

We are in a state where MNE–host country relations exist in a world in which middle-income countries have fully emerged onto the world stage, leaving behind a group of largely poor less developed countries which have so far been bypassed by globalization. Increasing locational 'tournaments', to attract FDI, may have reduced the benefits to the host countries, as have the increasing skill of the managers of MNEs in making their investments more 'footloose' (Oxelheim and Ghauri, 2004). Differences within developing countries may lead to divergence between those which can develop the velocity to catch up and those which will fall behind as the world economy becomes more interdependent.

Host country policies which have changed in this period include the relaxing of controls, increasing incentives to inward FDI, privatization, provision of guarantees and arbitration (Agmon, 2003). We have seen a trajectory of MNE–emerging market relations where tension increased during 1950–75 and then declined, whilst the host country gained bargaining strength in the first period, which relaxed as the MNE gained ascendancy. The role of the government, to encourage liberalization and ensure macroeconomic stability, is too simplistic. The present state of globalization that has increased the mobility and flexibility of MNEs demands from the government the creation and upgrading of assets to derive advantages for local economies (Dunning, 1997). This has to be done at specific industry level, including the creation of institutional support from MNE activities (Dunning and Narula, 1999, Yamin and Ghauri, 2004).

If we reexamine some of the above issues, we can see that the penetration of Northern multinationals in the South will increase. As asset prices fall in emerging economies, more of the firms denominated in these assets will be acquired by Northern multinationals from strong currency countries. The symmetry of the relationship will be further distorted by the decline of Southern multinationals in the North, which will be increasingly unable to fund outward DFI and which will be vulnerable to takeover. With increasing numbers of M&As, the balance of DFI will thus swing ever more decisively to the Northern firms.

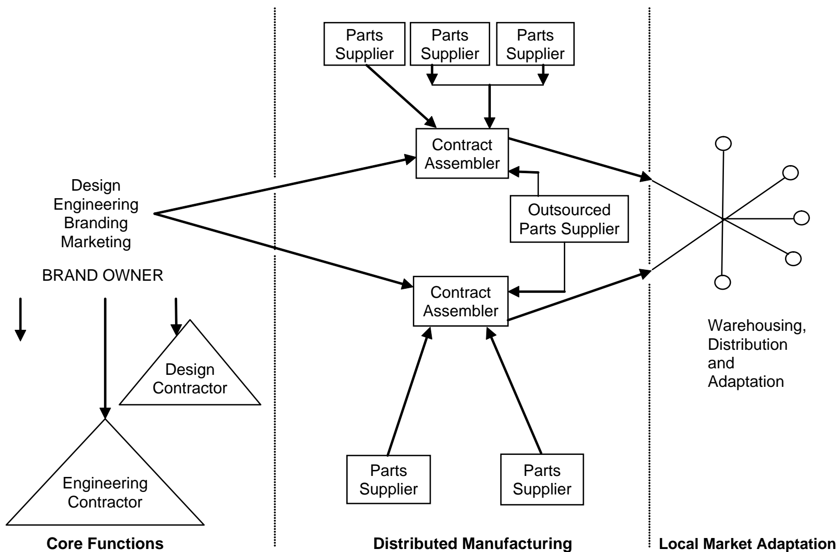
All of this, of course, is not without cost to the multinationals. Prahalad and Lieberthal (1998) say,

> in order to participate effectively in the big emerging markets, multinationals will increasingly have to reconfigure their resource base, rethink their cost structure, redesign their product development process, and challenge their assumptions

> about the cultural mix of their top managers. In short, they will have to develop a new mind-set and adopt new business models to achieve global competitiveness in the post imperialist age. (Prahalad and Lieberthal, 1998: 79)

Prahalad and Lieberthal thus predict the end of corporate imperialism and a more 'accommodatory' stance by multinational firms in emerging markets.

There are also grounds for believing that bargaining power will continue to move in the direction of multinational firms. They have a wider choice of investment locations as new 'emerging countries' put themselves forward as export platforms – usually on a tax-free basis. Their proprietary technology is widely sought after by host countries and their branded products sell at a premium to upscale consumers globally. Flexible manufacturing and production controlled by IT systems mean that more and more of the activities of MNEs are 'footloose'. As suggested by Buckley and Ghauri (2004), the manufacturing system of the future will use distributed manufacturing, where products are more and more responsive to customer needs through flexible factories (the global factory, see Figure 8.1). In flexible factories, all plants can make all firms' products and brands and can switch between different firms' products very quickly using new technologies and robots. The global factory concept is thus already in place.



Source: Buckley and Ghauri (2004: 89).

Figure 8.1 The global factory

Skilled jobs will thus be concentrated in the brand owners' (developed) countries while unskilled jobs will be performed in developing countries.

It might be suggested that increased globalization is beyond the control of any single nation state. One important response is the growth of regional cooperation which allows state policies to be coordinated to prevent wasteful competition or even combined to produce regional trading and investment blocs. The integration of these blocs into the global economy could potentially contribute to the 'continuation' scenario, as at present, but if they are focused internally and concerned with building 'regional champions' and diverting trade and investment via a common external tariff and investment regulations, then they may contribute to the size of the other scenarios.

Table 8.1 examines the impact of policies of developing countries on MNEs and the reciprocal impact of the strategies of MNEs on emerging markets. The second part of the table examines the impact of international

Table 8.1 The interdependence between MNEs and developing countries

Policies of Developing Countries	Impact on MNEs
Subsidizing industries	Increased local competition
Education improvements	Potential to recruit managers, scientists and develop new technologies in emerging markets
Stronger markets	Development of new products specifically aimed at emerging markets
Developing export processing zones	Export platform opportunities
Regionalization	Decreased opportunities for investment tournaments
Strategies of MNEs	**Impact on Developing Countries**
Multiple sourcing	Increased competition between host countries
Reduced unskilled labor component in production and services	Reduced DFI in emerging markets
Risk management (shift away from political to financial risk)	Variable impact depending on financial 'soundness'
'Flexibility'	Joint ventures
	Danger of increasing 'footloose'
Local sourcing	Increased spillovers and positive linkages

developments. Several policies are listed which individual emerging countries may follow to attract inward investment by MNEs. The results of these policies may well increase competition among emerging countries, unless the final policy – regionalization – is followed to ameliorate the impact of the others. Regionalization requires coordination of policies, cooperation between countries and the willingness of countries to forge opportunities in the wider interests of the region; these factors are not always present.

The strategies of MNEs in the global economy are largely geared towards achieving flexibility of operation, including multiple sourcing and risk management (Buckley and Casson, 1998). The reduction of the unskilled labor content in many areas of production distribution and services, through substitution of capital and information technology, together with new methods of operation, means that efficiency-seeking DFI is often not plentiful. Use of local inputs will benefit emerging economies.

Finally, international developments, such as increased volatility, and interference by NGOs, favor flexible strategies but attempts to regulate trade (by the WTO) and to bring investment and services within the audit of international regulation have so far proved largely ineffectual.

MANAGING INCREASING INTERDEPENDENCE

The notion that increasing interdependence can in any sense be 'managed' is a curious one. Who is to do the managing? There are two groups of actors that have been the focus of attention: firms and governments. Firms can be seen as 'islands of conscious power' within a sea of market relations. Their internal planning supplants the market and the boundaries of the firm are defined by the point at which the costs of using the market fall below the cost of internal organization (Coase, 1937). This became the key to the theory of the multinational enterprise (Buckley and Casson, 1976) and it is multinational enterprises whose writ runs large in the world economy, as we see below.

The second group of actors is made up of governments and governmental bodies who seek to regulate their economies in line with the perceived best interests of their population (or a subset of the population). Governments aim to plan their economies to seek goals which they believe a purely market outcome will not secure. This is particularly true for less developed countries for which the market outcome is, by definition, unsatisfactory. Conflicts between the operations of markets and government policies are greatest in these situations (Buckley and Ghauri, 1999).

Thus we can expect an inharmonious conjunction of the strategies of MNEs and governments' policies. However, we need to consider the fact that markets are not perfect and both firms and governments are attempting to appropriate rents in a world of imperfect markets (Buckley, 1996). This opens up the possibility of collusion between governments and MNEs in dividing rents and mitigating conflicts between them. It is this game which is taking place in a globalizing world where markets are becoming increasingly interdependent and this is critical in allocating the benefits of improving technology, communication, productivity and output.

For years the absence of strong local competitors in most emerging markets was one of the reasons that the FDI flow was predominantly from the industrialized countries of the North to the developing countries of the South. The import substitution and protectionist strategies of most emerging markets made FDI a more viable mode than trade to gain access to these markets. Now government-induced market imperfections are declining, there are some strong and competitive local firms that can beat off the entry of foreign firms. Moreover, most of the countries have moved away from protectionist politics and are opening up their markets to all types of entry by foreign firms; the nature of the resource flow has thus changed. However, in the last decade macroeconomic determinants, rather than the microeconomic determinants mentioned above, have become more important. Factors such as the investments or capital flow to countries where it can achieve highest returns and the market size or potential for local sales and benefits which can be achieved through local sourcing have become more important (Brewer, 1993; Pfefferman and Madarassy, 1992; Contractor, 1991).

In addition to the above, it has been established that the investments flow to the markets where a certain level of FDI is already in existence, agglomeration, has become a major factor in MNE strategies towards FDI (Oxelheim and Ghauri, 2004). This leads to synergetic effects such as foreign firms buying from each other. Moreover, the presence of a number of foreign firms helps to develop specialized know-how and skills with regard to the availability of skilled labor, suppliers and distribution networks. Thus it is not surprising that the stock of FDI in a given country is often a good predictor of future FDI.

Indeed, the weakness of indigenous firms in the countries affected provides an opportunity for foreign multinationals to acquire assets at lower prices, a process very much in operation after the Asian crisis. Foreign direct investment in fact can continue to restructure these economies and to provide the impetus towards renewed competitiveness.

CONCLUSION

This chapter charts a series of profound changes in the configuration of the world economy since the end of World War II. Many less developed or undeveloped economies now deserve the epithet 'emerging'. This reflects the reality of the waves of economies which have become significant players in the globalizing world economy. A new assertiveness has followed economic success and this is influencing future economic and political relationships. The new assertiveness in emerging economies came at a time of increasing interdependence between economies. This growing interdependence is manifested by an increasing amount of international trade (UNCTAD World Development Report, 1997) but is clearest in the quantum leap in international direct investment which flows between established developed countries (Buckley and Ghauri, 2004).

Foreign direct investment is strategic, not only from the point of view of the investing multinational firm but also from the viewpoints of both the parent and recipient countries. Negotiation between governments and multinational firms thus become a flashpoint of potential tension (Agmon, 2003). The globalization across markets creates new challenges that need sophisticated decision making on the part of governments and multinationals. In this respect, multinationals are better equipped to handle these new conditions. The governments, particularly from developing countries, are not in a position to perform even the intermediate functions (see Table 8.2) as stipulated by IBRO (1997), where governments have to address basic education, environment protection, regulation of monopolies, overcoming market imperfection and providing social insurance such as poverty reduction. The decline of FDI in the period after 9–11, the increasing oil prices due to the war on terror and the inability of LDC governments to handle disaster relief after the tsunami, have demonstrated the dependence of LDC governments on MNEs and governments from developed countries.

The recent developments in the political economy have created an atmosphere of mistrust between DC governments and LDC governments. Most LDCs now believe that market economy is the only system that can increase sustainable development and poverty reduction. However, they want to adopt this system in a certain controlled manner and not one imposed by a third party. They fear that a focus on the war on terror is diverting DCs from the pre 9–11 goals of poverty reduction and development in the Third World. These governments also want the World Bank, IMF and WTO to play a neutral role binding all members and asking DCs to open their markets for imports from LDCs as well (Wolf, 2004).

As suggested by Prahalad (2004), to be successful MNEs need to adapt their products and strategies to the markets and consumers of the

Table 8.2 Functions of the state

	Addressing market failure			Improving equity
Minimal functions	*Providing pure public goods*: Defense Law and order Property rights Macroeconomic management Public health			*Protecting the poor*: Antipoverty programs Disaster relief
Intermediate functions	*Addressing Externalities*:	*Regulating Monopoly*:	*Overcoming Imperfect information*:	*Providing Social insurance*:
	Basic education Environmental protection	Utility regulation Antitrust policy	Insurance (health, life, persions) Financial regulation Consumer protection	Redistributive pensions Family allowances Unemployment Insurance Environmental
Activist functions	*Coordinating private activity*: Fostering markets Cluster initiatives			*Redistribution*: Asset redistribution

Source: IBRD (1997: 27).

developing countries. They must make products that are affordable and accessible to the majority of the population in these countries. He believes that there are psychological barriers between MNEs and LDCs. While MNEs believe that LDC consumers are poor, living under poverty without buying power, and LDC governments are often corrupt regimes, the LDCs on the other hand believe that MNEs and their governments are dominant powers and crafty exploiters. As these barriers are psychological not structural, economic or historical, they are not difficult to overcome thus creating a win–win situation.

There has thus been a reassessment of the realignment of the goals of (developing) country government towards 'competitiveness': joining the globalizing world economy instead of resisting the impact through protectionism. Problems clearly remain. One of the starkest problems, however, is that of the excluded. Although successive economies have achieved the breakthrough, many countries have been completely bypassed, gaining a

minuscule fraction of the world FDI growth. There has also been a growth of the 'New Mercantilism' where, through the rhetoric of competitiveness (as Krugman, 1994, shows), beggar-my-neighbor policies are followed. Trade is described in terms of metaphors from warfare, rather than being regarded as mutually beneficial. FDI is seen as a competitive weapon against other firms and, by curious identification, against other countries.

The shareholder return–driven environment which prevailed in 1990s and the perceived difficulties of global governance in MNEs have fueled the current crisis in governance of firms. This has led to opinions that MNEs are safely looking for control and benefit only owners and executives rather than other stakeholders such as members of society (Ghauri and Buckley, 2002; London and Hart, 2004; Buckley and Ghauri, 2004). It is therefore important to be aware of the dangers of imposed capitalism and risks of mismanaged liberalization. We need to re-divert our attention to ensuring effective responses to global environmental changes instead of forcing LDCs to do what they would prefer not to do. Globalization and global economic integration do not render states helpless or enhance poverty and inequality (Wolf, 2004). However, as far as the MNEs' role is concerned, it should involve companies engaging in promotion of core UN principles as regards the environment, human rights and corporate responsibilities. The companies should also be involved in the entrenchment of revised codes and rules concerning health, inequalities and poverty reduction. Moreover, the MNEs should consider focusing on the development aspects of LDCs, such as the reversal of the outflow of net capital and elimination of unsustainable debt (Held, 2005). It is not globalization but the mismanagement of this process that is creating mistrust.

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9. Globalization and the development of competing standards for corporate conduct

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INTRODUCTION

Globalization has heightened concerns about the ability of national governments to regulate the environmental conduct and labor conditions of multinational companies (MNCs) and firms in their global supply networks. A central concern is that countries will find themselves competing to attract foreign direct investment by lowering their regulatory and enforcement standards (Drezner, 2001; Spar & Yoffie, 2000). While international cooperation between governments could overcome this problem a lack of international consensus about the rules for acceptable corporate environmental conduct and labor conditions in the global economy has so far precluded this. This situation has caused various non-governmental organizations, such as social advocacy organizations, industry associations, and international standard-setting bodies to develop and promote new global standards for firms' environmental conduct and labor conditions. A firm's compliance with the requirements of such standards can be verified and certified by independent third-party auditors, and firms can use this seal of approval in marketing their products and in attracting investors. These standards are not enforced by any government. Instead this system is based on the idea that firms will voluntarily adopt these standards because it is good for business – because customers and investors prefer to do business with certified companies (Florini, 2003). Thus, this system intends to govern corporate conduct by substituting standards established by various stakeholders for government regulations, and independent auditors that certify compliance for government monitoring.

In the past decade, the number of international environmental and labor standards has grown tremendously and increasing numbers of companies have obtained certification (United Nations Environmental Programme, 2000). These standards are adopted not only by MNCs but also by firms in

their enormous global supply chains, extending into countries all over the world and far beyond the large, publicly traded, brand-name companies that are the usual target of pressures for corporate responsibility (Christmann & Taylor, 2001). At the same time, the diversity of standards has increased, which is evidenced by the development of competing standards addressing the same issue by different organizations with divergent goals.

In this chapter we identify and explore the implications of three different approaches to standard setting carried out by different organizations with divergent goals: a technical engineering approach carried out by standard-setting bodies, a social responsibility approach carried out by non-governmental advocacy organizations, and an industry-centered approach carried out by industry associations and other industry groups. These three types of organizations sometimes develop and promote different standards addressing the same issue, which leads to competition between standards for legitimacy in the marketplace. Drawing on a case example, we propose that competing standards may not need to be in conflict but can provide an avenue for establishing consensus about universally accepted norms for corporate environmental conduct and labor conditions in the global economy. Competing standards on an issue indicate the importance of the issue for industry participants and different stakeholder groups. The existence (or potential threat) of competing standards can lead to increasing engagement between the different types of organizations as they aim to increase the legitimacy for their standards. This process may result in competing standards becoming more similar and may eventually result in the emergence of dominant standards, which facilitate widespread standard adoption and diffusion. Widespread adoption and diffusion of these standards is one necessary condition for certifiable global standards for corporate conduct to become effective governance mechanisms for environmental and labor conduct in the global economy.

Given that certifiable global standards for corporate environmental and labor conduct are a relatively new phenomenon, and the processes of development, refinement, adoption and diffusion of these standards are still going on, it is too early to know with certainty whether we will see long-run equilibria with multiple equally balanced competing standards or with dominant standards. Our early evidence provides support for the argument that competing standards are becoming more similar over time, which lends support to a situation with dominant standards. We suggest that the existence of dominant standards increases standard diffusion and thus the potential for certifiable standards to govern firm conduct in the global economy.

To place the emergence of standards in the broader context of the debate about the environmental and social effects of globalization we begin by

summarizing concerns and empirical evidence about the impact of globalization on firms' environmental conduct and labor conditions and about the ability of national governments to regulate firm conduct. We then describe two alternatives to national government regulations – international government cooperation and codes of conduct – and discuss their limits. We suggest that certifiable standards have the potential to be an alternative governance scheme for firms' environmental conduct and labor conditions in the global economy. We then turn to our discussion of different approaches to standard setting with divergent goals and the potential conflicts and complementarities of competing standards. We conclude with a discussion of the prospects and limits of certifiable standards to govern firms' conduct in the global economy.

EFFECTS OF GLOBALIZATION ON FIRMS' ENVIRONMENTAL CONDUCT AND LABOR CONDITIONS: CONCERNS AND EVIDENCE

The reduction of barriers to trade and foreign direct investment in recent decades set the stage for a period of tremendous growth in cross-border flows of goods and capital, an era frequently referred to as 'globalization'. While advocates of globalization emphasize increased efficiencies resulting from division of labor between countries and the crucial role of multinationals in bringing capital, jobs, and technologies to emerging economies, critics suggest that globalization poses a serious challenge to the authority of national governments to regulate firms' environmental conduct and labor practices (Strange, 1996). This is because falling barriers to trade and foreign investment allow MNCs to exploit differences between the environmental and labor regulations of individual nation states. Critics contend that multinationals relocate the most polluting activities in their value chains to subsidiaries or suppliers in countries with lax environmental regulations and adapt their subsidiaries' environmental and labor policies to local country conditions (Gladwin, 1987; Korten, 1995; Vernon, 1998). Likewise, it is argued that countries with low labor standards attract labor-intensive industries and become export platforms for labor-intensive goods (Mah, 1997). As global competition tightens the margins for companies, incentives to establish production and export platforms in countries with low costs and lax environmental and labor regulations are increased. Thus, national environmental and labor regulations are becoming determinants of firms' and industries' location decisions, which may result in industrial flight from countries with high levels of regulations to ones with lower levels of regulations (Leonard, 1988).

Critics suggest that this threat of industrial flight increases the power of MNCs relative to national governments. Because falling barriers to trade and foreign investment create a global arena in which national governments compete to attract inflows of foreign capital, the shifting balance of power forces governments that are trying to retain and attract foreign direct investment in their geographic borders to make concessions to MNCs (Lee, 1997). The concern has been voiced that these developments may induce a 'race to the bottom' in environmental and labor regulations: a downward spiral of lower and lower environmental and labor regulations among competing countries as they try to become the lowest-cost location for production activities (Spar & Yoffie, 2000). These developments suggest that globalization can constrain the ability of national governments to impose environmental and labor regulations that reflect domestic preferences for environmental quality and labor standards within their own jurisdiction. External developments such as competition between nation states seeking to attract investment, tougher global competition between firms that makes them more cost conscious, and shifts in the power balance between MNCs and national governments determine the level of national environmental and labor regulations (Strange, 1996).

In contrast to the rhetoric, empirical research using data on foreign direct investment and trade flows provides almost no support for anti-globalization assertions. If MNCs took advantage of cross-country differences in regulations we should observe flows of foreign direct investment of polluting industries from countries with stringent environmental regulations to countries with lower levels of environmental regulations and enforcement. However, empirical research on the impact of environmental regulations on foreign direct investment flows does not support the industrial-flight theory of MNC location (Walter, 1982; Leonard, 1988). Likewise, if lax labor regulations were an important determinant in MNCs' international location decisions FDI should be attracted to countries with lax labor regulations. Empirical evidence shows that no matter how workers rights are defined (number of ILO conventions ratified, indices of child labor, and so on) FDI does not appear to be attracted to countries with poorly protected workers' rights (Cooke & Noble, 1998; Organization for Economic Cooperation and Development, 2000; Kucera, 2001; Rodrik, 1996; Brown, Deardorff & Stern, 2003). Only results on the rate of unionization are mixed. While Cooke & Noble (1998) found that in developing countries the rate of unionization has a negative effect on FDI, Kucēra (2001) found the opposite result. If, as critics suggest, countries with lax environmental regulation will become production and export platforms for products manufactured by dirty industries, we should observe a negative relationship between the level of environmental regulations and the exports

of dirty industries. However, most studies that empirically examined this issue failed to detect any significant relationship between the level of environmental regulations and exports of dirty industries (Tobey, 1990; Ferrantino, 1997; Rugman, Kirton & Soloway, 1999). Only a few studies found the expected negative effect of stringency of environmental regulation or environmental protection costs on net exports (Kalt, 1988; van Beers & van den Bergh, 1997). Studies that examined whether countries with lax labor regulations become export platforms for labor-intensive goods show mixed results with a few studies suggesting that high labor standards negatively affect export performance (Mah, 1997), while most studies find no significant results for most labor standards' variables (Organization for Economic Cooperation and Development, 1996; Rodrik, 1996; Dehejia & Samy, 2004).

The finding that environmental and labor regulations do not significantly affect FDI flows indicates that MNCs may not take advantage of cross-country differences in environmental and labor regulations. This interpretation is consistent with the finding that the environmental performance of MNCs in low-regulation developing counties is often better than the performance of domestic firms (Christmann & Taylor, 2001). Research has also shown that MNCs often adopt stringent internal minimum environmental standards for all their operations worldwide, which limits their ability to take advantage of differences in environmental government regulations across countries (Dowell, Hart & Yeung, 2000). An important reason why MNCs adopt standardized environmental policies is to pursue globally integrated and standardized strategies for other business functions (Christmann, 2004). Because environmental policies are closely integrated with other functional areas of the firm (Christmann, 2000), adapting environmental policies to local country regulations may not lead to cost savings in low-regulation countries if the MNC has globally standardized strategies for other functional areas. For example, if an MNC has standardized its production technologies on a global basis, then differentiating its environmental technologies across countries to exploit lax local regulations in some countries may not provide any cost benefits to the MNC. Far from contributing to lower global costs, differentiating environmental technologies across countries may require expensive adaptations of their production technologies. This suggests that MNC subsidiaries may exceed local government regulations for strategic reasons even if MNC management does not inherently value responsible environmental conduct.

Another reason for MNCs' adoption of standardized environmental policies is pressures by customers and other stakeholders who are concerned about MNCs' global environmental conduct (Christmann, 2004). Certifiable global standards for corporate conduct play an important role

in increasing the transparency of MNCs' environmental conduct and labor conditions in all subsidiaries. Such transparency of conduct is necessary for customers to take a firms' environmental conduct and labor conditions into account in their purchasing decisions (Christmann & Taylor, 2002; Christmann, 2004).

The finding that environmental and labor regulations do not significantly affect trade flows may indicate that pressures for environmental protection are also diffusing through global supply chains. In the pulp and paper industry the influence of customers on environmental conduct has increased relative to regulators since the 1970s (Lundan, 2001). Export-oriented firms in China, which may face pressures for responsible environmental conduct by their foreign customers, were found to be more likely than firms selling to domestic customers to adopt environmental standards (Christmann & Taylor, 2001). Certifiable global standards can play an important role in the diffusion of environmental and labor practices through supply chains. Certification lowers the search and monitoring costs for customers in global supply chains that are looking for suppliers with certain environmental conduct and/or labor conditions and thereby make it easier for customers to include environmental and labor criteria in their supplier selection requirements.

This discussion suggests that national government regulations are becoming less important as determinants of firms' environmental conduct and labor conditions while other factors and pressures increase in importance. Certifiable standards enhance the effectiveness of non-governmental pressures by increasing transparency of firms' environmental conduct and labor conditions, which allows customers and investors to consider these factors in their purchasing and investment decisions without incurring high search and monitoring costs.

GOVERNANCE OF FIRMS' ENVIRONMENTAL CONDUCT AND LABOR CONDITIONS IN THE GLOBAL ECONOMY

Various alternative governance schemes have been suggested to overcome the potential failure of national government regulations to protect the environment and enforce adequate labor standards in a situation of globally integrated markets. These alternatives include international government cooperation and agreements as well as schemes that focus on non-governmental actors to bring about greater accountability and control of the environmental conduct and labor conditions of firms involved in the global economy.

Fora for international government cooperation in environmental and labor issues include multilateral institutions such as the United Nations (UN) or the World Trade Organization (WTO), as well as international treaties. The International Labor Organization (ILO), a specialized agency of the UN, seeks to promote labor rights internationally and provides for an international institutional framework for dialog between employers, workers, and governments. The ILO Declaration on Fundamental Principles at Work is binding for all 175 ILO member countries. However, the ILO lacks an effective mechanism to encourage compliance by member countries. As a result, incorporating environmental and labor standards in international trade rules of the WTO as a means to force nation states to adopt more stringent environmental and labor regulations has been suggested and is extensively discussed in the literature (for example, Brown, 2001). Advantages of such a scheme include the fact that trade sanctions can be used as an enforcement mechanism against non-complying countries. However, environmental and labor issues have been largely absent from the WTO's agenda and are not included in any agreement. (The only exception is GATT Article XX, which addresses prison labor.) A reason for this absence is the lack of an international consensus on what constitutes universally accepted labor and environmental standards that should be implemented by all countries. Critics suggest that it is unfair to attempt to establish standards without regard for the level of economic development and cultural norms (Bhagwati, 1995). In particular, developing countries argue that adoption of higher environmental and labor standards would translate into unwarranted interference on the part of rich countries in the form of disguised protectionism. So far governments have only been able to achieve consensus and create agreements on specific environmental issues that have global reach. Such agreements include the Montreal Protocol for the Protection of the Ozone Layer and the Kyoto Protocol Framework Convention on Climate Change.

The difficulty of establishing mechanisms for governing firms' environmental conduct and working conditions in the global economy through international government cooperation has led to the emergence of non-governmental pressures on MNCs and their supplier networks to regulate their conduct voluntarily. The ability of firms to regulate their own behavior voluntarily offers a potential alternative to government regulation. Many groups participating in the United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro in 1992 agreed that business self-regulation was an essential element in improving environmental performance of firms. Self-regulation pressures come from participants in the marketplace – customers and investors – as well as from a large number of non-governmental organizations (NGOs) that

represent the interests of various stakeholders. Research has shown that customers increasingly consider firms' environmental conduct and labor conditions in their purchasing decisions (Arora & Cason, 1995; Christmann & Taylor, 2001; Henriques & Sadorsky, 1996) and that customers are concerned not only with MNCs' environmental conduct in their own country, but with MNCs' global environmental conduct (Christmann, 2004). The growth of socially and environmentally responsible funds indicates that investors are considering firms' environmental and social conduct in their investment decisions (Guay, Doh & Sinclair, 2004). While NGOs do not directly affect firm performance through a market relationship they influence decisions of participants in the marketplace by providing information and creating awareness through public relations campaigns (Guay, Doh & Sinclair, 2004). Because MNCs have the financial, technical, and organizational capabilities to address environmental and labor issues in developing countries they are not only viewed as part of the problem, but also as part of the solution. In addition, MNCs – many of which have brand name reputations to lose – are visible targets for NGOs' public relations campaigns. Therefore, stakeholders focus on MNCs in their efforts to improve the environmental and labor conditions in developing countries.

One outcome of this movement towards corporate self-regulation has been the development and adoption of codes of conduct, policy statements that define ethical standards and guidelines for corporate behavior mostly in rather general terms. Codes of conduct have been established by multilateral institutions (for example, the OECD Guidelines of Multinational Enterprises or the UN Global Compact), industry associations (for example, the International Chamber of Commerce 1972 Guidelines for International Investment) as well as by many individual MNCs (International Labor Organization, 2002). However, codes of conduct lack effective means to verify whether the companies that subscribe to these codes actually comply with the requirements laid out in the code (Kolk, van Tulder & Welters, 1999). Thus codes of conduct cannot be seen as effective mechanisms for governing firms' environmental conduct and labor conditions in the global economy.

As a result of the shortcomings of codes of conduct, the focus has shifted to establishing environmental and labor standards that include mechanisms for verification by independent external auditors. Standards have more credibility if independent third-party auditors verify that firms actually adhere to prescribed principles, practices and management systems. A few companies such as Nike and Mattel have established internal standards and use external auditors to monitor adherence to these standards in their own and their suppliers' operations. However, the great majority of such standards are established by other organizations representing various

stakeholders and/or corporate interests. These organizations also provide the infrastructure for monitoring firms' adherence to the standard and for certification. Some of these organizations have established environmental and social product standards that can be certified, while others have established process standards for certifiable management systems. Firms that obtain environmental or social responsibility certifications can advertise compliance and display the stamp of approval on their products. Certifiable standards have the largest potential to fill the governance gap left by the failure of governments to protect the environment and workers' rights in the global economy and provide an alternative governance scheme for firm conduct. We will focus on these standards in the remainder of this chapter.

APPROACHES TO STANDARD SETTING

The task of translating corporate self-regulation and accommodation of stakeholder interests into meaningful standards has been approached from multiple directions: (1) a technical engineering approach that is advocated by national non-governmental standards organizations such as the American National Standards Institute (ANSI) and international non-governmental organizations such as the International Standards Organization (ISO) in Geneva; (2) a social responsibility approach to standards for corporate conduct that is advocated by a wide range of NGOs that practice a variety of forms of social advocacy to influence environmental conduct and labor conditions of corporations; and (3) an industry-centered approach to self-regulation of corporate conduct that is advocated by industry associations and other ad hoc industry groups.

Of these various approaches to standard setting, the technical engineering approach seems to have had the greatest impact on the daily operations of multinational firms.[1] Multinational firms, independent experts, and a range of stakeholders participate in the standard-setting process and participate as members of both ANSI and ISO to forge standards that reflect their corporate interests, professional orientations and special interest representations. This approach has been an effective way to establish technical engineering standards and management system standards that enjoy widespread adoption pertaining to an ever-expanding range of business activities. The primary goal of these standards is to facilitate efficient production, to provide information that lowers the costs of searching for and monitoring suppliers and to promote international trade.

The best-known management system standards are the families of quality and environmental management standards known as ISO 9000 and ISO 14000, respectively. The ISO management systems are generic systems

that can be implemented in any manufacturing or service industry. The ISO 9000 standards evolved from the convergence of quality control management systems developed in Japan, Europe and the United States and are now accepted as global standards for quality management systems with more than 550 000 certifications in almost 160 countries by the end of 2002 (ISO, 2004). The ISO 14000 environmental management system standards established in 1996 are the result of an effort to take the approach used in ISO 9000 quality standards to create a certifiable standardized environmental management system (ISO 14001). Many companies that have adopted ISO 9000 find ISO 14001 to be a logical extension of their quality management system, which may in part explain its widespread adoption. As of December 2003, 61 287 facilities had obtained ISO 14001 certification (ISO World, 2004).

Standardized management systems facilitate third-party auditing by independent organizations that certify the proper implementation of the system. However, certification does not serve as a guarantee of firm performance; indeed there is no intention in the certification process of management systems such as ISO 14001 to measure performance. All that can be said is that the certified firm has adopted management practices and a management system that are consistent with the standard's requirements. The adoption of a standardized approach for monitoring the implementation of ISO 14001 enables firms to judge the environmental management capabilities of their suppliers and facilitates efficient contracting in supply chains.

While ISO has not yet developed a standard addressing the social or labor dimensions of firms' operations, it convened an international conference on social responsibility of organizations in June 2004 to explore social responsibility initiatives around the world, and to gage whether there is sufficient support for and value from ISO involvement in setting social standards (International Standards Organization, 2004). However, without broad stakeholder and corporate consensus around an issue, it is highly unlikely that a certifiable management system standard will emerge through channels such as ANSI and the ISO.

Social responsibility standards differ from the ISO approach. Social responsibility standards are arrived at through a social engagement process, where non-governmental advocacy organizations representing stakeholders covering a wide range of special interests and possibly industry participants cooperate and compete to promote environmental and labor standards to which firms are encouraged to voluntarily subscribe. Advocacy organizations play a lead role in promoting corporate standards to protect the interests of stakeholders. Advocacy organizations draw their legitimacy from the strength of their claim to represent particular

stakeholders and from their ability to contribute specific subject-related expertise. They frequently use public relations campaigns to generate awareness of specific problems and issues and influence public opinion and government policies. Increasingly, advocacy organizations not only get involved in and influence legal and policymaking processes to focus also on directly affecting firms' environmental conduct (Broad & Cavanagh, 1997); they monitor corporate activities and publicly target firms using a range of techniques such as street demonstrations, position papers and public relations campaigns.

Advocacy organizations can use certifiable standards as a tool to influence corporate conduct. The primary goal of standards for corporate conduct that are developed and promoted by advocacy organizations is to help protect weaker members of society and the environment. Advocacy organizations have introduced numerous standards for environmental conduct and labor conditions, some of which are generic and can be applied to multiple industries, while some are specific to certain industries. For example, SA 8000 is a social responsibility standard that can be adopted in any industry. SA 8000 is an international workplace and human rights standard that was launched by Social Accountability International (SAI, formerly named Council of Economic Priorities Assessment Agency) in June 1998. The standard, which was developed with participation from NGOs, unions, and companies, requires certified firms to uphold many ILO Conventions and the UN Universal Declaration of Human Rights and the Convention on the Rights of the Child. In addition to meeting verifiable basic standards for child labor, forced labor, health and safety, freedom of association, non-discrimination, disciplinary practices, working hours, and compensation certification, it also requires the implementation of a Social Management System to ensure compliance and continuous improvement in delivering the aforementioned requirements. As of August 2004, 430 establishments in 39 countries had received certification (Social Accountability International, 2004).

Several social responsibility standards have been developed to promote social responsibility in the apparel industry where child labor and 'sweatshop' working conditions have been commonplace (Brown *et al*., 2003). For example, the Fair Labor Association (FLA) was established by Apparel Industry Partnership (AIP) in 1998 to implement and monitor a code of conduct to correct sweatshop labor abuses. AIP itself was created on the initiative of the U.S. Department of Labor in 1996, working with NGOs, unions, and companies to address sweatshop issues globally. FLA provides a brand certification rather than a product or facility certification. FLA standards require that, for a brand to be certified, only 5 percent of factories producing the brand's products need to be monitored (Bernstein,

2003). In order to increase transparency the FLA started in 2002 to post noncompliance findings of each independent factory monitoring visit on its website to complement its annual report on company efforts to fulfill FLA requirements. Since FLA membership includes most of the largest apparel producers, its standards may offer the prospect of having high impact on working conditions. Major brands that have received certification include Adidas-Salomon, Eddie Bauer, Liz Claiborne, Lands End, Nike, and Nordstrom Private Apparel. However, prominent corporate participation in the FLA raises the concern that it might be dominated by corporate interests that would favor a weak code of conduct. (The criticism has been raised that the actual factories inspected are not named by FLA, which makes it difficult for 'watchdog groups' to verify the results of the inspections (Bernstein, 2003), which leads to speculation that the factories producing goods for FLA members might be engaging in unsavory labor practices beyond the reach of adequate monitoring.

Another sector for which many international environmental and social responsibility standards have been developed is the agricultural sector. Environmental certification exists for a wide range of products such as bananas, citrus fruits, coffee, cocoa, forest products and flowers and ferns. These standards differ widely in their diffusion and adoption by firms. For example, the Rainforest Alliance's *Better Banana* project developed in 1991 is an international certification program focused on environmental and social standards for banana farms, which allows certified producers to use the *Better Banana* trademark in the marketing of their products. Today, more than 15 percent of all the bananas in international trade come from Rainforest Alliance certified farms largely owing to widespread adoption by major international producers such as Chiquita and Reybancorp (Favorita Fruit Company). Another example is the Forest Stewardship Council's (FSC) Forest Management Certification. FSC is a multi-stakeholder standard-setting and certification initiative founded in 1993 with the help of a number of NGOs such as the World Wildlife Fund (WWF), Greenpeace, and Friends of the Earth International (Overdevest, 2004). FSC certifies individual forests on their adherence to specific forest management practices, labor conditions, and the protection of community rights in the harvesting of wood. The adoption of the FSC standard has been somewhat limited. As of August 2004 more than 45 million hectares in more than 60 countries had been certified to FSC standards, which only accounts for less than 5 percent of the global marketed wood total (Overdevest, 2004).

Industry associations or other ad hoc industry groups are the third group that is taking the lead in setting norms for responsible corporate conduct in the global economy. Goals of establishing industry norms for corporate

environmental conduct and labor conditions include protecting the collective reputation of the industry (King & Lenox, 2000), raising the capabilities of industry members to address environmental or labor issues, as well as preempting other presumably more stringent standards established by advocacy organizations (Christmann & Taylor, 2002). Traditionally, industry norms for corporate conduct were rather vague codes of conduct that did not provide for third-party monitoring and certification (for example, the Chemical Industry's Responsible Care Program). However, concerns about the effectiveness and credibility of industry self-regulations based on codes of conduct (King & Lenox, 2000) have led industry groups to develop standards of conduct that are designed to be monitored and certified by independent third-party auditors. For example, the organization Worldwide Responsible Apparel Production (WRAP) is an independent certification agency that was originally created by the American Apparel and Footwear Association in 2000. WRAP developed a certifiable industry code of conduct based on 12 principles for ethical and socially responsible working conditions in the garment business, including the elimination of child labor. As of November 2003, WRAP had certified 570 facilities in 50 countries. As we will discuss in more detail below, the American Forest and Paper Association's (AF&PA) Sustainable Forestry Initiative (SFI) has also recently moved towards providing independent third-party certification of sustainable forestry practices. However industry efforts cause skepticism in the advocacy organization community, which argues that WRAP or SFI are attempts to compete with and undermine more stringent certification programs such as FLA and SA 8000 or the FSC Forest Management Certification.

COMPETING STANDARDS: CONFLICT OR COMPLEMENTARITY?

The three different approaches to standard setting outlined in the preceding section aim to achieve different goals. The technical engineering approach to standards aims to bolster economic activity. The social responsibility approach to standards aims to protect society and the environment from the consequences of economic activity. The industry approach to standards aims to protect industry from the economic burden of regulation and from challenges to the collective reputation of the industry while making some accommodation to stakeholder interests. These divergent goals sometimes bring these approaches into conflict. Industry groups may develop standards for corporate conduct to preempt the development of more stringent standards by advocacy organizations or to respond to stringent standards

designed by advocacy organizations. As a result we encounter situations in which standards addressing the same issue that have been developed by different groups with conflicting goals compete for legitimacy and acceptance in the marketplace. For example, the American Forest and Paper Association (AF&PA), an industry association representing the interests of US forestry and paper companies, formed the Sustainable Forestry Initiative (SFI) in 1994 in response to the more stringent requirements of the Forest Management Certification that had been developed by the Forest Stewardship Council (FSC), an organization founded in 1993 by environmental advocacy organizations such as the World Wildlife Fund and Greenpeace. A report by the Meridian Institute (2001), an independent think-tank, found significant differences between the two initiatives. While the FSC Forest Management Certification has specific requirements and demands external third-party certification, the SFI has less stringent requirements and does not demand third-party certification. The SFI simply demands that firms compile a report detailing their compliance with the SFI requirements that is reviewed by a panel of experts.

Not every situation with multiple standards addressing an issue is a situation of competing standards. Some stringent standards may be designed with the goal of excluding most of the firms in order to provide the few firms that obtain certification a differentiation advantage. A stringent standard may be too costly to be adopted by most firms that do not possess the resources and capabilities to comply with the standard's requirements. Firms with superior resources and capabilities that adopt the standard will achieve differentiation advantage in the eyes of those customers that value the adoption of the standard. Such excluding standards can be expected to persist, maybe in parallel with other less stringent standards if customer or investor preferences differ, so that a subset of customers or investors will value the more stringent standard. Thus, different standards that are aiming to appeal to certain subsegments of market participants are not in competition for legitimacy and acceptance in the marketplace with other (less stringent) standards. The following discussion of competing standards only pertains to standards that are intended to have appeal to the same (relatively broad) segments of customers and investors.

While competing standards indicate the existence of conflicting interests around an issue, competition between standards may also be an avenue for gradually creating consensus around acceptable norms for corporate environmental conduct and labor conditions. While the long-term outcome of competition among standards can never be known with certainty in advance, institutional and economic forces may compel industry and stakeholders to pursue harmonization of competing standards for environmental conduct and labor conditions.

Where competition among standards exists, it is likely to be more difficult for any one standard to achieve legitimacy and broad acceptance in the marketplace than would be the case if there was only one standard. Customers may be confused by the existence of multiple standards and may not have the knowledge to differentiate between the meanings of various standards. Furthermore, MNCs and other firms are likely to prefer a situation with a single standard addressing an issue for economic efficiency reasons. Firms do not want to incur the additional costs of compliance and certification for multiple and potentially redundant or conflicting standards. Firms selling into the global supply chains have much to gain from harmonization of global standards. If major customers in an industry require their suppliers to adopt different standards, firms in their global supply chains will be swamped by competing and conflicting compliance and certification requirements. Research has shown that MNCs benefit from adopting globally standardized environmental strategies (Dowell, Hart & Yeung, 2000). The existence of multiple standards may make it difficult for MNCs to standardize globally their environmental conduct and labor conditions, undermining their ability to enjoy the benefits of global standardization and integration.

The existence of competing standards around an issue indicates that different stakeholder and industry groups consider the issue to be important and are taking action. This interest in the issue combined with the institutional and economic benefits of standard harmonization may lead to a social engagement process between advocacy organizations and industry interests with the goal of establishing standards of corporate conduct that can be accepted by all groups. Such engagement raises concerns by advocacy organizations that they will lose strength and independence by becoming too close to and dependent on corporate interests, with the result that the standards arrived at through such social engagement processes will not be stringent enough. However, this is not necessarily the case. What ultimately determines the success and diffusion of a standard is the acceptance of the standard by customers and investors in the marketplace that demand products from certified companies or consider certification in their investment decisions. Standards established by industry alone are more likely to be viewed skeptically by these market participants. Advocacy organizations have the power to provide legitimacy to standards through their participation in standard design and their endorsement. Advocacy organizations also have the ability to influence the decisions of participants in the marketplace through public relations campaigns and other means (Guay, Doh & Sinclair, 2004). Thus a competition between standards may result not in a 'race to the bottom' but in a consensus around acceptable norms for corporate environmental conduct and labor conditions at a level

between the levels of competing standards. This suggests that, despite their divergent aims, engineering, social responsibility, and industry standards need not be in conflict and can result in a process of social engagement that brings about convergence of competing standards based on areas of complementary interest.

An example of a social engagement process in a situation of competing standards can be found in the forestry industry. Competition between the American Forest and Paper Association's SFI code and the FSC's Forest Management Certification has resulted in involvement of advocacy organizations by the AF&PA and in a tightening of SFI requirements. The AF&PA transferred the authority for governance of the SFI code to an independent non-profit organization with a balanced board membership of forest industry, environmental/conservation organizations (including Conservation International and the Nature Conservancy) and members from the professional, academy and broader forestry community. The outcome of this process was a tightening of SFI requirements for firm conduct, introduction of third-party certification and mandatory performance measurement. Members of the NGO community agree that this involvement of stakeholders, combined with the more stringent requirements and independent monitoring, is a real improvement (Overdevest, 2004). They attribute these changes in the SFI to 'the success of the FSC program in getting the certification idea established and engaging . . . industry and retailers' (Conservation International member quoted from Overdevest, 2004). This example shows how the existence of a competing standard – the FSC created by advocacy organizations – induced industry to engage stakeholders and led to more stringent requirements of the SFI industry standard, resulting in the requirements of these standards becoming more similar over time. While advocacy organizations are concerned about loss of independence and the possibility of cooptation by corporate interests as they cooperate with industry, the FSC–SFI example illustrates that advocacy organizations have considerable power to influence industry standards in the search for legitimacy. The two competing standards are currently still battling for legitimacy and acceptance by stakeholders and customers. Environmental NGOs maintain that the FSC Forest Management Certification is the only valid certification program and have managed to drive major retailers to voice their preference for FSC-certified wood. Thus we have not yet arrived at a dominant standard and only the future will tell whether a dominant standard will prevail or whether the two standards will continue to exist in parallel.

It is important to keep in mind that the development, refinement, acceptance, and diffusion of standards are dynamic processes in which there are diverse patterns of standard emergence, adoption, and acceptance.

Advocacy for higher social responsibility standards on an issue is likely to emerge long before there is a broad consensus within industry and national and international technical standard-setting organizations on the need for new standards. Social responsibility advocacy standards may also be able to push some industry participants to be first-movers and act as industry leaders by virtue of being involved in the standard-setting process and being early adopters of emergent standards before a widespread industry consensus exists or market participants require standard certification. These firms may gain a differentiation advantage if there is a segment of market participants that values standard certification. As more market participants become concerned about an issue, industry participants may develop competing (possibly less stringent) standards that battle for legitimacy in the marketplace. This battle for legitimacy may lead to a refinement of industry standards to incorporate new (more stringent) requirements. Over time standards that today only appeal to a small segment of market participants may become requirements for doing business for most firms as customer and investor preferences change and more firms build capabilities to adopt such standards. While firms may view social responsibility standards as 'disruptive', such standards can tap into as well as stimulate emergent public sentiment about corporate behavior that provides business firms with advance warning as public expectations of them change and evolve both locally and globally.

PROSPECTS AND LIMITS OF CERTIFIABLE STANDARDS AS TOOLS FOR SELF-REGULATION

International certifiable environmental and labor standards have the potential to be a widely used tool for firm self-regulation. Many MNCs have reason to be concerned about their corporate reputations and the reputations of their industries, particularly if they have significant investments in their brand names. Certified standards provide MNCs with a tool to protect their reputations. Because MNCs' reputations are also affected by the conduct of their suppliers, many MNCs go beyond adopting standards for their operations only and make them a criterion for supplier selection resulting in widespread diffusion to other firms. MNCs can influence the conduct of thousands of other firms in this way. In time, some environmental and labor standards have the potential to become basic requirements for all firms doing business in the global economy. Firms that cannot meet these global standards will tend to see them as barriers to trade. Firms capable of meeting or exceeding these standards will view them as minimum criteria, useful in leveling the international playing field and

preventing environmental, social and labor subsidies in the form of substandard government regulations and enforcement.

Environmental and labor standards will only be able to fill the void left by the failure of government regulations if they are broadly diffused and adopted. The mere existence of certified standards is no guarantee that they will be widely adopted and, in fact, most standards have not yet achieved broad diffusion. Widespread adoption of a standard is unlikely unless and until there is a broad consensus around a specific standard for corporate conduct on a particular issue among firms, stakeholders and market participants. Only if such consensus exists will large number of customers and/or investors require firm certification as a precondition for entering into a market transaction with the firm. Given that the primary drivers for standard diffusion are customer requirements and preferences, a lack of customer demand for certified products or products from certified facilities may prevent broader diffusion of standards. Reasons for lack of demand include lack of customer awareness of environmental and labor standards and labels and their role in promoting responsible corporate conduct. Customers may also be confused by the multitude of 'responsible' labels in some industries, such as forest products, which make it difficult for customers to distinguish between the meaning of these labels. However, consensus about standard requirements and the resulting market pressures are a necessary but not a sufficient condition for broad diffusion.

A limitation to the broader diffusion of environmental and labor standards is that in developing countries only MNCs and export-oriented firms face pressures for their adoption, while most firms producing for the domestic market do not. So far, environmental and labor standards have been primarily implemented by multinationals, their suppliers, and export-oriented firms in developing countries (Christmann & Taylor, 2001). Thus standards do not yet seem to reach domestic firms that are not producing goods for the export market. While some anecdotal evidence suggests that there are domestic firms that adopt standards such as ISO 14001 and use the ISO 14001 environmental management system as a model to manage their environmental impact, this practice is not very widespread. It remains to be seen whether certifiable standards or the environmental and labor practices promoted by these standards will broadly diffuse throughout industries and firms with lower degrees of international linkages.

Another concern about standard diffusion is that standards that are required by an MNC from its first-tier suppliers are not necessarily required of their second and third-tier suppliers, where a much higher percentage of the actual value-added work is performed. If certified standards do not penetrate more deeply through supply chains then it is not clear that

standards will do anything beyond creating the superficial appearance of self-regulation of MNC supply chains, or a two-class system where activities that are affected by certifiable standards will be passed down by a first-tier supplier to local suppliers that are playing by a different and less noble set of rules.

Another important barrier to diffusion of standards is a lack of the necessary firm resources and capabilities to implement complex performance requirements or management systems, especially by many firms in developing countries (Christmann & Taylor, 2004). These firms may view certifiable environmental and labor standards as a trade barrier that prevents them from exporting their products to countries in which customers require certification.

In order to fill the void left by the failure of government regulation, standards do not only need to be adopted, but they also need to be effectively implemented and monitored. It is clear that compliance with the requirements of a standard is not a one-time event, like certification, but an ongoing process. Management system standards take account of that and promote the implementation of systems to deal with environmental issues or labor conditions, rather than setting performance targets. However, management system standards such as ISO 14001 have been criticized for exactly that, a lack of performance targets. Standards that require specific outcomes have been criticized for allowing firms to 'window-dress' for the visits of auditors which are frequently pre-announced, and not uphold the standards between visits. Some standards have incorporated surprise follow-up visits to address this problem. Critics of certification also voice concerns about the effectiveness of the certification process and the independence of auditors who are paid for by the companies that they are auditing. The sanctions imposed for failing to meet a standard's requirements differ between standards from remediation to loss of certification. While some standards provide information about the findings of all audits to the public, others do not. Thus the effectiveness of different standards in assuring responsible corporate conduct differs widely.

Despite these limitations, the trend is clear: MNCs and other firms doing business in the global economy can expect to be confronted by strong pressures to adopt certified standards by which society can hold them more accountable for their own conduct, above and beyond what is expected and enforced by various governments around the world. Firms that understand this and move to engage stakeholders to develop and adopt standards effectively can benefit society by doing so while at the same time they also open up new opportunities to develop their own global competitive advantage.

NOTE

1. The ISO lists 14 251 international standards documents, 490 431 pages of standards text and over 5000 technical committees and working groups. Technical standards for specific products and technologies outnumber all other standards, but lie outside the scope of this chapter which is focused on standards for management systems and corporate governance.

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10. Global governance, social responsibility and corporate–NGO collaboration

Jonathan P. Doh

INTRODUCTION

Collaborations among corporations and not-for profit non-governmental organizations (NGOs) have become an important subject of management research (Doh and Teegen, 2003; Hess, Rogovsky and Dunfee, 2002; Rondinelli and London, 2003). Sometimes termed 'social partnerships', 'collaborative social initiatives', and 'social alliances', these relationships appear to provide benefits for both corporate and NGO participants, yet there have been few systematic efforts to assess the factors that influence the decisions by corporations to pursue these associations.

In this chapter, I review the emerging pressures on corporations to engage in projects that have discernable social benefits, and recount the emergence of not-for-profit non-governmental organizations as a vehicle for firms to achieve their social responsibility goals. I develop a model to predict the range of factors at the country, industry, company, NGO, and managerial level that influence the propensity of corporations to collaborate with NGOs. I also suggest that the sector and orientation of NGOs will affect the potential compatibility of a given NGO with a given company, and that this strategic fit will influence the likelihood of the company to pursue active engagement with NGOs. I also hypothesize that prior experience with NGOs will influence affective perceptions of NGOs by managers, and that these perceptions will shape managerial inclination to collaborate with NGOs via interactive influences on the main effects attributable to company and NGO characteristics. In addition, the history and character of institutional and personal networks among individual responsible managers and NGOs is hypothesized to moderate the main effects, especially those emanating from company and managerial/demographic factors.

This model and framework are intended to provide new insights regarding the factors influencing corporate–NGO engagement, inform extant

theory regarding power, alliances and networks among organizations, and offer practical implications for company and NGO managers who are involved in or are contemplating closer federations with their private/non-profit counterparts.

THE CHALLENGE OF CORPORATE SOCIAL RESPONSIBILITY (CSR)

The motivation for company executives to contribute to the general welfare of society beyond the returns delivered to shareholders is an important and controversial topic. The proper role of corporate social responsibility (CSR) – the actions of a firm to benefit society beyond the requirements of the law and the direct interests of the firm (McWilliams and Siegel, 2001) – has been a longstanding theme of management and economic research and philosophical discourse, but continues to generate heated debate in the boardroom and business school classroom. For many decades, political representatives and the broader civil society have maintained that businesses are the trustees of societal interests and should be managed for the public good. At the same time, periodic reactions from the business community and economists have asserted that profit maximization is the only legitimate goal of business (Friedman, 1970). Despite this debate, a consensus appears to be emerging among all sectors that CSR is a relevant and integral element of business practice, if for no other reason than that a range of stakeholders now expect their views to be considered and even incorporated into managerial decisionmaking.

Research on the CSR–Corporate Social Performance (CSP)–Financial Performance Link

In the past, research on the impact of CSR on firm financial performance produced inconsistent and often contradictory findings. Scholars found evidence that CSR resulted from economic performance, that economic performance resulted from CSR, and that CSR and economic performance co-varied (see Griffin and Mahon, 1997; Roman, Hayibor and Agle, 1999; Ruf, Muralidhar, Brown and Paul, 2001; Margolis and Walsh, 2001, 2003; Balabanis, Phillips and Lyall, 1998; Moore, 2001).

Improved theory and research designs, data, and analysis since the mid-1990s have produced empirical research with more consistent, albeit sometimes conflicting results. Large-scale studies have reached conclusions including a positive relationship, negative relationship, and no relationship between CSR and economic performance (see McWilliams and Siegel,

2000; Preston and O'Bannon, 1997; Stanwick and Stanwick, 1998). Importantly, a recent meta analysis of more than 10 studies found that, on balance, positive relationships can be expected, but that the primary vehicle for achieving superior financial performance from social responsibility is via reputation effects (Orlitzky, Schmidt and Rynes, 2003). Of more practical relevance, CSR is now almost universally embraced by top managers as an integral component of their executive role. In retrospect, Milton Friedman's infamous statement (1970:1) that the 'one and only one social responsibility of business [is] to increase profits so long as it . . . engages in open and free competition without deception or fraud' appears to have simply served as an executive's straw man, against which any positive social contribution over a range of options seemed at least somewhat reasonable. However, over the last 30 years, it has never been a position that received any measure of serious empirical support.

The implicit message in much of the research to date is that individual managers actively pursue social initiatives to one degree or another, although with varied motivations: self-interest, altruism, strategic advantage, or political gain (see Smith, 1994; Campbell, Moore and Metzger, 2002; Husted, 2003). Corporate-supported social initiatives are now a given. The issue, therefore, is not whether firms will engage in socially responsible activities, but how. For most firms, the challenge is how best to achieve the maximum social benefit from a given amount of company resources available for social initiatives.

CSR: Finding the Right Balance

Corporations face a variety of options to advance their social responsibility goals. These range from simple cash charitable donations to broad, multifaceted social responsibility strategies. Philanthropy without active engagement has been criticized because of its failure to fully exploit the range of resources that a firm could leverage for social impact (Husted, 2003). Hence, CSR activities are increasingly likely to include an exchange of resources between corporate and nonprofit partners (Smith, 2003). A critical gap in the literature is the absence of a model to guide managers in selecting social initiatives through which they can exploit the firm's core competencies for the maximum positive impact. As a start, research has recommended that corporations must determine the social causes that they will support and decide how the support should be organized (ibid.). These choices take three basic forms: donations of cash or material, usually to a non-governmental or nonprofit agency; creation of a functional operation solely within the firm to assist external charitable efforts; and development of a collaboration approach where a firm joins with an NGO

to form a collaborative relationship in which each partner contributes some combination of financial, human, and material resources (Husted, 2003). Evidence suggests that the collaborative approach may provide benefits beyond those available from other options (Smith, 2003).

The term 'social initiative' characterizes initiatives that take this collaborative approach. Ideally, programs take natural advantage of the complementary contributions and natural market forces to achieve social responsibility goals. Typically, social initiatives bring together the unique resources and capability of private and not-for-profit participants in an ongoing but limited involvement basis. As Hess, Rogovsky and Dunfee (2002) report, many of these 'social initiatives . . . are grounded in the core competencies of the firm'. Hence, social initiatives are inherently collaborative,involving ongoing information and operational exchanges among participants, and are especially attractive because of their potential benefits to both the corporate and not-for-profit non-governmental partners.

MNC COLLABORATIONS WITH NGOs

Corporate–NGO engagement has gained especially active attention in the evolving global business environment. Concerns about the consequences of globalization, economic integration, and expansion of capitalist business systems and practices provoke close scrutiny of the activities of MNCs. These concerns have also stimulated the growth of an active NGO sector dedicated to improving the social welfare of communities and societies. Some NGOs have focused on MNCs, seeking to pressure companies and managers to assume greater responsibility for the negative spillovers of their action. It is in this context that many corporations confront NGOs and undertake formal or informal decisions regarding their preferred method of engagement.

Teegen, Doh and Vachani (2004) propose that the emergence of civil society in general, and the activism of civic NGOs in particular, have broad implications for the role, scope and definition of MNCs in the global economy, and therefore for international management as a research field. They suggest that traditional research paradigms, such as the historically conceived dyadic approach to MNC–host government bargaining, must be relaxed to account for these new actors. While there are many definitions of NGOs (UN, 2003; Vakil, 1997), I follow a simple definition offered by Teegen, Doh and Vachani (2004) who suggest that NGOs are 'private, not-for-profit organizations that aim to serve societal interests by focusing on social, political and economic goals, including, *inter alia*, equity, education, health, environmental protection and human rights'.

NGO Goals and Purposes

NGOs have different organizational goals and purposes. NGOs can be loosely categorized as (1) advocacy NGOs (ANGOs), those primarily concerned with advocacy and promotion of ideas and agendas, (2) service-oriented NGOs (SONGOs), those primarily concerned with delivering services to specific groups and building capacity in local environments, and (3) hybrid NGOs (HNGOs) that both advocate and engage in service activities (Parker, 2003; Teegen, Doh and Vachani, 2004). In addition, NGOs employ a range of strategies and tactics to advance their goals. For example, Keck and Sikkink (1998) describe four political tactics employed by ANGOs: information politics, symbolic politics, leverage politics, and accountability politics. In each of these tactics, the NGO transforms information into power, typically using media to communicate with the public at large. In information politics, the NGO might pose as an unbiased source of scientific information. In symbolic politics, the NGO transforms an individual event into a symbol for the NGO ideal. Leverage politics uses government to act, pressuring the MNC to adopt a specific policy. Accountability politics holds the MNCs accountable for promises made, making public any lapses in performance.

NGO Pressure on MNCs

Citizens expect NGOs to serve in a monitoring and oversight role with respect to MNC behavior and activities, including monitoring corporate social and environmental responsibility. Many specialized NGOs now investigate and report on MNC pledges and actions in the areas of governance, labor practices, human rights, environmental impact, and many others. Through collective action, NGOs can harness the power of individual interests in a manner that can convey greater influence and impact on social and environmental concerns. NGOs can also pool their resources and capabilities to form broader collectives with other NGOs and/or governments and private corporations. MNCs are under increasing pressure by NGOs to change their practices and/or contribute positively to the social development of the countries in which they operate. These pressures have become especially acute for MNC activities in emerging economies, as it is here that MNCS have been criticized for lacking sufficient attention to the social, ethical, and environmental responsibilities of their investment. Some have been accused of engaging in business practices that exploit lower labor and environmental standards. Governments, civil society, and organized NGOs have urged changes in MNCs' conduct through public campaigns, boycotts, and other actions. Some NGOs have pressed MNCs

to adopt global standards and codes of conduct related to human rights, wages, working conditions, and environmental practices (Doh and Guay, 2004; Kolk and van Tulder, 2001, 2002). Although such codes have helped MNCs demonstrate their commitment to improved social and environmental performance in emerging economies and buffer criticism related to their global operations, NGOs from both host and home governments continue to prompt MNCs to 'raise the bar' by urging contributions that go beyond generic codes and agreements.

For example, a coalition of NGOs including Oxfam and Doctors without Borders was instrumental in successfully pressing multinational pharmaceutical firms to reduce AIDS drugs prices in developing countries and accept modifications in international intellectual property laws to allow for licensing and sale of generic AIDS medications in developing countries such as South Africa (Vachani and Smith, 2004). Such actions may be prompting MNCs to consider creative and mutually supportive relationships with NGOs and to use these collaborations to integrate social development strategies into broader business development efforts.

Benefits of and Challenges to Corporate Engagement with NGOs

NGOs are increasingly engaged in various connections with governments and private corporations (Doh and Teegen, 2003). More specifically, network relationships with NGOs may comprise an exchange of complementary resources not unlike those that occur in other types of alliances among private sector firms (Eisenhardt and Schoonhoven, 1996). Alliances involve resource complementarities among firms (Harrison, Hitt, Hoskisson and Ireland, 2001), some of which include social effects, including legitimacy (Eisenhardt and Schoonhoven, 1996). Network relationships with NGOs, however, may provide MNCs with access to different skills, competencies, and capabilities than those that are otherwise available within their organization or that might result from alliances with for-profit organizations. According to Rondinelli and London (2003), cross-sector alliances – collaborative relationships among NGOs and MNCs – may offer opportunities for MNCs to achieve the legitimacy and develop the capabilities needed to respond to increasing pressure from stakeholders to address environmental and other social issues (Waddock, 1988; Westley and Vredenburg, 1991).

Participation in a cross-sector alliance, however, presents challenges. Corporations and NGOs have fundamentally different structures and values (Rondinelli and London, 2003). Relations between corporations and NGOs, especially in the emerging markets context, have often been characterized by hostility and mistrust. Cross-sector alliances face an

additional challenge because organizational learning generally requires some level of common experience, a condition that is often weak or missing in alliances between profit-making and nonprofit organizations (ibid.). This lack of common experience, trust, and communication can sometimes result in conflict, even when partnerships have been established that appear to signal shared values and commitments. Indeed, partnerships with NGOs may sometimes open a path to escalating (and potentially unrealistic) demands for firms to upgrade their commitment to social development. Nonetheless, MNC–NGO collaborations have gained the attention of management researchers seeking to inform both theory and practice (Doh and Teegen, 2003; Spar and La Mure, 2003; Yaziji, 2004).

For some MNCs, demonstrated commitment to social development may be a precondition for market entry or a de facto requirement for maintaining market presence. As part of their response to these pressures, some MNCs pursue social development strategies involving partnerships with NGOs and other organizations as part of their overall emerging market strategies. Indeed, NGOs may present MNCs with special opportunities to shape socially responsive nonmarket strategies, often in response to initial criticism by NGOs (Teegen, Doh and Vachani, 2004). Such strategies may help safeguard the firm from escalating condemnation. In some cases, firms appear to preempt negative pressure by developing proactive strategies that focus on social development. But what conditions draw corporations to collaborate with NGOs? In the next section, I offer specific predictions regarding the factors that influence MNCs to collaborate with NGOs.

THE DECISION TO COLLABORATE: A RESEARCH MODEL

Management researchers are increasingly relying on multi-level theory building and empirical analysis as a preferred approach to capture the most comprehensive range of determinants of a phenomenon (Klein, Tosi and Cannella, 1999). This multi-level approach has been advocated as particularly appropriate for testing international business phenomena (Kostova, 1999). Given the fundamental differences in the origins, objectives and organizational nature of NGOs and MNCs, and the fact that the effect of NGOs on MNCs' social change activities is embedded in multidimensional aspects of the environment, namely the social, political and economic arenas, it is important to employ a multi-level approach to the study of the phenomenon. Hence, we suggest that both society-level institutional

determinants and organizational characteristics must be included in studying how NGOs affect MNC social change strategies in emerging economies. In addition, demographic and behavioral characteristics of individual managers who have responsibility for initiating or advancing these relationships will also be material factors. In this section, we consider a range of variables at multiple levels of analysis and offer research propositions to inform the conditions under which corporate managers will elect to engage with NGOs. I model both main and interactive effects.

Country Determinants

Corporations located in more advanced economies are more likely to have frequent interactions with and a more sophisticated appreciation of NGOs. NGOs are more well-established and have been more extensively integrated into the institutional architecture of more advanced economies. Such economies typically feature more advanced and stable institutions, pluralistic political processes, and explicit roles for citizens – both individual and collective – to participate in the political process (Keim, 2003). Khanna and Palepu (2000a, 2000b) argue that institutional voids arise in environments, such as developing countries, where specialized intermediaries (legal, financial, human resource), upon which a firm customarily relies, are absent or underrepresented. The absence of these intermediaries may result from weak or missing markets, underdeveloped and ineffective institutions, or poorly functioning organizations. One response of firms to these institutional deficits may be the emergence of NGOs to fill voids in political systems and respond to inefficient or corrupt bureaucracies, especially in regard to service delivery NGOs such as CARE, Save the Children, Doctors without Borders and similar organizations. On balance, however, we expect companies from more developed and institutionally advanced economies to be more likely to collaborate with NGOs.

As a related but discrete influence, we expect that companies headquartered in countries featuring cultures that are more collective in nature, as defined by Hofstede (1980, 1998, 2001) and more recently House, Hanges, Javidan, Dorfman and Gupta (2004), will be more likely to collaborate with NGOs. According to House *et al.* (2004), there are two important dimensions of collectivism: (1) institutional collectivism is the degree to which organizational and societal institutional practices encourage and reward the collective distribution of resources and collective action; and (2) in-group collectivism is the degree to which individuals express pride, loyalty, and cohesiveness in their organizations or families. We expect corporations headquartered in countries with each type of collectivism to be more likely to collaborate with NGOs.

Industry Factors

Stakeholder theory suggests that firms might adopt an instrumental approach to evaluating and responding to stakeholder pressures that takes account of the power stakeholders have over the organization and the degree of moral obligation the organization feels to particular stakeholders in designing responses (Jones, 1995; Mitchel, Agle and Wood, 1997).

Industry characteristics have been shown to affect a range of corporate strategic actions (Stimpert and Duhaime, 1997). We might expect industries facing higher levels of pressure from NGOs (for example, highly polluting industries) to be more inclined to develop strategic responses to those pressures (Adams and Hardwick, 1998), including active collaboration. At the same time, industries in an especially munificent (high growth, low competition) environment are also expected to be inclined to collaborate, as newer, technology-intensive firms tend to be ranked higher in a number of measures of corporate responsibility, such as the Domini Social 500 Index. This may be because they have younger, well-educated leaders and managers, cater to affluent and highly educated customers, and tend to be founded and headquartered in regions known for their liberal or progressive politics (Northern California, Massachusetts). In addition, service industries, because of their client focus, high degree of professionalism, and stakeholder responsiveness will also be more likely to partner with NGOs. Hence, I expect companies operating in pollution-intensive and high-technology industries to be more likely to collaborate with NGOs. In addition, I expect companies operating in industries with a high rate of change, that is characterized by a munificent competitive environment, which is highly concentrated and not competitive, to be more likely to collaborate with NGOs.

Dynamic economic environments are found in industries undergoing radical, discontinuous change and in countries that adopt economic liberalization programs (citation). In addition, countries that are forced into economic austerity programs by international institutions such as the IMF, or those that have chosen to join the WTO or trade agreements with developed countries, face dramatic industry deregulation and liberalization. In such environments, changes in laws and implementation of rules governing business conditions can affect sources of competitive advantage of different types of companies asymmetrically. For example, multinationals might benefit from being permitted to enter industry segments previously reserved for small- and medium-sized companies. This, in turn, can have asymmetric social impact on different segments of society. Local stockholders, drawn from relatively affluent segments of the developing-country

society might benefit, while poorer owners, workers and suppliers of SMEs might lose. This change in social welfare can mobilize NGOs to pursue the cause of resisting or reversing institutional changes that benefit multinationals and to demand higher levels of commitment from multinationals toward positive social change.

As Doh and Ramamurti (2003) and Doh and Teegen (2002) have documented, NGOs use the change in policy associated with infrastructure privatization and market liberalization to mobilize and advance their agenda, even if that agenda does not directly relate to the privatization or liberalization in question. Recent examples include the cessation of Enron's Dabhol project in India after NGO and government reaction, demonstrations in Brazil when the government announced the privatization of Embratel, Costa Rica's decision to withdraw from the US–Central American Free Trade Agreement after unions and other NGOs objected to US demands that Costa Rica open its telecom and energy monopoly to competition, and numerous examples of incoming, democratically elected governments renouncing deals cut by their predecessors and the targeting of MNCs by NGOs in that process.

Firms in concentrated industries are relatively protected from NGO pressure and influence, and therefore would be less inclined to partner with NGOs. One exception may be where concentrated industries remain highly competitive thanks to dualistic or competitive oligopolistic competition. If the leading or challenging firm has developed strategic competencies in managing and partnering with NGOs, other firms may feel pressure to follow.

Company Factors

Company size and profitability are important explanatory variables in a range of managerial research. From an organizational ecology perspective, the concepts of liability of newness (Stinchcombe, 1965) and liability of smallness (Aldrich and Auster, 1986) are widely accepted as limiting new and small firms and preferencing large, established ones. Moreover, smaller firms are resource challenged, and therefore do not have the latitude to explore alternatives and opportunities in the same manner larger ones do (Barney, 1991).

In the same manner, less profitable firms do not have the ability to accumulate resource stocks to the same degree that larger ones do and are more vulnerable to external shocks and cycles (Aldrich and Auster, 1986). Large multinational firms are likely to be subject to higher levels of attention and scrutiny from stakeholder groups because they are visible and commercially vulnerable to adverse reactions from stakeholders (Roberts,

1992; Watts and Zimmerman, 1978). In consequence, firms receiving this pressure are more likely to be responsive and incorporate their response into formal strategies and actions. Finally, firms that have a strong stakeholder orientation, and a history of weighing and valuing stakeholder input, are also more likely to engage NGOs on a continuing and collaborative basis. Hence, we expect larger, more profitable, and more multinational firms with higher market share to be more likely to collaborate with NGOs.

NGO Characteristics, Resources and Strategic Fit with Corporations

Rondinelli and London (2003) argue that cross-sector alliances offer opportunities for MNCs to achieve the legitimacy and develop the capabilities needed to respond to increasing pressure from stakeholders to address environmental and other social issues (Waddock, 1988; Westley and Vredenburg, 1991). However, these relationships also present challenges because corporations and NGOs have fundamentally different structures and values and organizational learning generally requires some level of common experience, a condition that is often weak or missing in alliances between profit-making and nonprofit organizations (Rondinelli and London, 2003). Hence, I expect larger NGOs possessing substantial resources, those in supportive (as opposed to potentially hostile) service-oriented sectors, and those that bring complementary resources and fit with the corporate culture to be more appealing partners.

Managerial Factors, Experience with NGOs and Social Networks

Three other areas are predicted to influence the propensity of corporations to partner with NGOs. First, I expect younger, more senior, more highly educated, more broadly experienced, locally engaged managers to be more likely to collaborate with NGOs. Managers who have themselves worked for NGOs will be especially likely to collaborate with NGOs.

Second, I expect firms that have been the target of NGO campaigns to be negatively associated with the propensity of a firm to collaborate with NGOs, while previous experiences with collaboration with NGOs is positively associated with the propensity of a firm to collaborate with NGOs. Managers that perceive NGOs as trustworthy and providing reciprocal benefits are more likely to collaborate with NGOs. Finally, I expect managers who, as part of their social networks, interact frequently with NGOs, possess close ties with NGOs, have had longstanding relationships with NGOs, and use NGOs to gather information and influence their agenda, are more likely to collaborate with NGOs.

MNC–NGO COLLABORATION: THREE ILLUSTRATIVE EXAMPLES

There are numerous examples of collaboration between corporations and nonprofit non-governmental organizations. These collaborations take various forms and evolve in a range of directions. Descriptions of three of these initiatives are presented below.

HP I-Communities

Hewlett Packard Corporation has initiated a series of 'i-communities' in economically deprived areas such as the town of Kuppam in the state of Andhra Pradesh, India. These communities use public/private/NGO partnerships to enhance economic development through technology. NGOs promote the projects and enlist community support. HP is able to use the projects to build markets, test products and expand global marketing knowledge. The experience provides HP with valuable knowledge of how to identify and negotiate with rural customers, which positions it to reduce search, monitoring and enforcement costs of doing business in rural markets of India and other countries in the future. In addition, HP has received positive reputation effects in development circles.

IBM's Reinventing Education Program

IBM's Reinventing Education program is an initiative that works with school partners throughout the world to develop and implement innovative technology solutions designed to solve educational problems. To each grant site, IBM contributes financial resources, researchers, educational consultants, and technology. Through these contributions, IBM seeks to find new ways for technology to spur and support fundamental school restructuring and broad-based systemic change to raise student achievement. Reinventing Education also includes an interactive web-based Change Toolkit designed to help school leaders expand and sustain their education reform efforts. In addition, IBM solicits independent evaluations of this program by the Center for Children and Technology and Harvard Business Schools. According to IBM, these investments of technology and know-how are having a positive, measurable impact on school partners.

Chiquita/Rainforest Alliance Better Bananas Project

Since the early 1990s, Chiquita has participated in the Rainforest Alliance Better Bananas Project. Under this program, companies commit

themselves to ecosystem conservation, wildlife conservation, fair treatment and good conditions for workers, community relations, integrated pest management, integrated waste management, conservation of water resources, soil conservation, and planning and monitoring. External auditors audit all Chiquita farms annually (Lavery, 2001). The RA has annually accredited every Chiquita farm since 2000. Chiquita also encourages its independent producers, which supply Chiquita with about 50 percent of its bananas, also to achieve Rainforest Alliance certification. In 2002, the volume of purchased bananas from certified farms rose from 33 to 46 percent, and farms certified up to June 2003 brought the total to 65 percent. According to insiders, the adoption of third-party standards has helped Chiquita drive a stronger internal commitment to achieving excellence and cutting costs. In 2003, the RA estimated that Chiquita reduced production spending by $100 million as a result of a $20 million investment to reduce agrochemical use.

CONCLUSION

Innovation emerges from the combination of existing practices and processes in new and novel ways. 'Combinative capabilities' refers to the ability of firms to aquire and synthesize resources and build new applications from those resources, especially in changing environments (Kogut and Zander, 1992). Research on alliances and networks among firms suggest that each partner can benefit when the other brings resources, capabilities or other assets that it cannot easily attain on its own. Consistent with this literature, collaborative social initiatives have the potential to generate both economic and social value by leveraging the complementary resources and capabilities of each participant.

By understanding the factors that contribute to the propensity of managers and firms to engage in collaboration with NGOs, theory regarding power, alliances, networks, and interorganizational cooperation can be further specified. In addition, practical implications should yield insights for company and NGO managers who are involved in or are contemplating closer federations with their private/nonprofit counterparts.

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11. Legitimating global governance: multinational corporations and the G8's multi-stakeholder approach

Jeffrey A. Hart

INTRODUCTION

Global governance as provided by international institutions like the G8, the WTO, the IMF, and the World Bank has been under attack from the anti-globalization movement as undemocratic. Many groups within the movement have been asking for better and more direct representation of 'civil society'. Since the above-mentioned institutions are mostly intergovernmental in nature they have not historically allowed for direct representation of non-governmental actors. The organizing principle behind most intergovernmental organizations is that whatever representation of civil society is necessary can be done satisfactorily through the domestic political processes of member governments. Anti-globalization groups (and others) argue that this is no longer sufficient and that civil society organizations need to be represented directly in global governance institutions.

A number of theorists and practitioners have begun to address alternatives to the intergovernmental model of global governance. Phil Cerny, for example, has been promoting the concept of 'multi-level governance'. Inspired by the example of the European Union, Cerny suggests that it is necessary to recognize the desirability of allowing for a distribution of governance tasks across a variety of political levels. Some of these levels go beyond the traditional ones of local, state/provincial, central governmental, and international to incorporate cross-local, cross-regional, and transnational forms of governance. Along with advocating multi-level governance, Cerny recognizes the need to create new forms of participation by civil society groups in the various levels (Cerny, 2005).

Some theorists have been calling for a 'global republicanism' to replace the currently limited representation of civil society in intergovernmental forums with something more like the republican forms of democracy in liberal

democracies (Doyle, 1986; Onuf, 1998; Ikenberry, 2001; Alker *et al.*, 2001). In a period when republican forms of government are on the rise again, this makes a bit more sense than it did, for example, at the height of the Cold War. Nevertheless, the problem remains that a republican form of global governance will be difficult to implement fully until the globe is populated entirely by governments with elected representatives. Even in organizations like the G8 where all the member governments are republics, international governance remains intergovernmental rather than republican in essence.

David Held calls for a 'cosmopolitan multilateralism' to replace the 'executive multilateralism' of the contemporary period (Held, n.d.). The term 'executive multilateralism' was coined by Michael Zürn to represent 'a decision-making mode in which government representatives (mainly cabinet ministers) from different countries coordinate their policies internationally, but with little parliamentary control and away from public scrutiny'.[1] This is very similar to intergovernmentalism as I have used it above. Zürn argues that executive multilateralism is the essence of what John Ruggie earlier called 'embedded liberalism' – a solution to the problem of diversity of forms of government among the liberal democracies after World War II so that they could pursue the development of the world economy though liberalization of trade and financial flows without having to harmonize domestic social welfare policies (Ruggie, 1982).

Held argues that a new kind of multilateralism is needed to recognize the changes caused by globalization: (1) the creation of overlapping networks of power that cut across territorial boundaries, (2) the fact that the locus of effective political power can no longer be assumed to be simply national governments, (3) gaps in existing political institutions caused by the first two factors, and (4) increasing global inequality which engenders a 'moral gap'. What is cosmopolitan multilateralism? According to Held, it involves the following:

> a) a recognition of the increasing interconnectedness of political communities in diverse domains (including the social, economic and environmental);
> b) the development of an understanding of overlapping 'collective fortunes' which require collective norms and solutions – locally, nationally, regionally and globally;
> c) the acknowledgement of the need for more decisions and more effective and accountable decisions at transnational levels;
> d) the extension and transformation of our existing multilevel, multilayered polity, running from the local to the regional and global, so that it adopts, within its *modus operandi*, the principles of transparency, accountability, and democracy. (Held, n.d.)

As we shall see, the G8's attempt at cosmopolitan multilateralism in the governance of cyberspace is called the 'multi-stakeholder approach'. While

the intention was to address criticisms from the anti-globalization forces about the undemocratic nature of G8 governance, the actuality was a form of global neocorporatism that has its own problems of legitimation (Streeck and Kenworthy, 2005; Wilson, 1983; Gerber, 1995). According to Philippe Schmitter, corporatism can be defined as follows:

> a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports. (Schmitter, 1984, p. 13)

There are two main forms of corporatism. *State corporatism* occurs in dictatorial states that rule using state-instituted bodies (for example Nazi youth or women's organizations) in a simulacrum of group representation. *Neocorporatism* occurs in postwar European democracies where the state (already subject to republic forms of representation) shares 'the public space with social groups organized on a more voluntary basis and entitled to various forms of collective participation and self-government, provided they recognized the primacy of parliamentary democracy' (Streeck and Kenworthy, 2005). I will argue below that the move away from intergovernmentalism or executive multilateralalism toward a cosmopolitan multilateralism of a neocorporatist variety was clearly a step in the right direction for the G8.

THE G8 AND THE GOVERNANCE OF CYBERSPACE

The representatives of the countries that comprised the Group of Eight (G8) began to address the problems of coordinating policies regarding the governance of cyberspace in the early 1990s.[2] The governance issues they dealt with initially included, among others, the establishment of norms, principles, and rules regarding the interconnection of computer networks via networks of networks like the Internet, rights of access to those networks, pricing of access, monitoring of network-mediated economic transactions, intellectual property protection, taxation of goods and services delivered via the networks, privacy, security, and a variety of other matters thought to affect the confidence of users. Towards the end of the decade, the G8 turned to a new issue: reversing the tendencies toward an increasing 'global digital divide' between rich and poor countries.

One of the key questions addressed here is why the G8 turned from the previous set of cyberspace governance issues in 1999 to consideration of

how to bridge the digital divide. In a previous paper I suggested that one of the main reasons was the G8's need to respond to the criticisms by anti-globalization forces that G8 governance was undemocratic and therefore contributed to increased global inequality. The members of the G8 wanted to provide a counterargument to the anti-globalization movement's claim that there was a democratic deficit in global governance. To do this credibly, the G8 attempted to transcend its inherently intergovernmental character by including representatives from 'civil society' in its deliberations on the global digital divide. The Digital Opportunity Taskforce (DOT Force) developed a method called the 'multi-stakeholder approach' to do this. To judge by the survey of participants discussed below, many of them considered this innovation to be a success, but some thought it should be deepened and generalized to other issue areas.

ORIGINS OF THE DEBATE OVER THE DIGITAL DIVIDE

Although originating in the late 1960s in research begun under the auspices of the U.S. Department of Defense Advanced Research Projects Agency (ARPA), the Internet emerged in the 1990s as the most important network of networks with the capability, in principle, to interconnect every computer (large or small) on the planet. While the ARPANET was built in the 1970s to interconnect military contractors with one another, it was succeeded first by the NSFNET, which expanded interconnection to university scientists and engineers, and then by the Internet. Commercial interconnection to the Internet began in the late 1980s and soon many businesses had shifted at least some of their activities to cyberspace (Abbate, 1999; Berners-Lee, 1999, Cerf, 2004; Hafner and Lyon, 1998; Hart *et al.*, 1992).

By the early 1990s, the US government began to ask the rest of the world to adopt policies that it believed would be conducive to the spread of Internet-based commercial activity. This was the Global Information Infrastructure (GII) initiative of the Clinton administration.

One particularly important aspect of the Clinton administration's GII initiative was the push for policies of minimal restrictions on e-commerce in order to encourage the shift of economic transactions to the Internet. According to one official publication, *A Framework for Global Electronic Commerce*, there was a danger of killing off the goose that lays the golden eggs:

> Commerce on the Internet could total tens of billions of dollars by the turn of the century. For this potential to be realized fully, governments must adopt

> a non-regulatory, market-oriented approach to electronic commerce, one that facilitates the emergence of a transparent and predictable legal environment to support global business and commerce. Official decision makers must respect the unique nature of the medium and recognize that widespread competition and increased consumer choice should be the defining features of the new digital marketplace. (The White House, 1997)

The Clinton administration called on the World Trade Organization (WTO) to declare the Internet a tax-free environment and to request the development of a uniform commercial code for electronic commerce. They asked that there be a WTO effort to make national intellectual property regimes more consistent and enforceable. A series of reports were issued to provide background information for these and other related policy proposals over the next three years (Smith *et al.*, 2001, p. 12). The US government was largely successful in these policy initiatives, although not without generating considerable controversy.

The Clinton administration also called for a meeting of the information ministers of the G8 in 1995 to be held on 25–6 February in Brussels. The main topic of discussion was the means by which to 'encourage and promote the innovation and development of new technologies, including, in particular, the implementation of open, competitive, and world-wide information infrastructures'. The conference concluded with the identification of a set of pilot projects that would benefit from international cooperation (European Commission, 2001). These projects were adopted formally and funded by the G8 at the following summit.

At around the same time, a joint symposium of the Asia-Pacific Economic Cooperation (APEC) countries and the Organization for Economic Cooperation and Development (OECD) in Vancouver, Canada, addressed 'Building the Foundation for the 21st Century'. The APEC–OECD symposium laid the framework for a market-led policy for infrastructure and service development. The OECD followed up in Turku, Finland, in 1997 with a joint government and business conference on the theme of 'Dismantling the Barriers to Global Electronic Commerce'. In 1998, the OECD held a ministerial conference in Ottawa on 'A Borderless World: Realizing the Potential of Electronic Commerce' (OECD, 1998). It was at this conference that the members of the OECD agreed to the Ottawa Taxation Framework Conditions (see below for details). APEC also held follow-up meetings that focused on using the Internet and information technologies to solve problems of economic development. These meetings probably influenced later discussions on bridging the digital divide among the G8 (Beaird, 2003).

A Global Information Infrastructure Commission (GIIC) was formed in February 1995 that has met annually since then. The first full meeting of

the GIIC took place in Washington in July 1995. The GIIC was designed to facilitate cooperation between governments and the private sector in order 'to foster private sector leadership and private–public sector cooperation in the development of information networks and services to advance global economic growth, education and quality of life' (GIIC, 1995).

The National Telecommunications and Information Administration (NTIA) of the Commerce Department issued a report in 2000 entitled *Falling Through the Net: Toward Digital Inclusion* (NTIA, 2000). This was the first major US governmental effort to study and document inequalities in access to and usage of the Internet across social groups. The report showed a trend of increasing usage of the Internet but also an increasing gap in usage between urban and rural, minority and non-minority groups, and high and low socioeconomic status households. For some variables, such as gender and income, the gap was decreasing. But the key finding was that 'noticeable divides still exist between those with different levels of income and education, different racial and ethnic groups, old and young, single and dual-parent families, and those with and without disabilities' (NTIA, 2000, executive summary).

The NTIA report focused mainly on the United States, but it did not take long for similar studies to appear that highlighted international aspects of the digital divide. For example, the World Economic Forum (WEF) launched its Global Digital Divide Initiative (GDDI) in 2000 'to develop public–private partnerships that would help bridge the gap between those who have ICT access, skills and resources and those who do not' (WEF, 2002). The International Labor Organization (ILO) released a study in 2001 arguing that lack of access to information and communication technologies (ICTs) on the part of workers in the developing world denied them access to jobs in the technology sector. The report noted that access to ICTs without appropriate education and training would not be a sufficient response to the growing North–South digital divide (ILO, 2001). Similar studies were done by the World Bank and special agencies of the United Nations.

THE OKINAWA CHARTER

At the international economic summit held in Okinawa and Kyushu in June–July 2000, the G8 adopted the *Okinawa Charter on Global Information Society* (Government of Japan, 2000). A draft for this document was prepared for pre-summit discussions with representatives from developing countries at a meeting in Tokyo just before the summit under the sponsorship of Japanese Prime Minister Yoshiro Mori. The Japanese gov-

ernment wanted the G8 to go beyond the scheduled discussions of debt relief in the Okinawa summit, partly as a response to the demonstrations against the G8 and the WTO that had taken place in Seattle in 1999. It raised the possibility that there would be a large fund of new aid money available to developing countries to assist them in the process of integrating new information technologies into their current economic development efforts – possibly as much as $15–20 billion (Chandler, 2000).

The Okinawa Charter started by stating that ICTs are 'fast becoming a vital engine for the world economy'. It argued that ICTs have the potential to transform economies and societies because of their 'power to help individuals and societies use knowledge and ideas'. The Okinawa Charter put forward a principle of inclusion in which 'everyone, everywhere should be enabled to participate and no one should be excluded from the benefits of the global information society'. It stressed the importance of governmental leadership in creating an 'appropriate policy and regulatory environment' which included the fostering of competition and innovation in an overall environment of economic and financial stability. It called for 'collaboration to optimize global networks, fight abuses that undermine the integrity of the network, bridge the digital divide, invest in people, and promote global access and participation'. The last paragraph of the preamble to the Okinawa Charter reiterated the G8's commitment to bridging the global digital divide (Government of Japan, 2000).

The second section of the Okinawa Charter focused on the need to create the right policy and regulatory environment for ICTs to have a positive impact. The private sector 'plays a leading role' but 'it is up to governments to create a predictable, transparent, and non-discriminatory policy and regulatory environment'. The document went on to stress the importance of enforcing intellectual property rights and liberalizing international flows, especially e-commerce. It urged taxation policies consistent with those pursued by the OECD, 'continuing the practice of not imposing customs duties on electronic transmissions' and the adoption of interoperable, market-driven standards. Like the OECD efforts described briefly above, the Okinawa Charter identified privacy protection, electronic authentication, and security to be important areas for future discussion.

The remainder of the document reaffirmed the commitment of the G8 to bridging the global digital divide and suggested ways of working with other international organizations and private sector groups to achieve this goal. In the final pages, the Okinawa Charter announced the decision of the G8 to establish a Digital Opportunity Taskforce (DOT Force) to respond to the needs of the developing countries. The Okinawa Charter became the foundational document for a G8 effort that was to begin in 2000 and end in 2003 with the creation of a number of pilot programs, reports, and policy

dialogues meant to advance the state of the art in applying ICTs to development concerns.

THE DOT FORCE

After the Okinawa Summit, 43 teams from organizations representing governments, the private sector, non-profit organization, and international organizations were assembled to 'identify ways in which the digital revolution can benefit all the world's people, especially the poorest and most marginalized groups' (DOT Force, 2001). The first meeting of the DOT Force was held in Tokyo on 27–8 November 2000. The meeting was chaired by Japanese Deputy Foreign Minister Yoshiji Nogami. A schedule was established for the preparation of a report prior to the next international economic summit in Genoa. The report, to be finished by May 2001, would be drafted with the help of the World Bank and the United Nations Development Program (UNDP). It would deal with the issues discussed in the Okinawa Charter and would be 'action-oriented' (DOT Force, 2000).

The report that resulted, *Digital Opportunities for All: Meeting the Challenge*, concluded that, 'when wisely applied, ICT offer enormous opportunities to narrow social and economic inequalities and support sustainable wealth creation, and thus help to achieve the broader development goals that the international community has set' (DOT Force 2002, p. (3). It proposed four areas for action: (1) fostering policy, regulatory, and network readiness; (2) improving connectivity, increasing access, and lowering costs; (3) building human capacity; and (4) encouraging participation in global e-commerce and other e-Networks (DOT Force, 2002, pp. 4–5).

The members of the DOT Force went so far as to assert that 'the basic right of access to knowledge and information is a prerequisite for modern human development'. The enthusiasm for using ICT as the primary vehicle for this was palpable in the report's comments.

The report went on to discuss and summarize the UN Millennium Declaration and the related Development Goals, which included, among other items, reducing the number of people living in extreme poverty by half between 1990 and 2015. It stressed the potential utility of using ICTs to reduce global inequality but also the need to put 'in place the appropriate infrastructure', which 'is a multi-sectoral and multi-stakeholder task'. The report referred to the need for governments to work together with nonprofit organizations, private firms, and international organizations. The report claimed that the DOT Force was the first G8 initiative to take this idea seriously. This emphasis on multi-stakeholder participation was no doubt partly a response to the criticisms of the so-called 'civil society

organizations' about their lack of access to decisionmaking in the G8, the WTO, and the World Bank/IMF systems.

The report did not ignore the difficulties of the tasks it recommended the G8 to undertake. It included discussions of the problem of general skepticism about the potential role of ICTs in development, opposition to using ICTs to enhance transparency and thereby reduce corruption, and the possibility of negative reactions to the effects of ICT diffusion on employment patterns. It called for fresh thinking on these matters and for a search for best practices on a global basis. The report concluded with nine 'action points' that later were called the Genoa Plan of Action. The Plan of Action was fully endorsed by G8 leaders at the Genoa Summit in July 2001.

The G8 was led by Italy in 2001 and Canada in 2002. The governments of the two countries were given the responsibility to facilitate the work of the DOT Force after the Genoa Summit. The DOT Force implementation teams proposed a number of new projects in the following seven areas: national e-strategies, access and connectivity, human capacity building, entrepreneurship, ICTs for health, local content and applications, and global policy participation. These projects and the subprojects associated with them would continue beyond the life span of the DOT Force itself, mainly via a hand over to working groups of the newly created UN ICT Task Force.

The DOT Force prepared a final document, entitled *Report Card: Digital Opportunities for All*, that was published in June 2002 in time for discussion at the G8 summit in Kananaskis (DOT Force, 2002). This report asserted that the 'multi-stakeholder approach of the DOT Force now serves as the model for other global "ICT for development" initiatives that follow in its footsteps' (DOT Force, 2002, p. 2). With the conclusion of the Kananaskis summit the DOT Force officially ceased operations.

RESULTS OF AN E-MAIL SURVEY OF PARTICIPANTS

In another paper, I describe the results of an e-mail survey of participants in which it is generally agreed that the multi-stakeholder approach was intended to address the criticisms of the G8 by anti-globalization forces and that the approach actually helped to legitimize G8 governance by creating an atmosphere of trust that did not previously exist, especially among NGOs and Third World governments who were normally locked out of G8 processes. Many of the participants wanted to see this approach applied more widely and in other areas.

Some of the participants noted that the multi-stakeholder approach would have been more effective if the basis for selection of representatives

of non-governmental organizations had been more widely known and if there had been efforts to deepen the discussions so that they included a broader circle of societal actors. One representative of an NGO remarked about NGOs that 'we're a hard to satisfy group!' Some participants thought that the shift toward security issues that followed the 11 September 2001 attacks and the change in US administrations meant an uncertain future for the multi-stakeholder approach (which they regretted). Another participant argued that the need for such approaches arose from the fact that 'governments of the industrial countries realized that they are losing control [of] globalization processes' (Hart, 2005).

There were some differences of opinion about the multi-stakeholder approach across the types of participants. Generally speaking, representatives of nonprofit associations were the most enthusiastic while business participants were the least enthusiastic. Business had worked hard over a decade or more to win a seat at the table in cyberspace governance forums. They saw the NGOs as newcomers and interlopers who had not paid their dues. Like the representatives of governments, they were not fully convinced of the value of giving NGOs access to governance bodies, as opposed to access to forums for discussion and protest.[3] Representatives of governments were not fully convinced of the value of giving private businesses' representatives access to international governance bodies, but, if forced to do so, they seemed to prefer giving access also to the critics of private business.

CONCLUSIONS

The multi-stakeholder approach was probably a step in the right direction for legitimating global governance in the G8 because it inherently recognized the need to supplement the traditional intergovernmental approach with direct representation of societal interests, but the most important objections to it echoed the political objections to neocorporatism in domestic governance debates. Neocorporatism gives the state (or, in this case, the member states of the G8) the power to privilege certain social groups by giving them a seat at the table. While this may enhance the legitimacy of governance somewhat, there will be objections to the exclusion of other, unrepresented, groups. Included groups may be criticized for allowing themselves to be coopted by the member states: that is, their critics will argue that they have traded effectiveness for access.

The ability to privilege some groups over others may be a useful tool for governance bodies who wish to draw distinctions between what they deem legitimate and illegitimate forms of representation. In republics, this occurs

on a regular basis when, for example, radical groups eschew direct lobbying of executives or parliaments in favor of civil disobedience, mass demonstrations, or other protest activities while more moderate groups focus on lobbying. This occurs partly because the moderate groups are more likely to be invited to testify at parliamentary hearings or to be given access to the offices of individual elected representatives. The difference between neo-corporatist forms of representation and more purely republican forms of government is that some genuinely popular interest groups are denied access, thus creating a chink in the legitimating armor of the republic.

In conclusion, my advice to managers of private firms is to consider these issues when confronted with opportunities to participate in multi-stakeholder processes. It may be that the direct participation that they prefer in certain international governance bodies, like the G8 or the OECD, is more likely to persist and deepen if governments can argue that private interests are being offset by including representatives of other opposing interests. The long-term cost, however, beyond having to compromise from time to time with anti-business civil society organizations, may be that the multi-stakeholder approach will not necessarily end criticisms about the democratic deficit in global governance.

NOTES

1. Held acknowledges Zürn (2004) as the source in Held (n.d.).
2. I will use 'G8' to stand for both the Group of Seven (G7) major industrialized countries that met annually at international economic summits from 1974 through 1997 (the United States, Canada, Japan, Britain, France, Germany, and Italy) and the Group of Eight (G8) that began in 1998 with the addition of Russia as the eighth member of the group.
3. I thank Derrick Cogburn and Ernest Wilson for reminding me of this difference which is informed by their extensive field research on cyberspace governance.

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12. The competitiveness of local manufacturing firms of small, less-developed countries in an increasingly liberalized trading environment: the case of Jamaica

Lou Anne A. Barclay

INTRODUCTION

Since 1989, more than 100 less-developed countries, some at the behest of the World Bank and International Monetary Fund (IMF), have implemented some form of trade liberalization. However, the beneficial effects of trade liberalization are uncertain. The claims of renewed economic growth, enhanced factor allocation, improved access to superior technology, inputs and intermediate goods, and the increased productivity of local firms are still to be substantiated empirically. Yet it is clear that small, less-developed countries are especially vulnerable to the consequences of a liberalized trading environment. Moreover, it is ironic that, under the present orthodoxy of private sector-led development, it is the manufacturing sector of these economies that is particularly vulnerable to liberalized trade (Armstrong and Read, 1998). This thus begs the question as to what is the future viability of the local manufacturing firms of small, less-developed countries in an increasingly liberalized trading environment.

This chapter seeks to provide answers to this question by examining the competitive strategies implemented by local firms in the manufacturing industry of Jamaica. It will also analyze the manner in which policymakers, in their new facilitative role, are attempting to increase the competitiveness of these firms.

The outline of this chapter is as follows. The subsequent section explores the extant literature on trade liberalization and economic development. Section 3 examines the experience of Jamaica with respect to these issues. Section 4 discusses the sampling and data collection methods used for this study. It also analyzes the characteristics of the sampled firms, including

their motivations to engage in international business activity. Section 5 examines the strategies these firms used for international competition, while Section 6 discusses the role that the enabling home country plays in increasing the competitiveness of these firms. Section 7 concludes.

TRADE LIBERALIZATION AND ECONOMIC GROWTH IN LESS-DEVELOPED COUNTRIES

Within the last 20 years there has been a dramatic change in the policy stance of many less-developed countries. They have increasingly perceived trade liberalization to be the panacea for economic development. Indeed, the extant literature suggests that the potential benefits arising from liberalized trade are myriad. Some researchers argue that its immediate effect is improved factor allocation as resources shift from inefficient capital-intensive, import-substituting activities to efficient labor-intensive, export-oriented ones. They also posit that the long-term effects of liberalized trade are seen in the accumulation process, capital formation, and the growth of real output and trade (for example, Greenaway, 1998). Other researchers add the improved access to superior technology, imports and intermediate goods, the transfer of know-how, and the development of a more economical market structure (Dornbusch, 1992; Martin, 1999).

A number of empirical studies, which sought to investigate the above propositions have been conducted. These studies reveal that trade liberalization results in a rapid growth of exports (for example, Santos-Paulino, 2002) and a more rapid growth of real GDP (Papageorgiou *et al.*, 1991; Sachs and Warner, 1995; Wacziarg and Welch, 2003). Others concur with the growth-enhancing aspects of trade liberalization; however, they argue that this growth is not instantaneous; it is lagged (Greenaway *et al.*, 1998). Studies have also shown that trade liberalization results in an improvement in investment (Harrigan and Mosley, 1991). In addition, others cite the improved productivity and efficiency of local firms that benefit from easier access to technology and heightened import competition (Devarajan and Rodrik, 1989; Pavcnik, 2002).

However, several studies do not adopt such a sanguine perspective on trade liberalization. Indeed, it is argued that, in the short run, trade liberalization does have 'some undesirable but inevitable' side-effects; unemployment may increase and fiscal depletion may occur (Greenaway, 1998). Further, the proposed short-run effect of trade liberalization of improved factor allocation has not been supported by empirical investigation (for example, Davis, 1996). In fact, some researchers emphasize the importance of including the effect of agglomeration economies on the location of

activity among liberalized economies (Amiti, 1998). It seems that the effect of agglomeration economies is to reinforce the existing concentration of knowledge-intensive activities within countries as well as to relocate more footloose activities to large, domestic markets (Hanson, 1994).

In addition, the proposition that trade liberalization results in economic growth is subject to controversy. The conclusions of some of the empirical studies supporting this claim have been challenged.[1] Indeed, Greenaway *et al.* (1998), examining the extant literature, note that both positive and negative growth impacts have been recorded. Hence, in some instances, economic growth *does* deteriorate after trade liberalization. In addition, they note that several countries experience investment slumps subsequent to trade liberalization. It seems that the privatization initiatives mounted by the government are not accompanied by an increase in investment by the private sector since the latter questions the credibility of these reforms (Greenaway, 1998). Further, the notion that trade liberalization results in the improved productivity and efficiency of local firms has been disputed (for example, Rodrik, 1988).

Researchers also posit that these empirical studies suffer from 'identification problems' (ibid.). Trade liberalization has been accompanied by 'sensible' macroeconomic policies such as realistic exchange rates and fiscal discipline, which are often implemented under the auspices of the stabilization and structural adjustment programs of the International Monetary Fund (IMF) and the World Bank (ibid., p. 27). Hence, it is difficult to ascertain the beneficial effects for an economy solely from liberalizing its trade regime.

Clearly, the economic consequences of less-developed countries implementing trade liberalization programs are uncertain. Interestingly enough, the literature is relatively silent on the impact of trade liberalization on the smaller, less-developed countries, which are likely to be especially vulnerable to the consequences of a liberalized trading environment.[2] It is noteworthy that one study that examines this issue also emphasizes the uncertain impacts of trade liberalization (Armstrong and Read, 1998). Most importantly, this study revealed that liberalized trade would have a negative effect on the local manufacturing sector because of the erosion of preference margins (ibid., p. 560). Other researchers prophesy the death of the local firms in smaller, less-developed economies, which would be unable to compete with the 'economic juggernauts' from larger, more developed economies (Reubens, 2003).

The vulnerability of local manufacturing firms to liberalized trade is noteworthy since many small, less-developed countries have implemented the strategy of trade liberalization in tandem with the World Bank-inspired orthodoxy of private sector-led development. Thus, in this newly

liberalized trading environment, it is the private sector, not the government, which is the agent of economic transformation. The government's role in economic development is merely that of facilitating the activities of the private sector.

From the foregoing discussion, it is evident that the beneficial effects of the trade liberalization initiatives currently being implemented by many less-developed countries are uncertain. Moreover, it is ironic that, given the present orthodoxy of private sector-led development, it is the manufacturing sector of small, less-developed countries, which is especially vulnerable to liberalized trade. This has tremendous implications for the future viability of local manufacturing firms in small, less-developed countries. As was earlier discussed, this chapter seeks to examine this issue. To this end, it will analyze the competitive strategies which are being employed by Jamaican manufacturing firms, in response to an increasingly liberalized trading environment. It will also examine the manner in which policymakers, in their new facilitative role, are attempting to increase the competitiveness of these firms. However, this analysis will be preceded by a discussion of the evolution of the trade liberalization initiatives implemented in Jamaica.

TRADE LIBERALIZATION AND ECONOMIC GROWTH: THE EXPERIENCE OF JAMAICA

Jamaica is a member of the 15-country grouping that comprises the Caribbean Community (CARICOM).[3] The Caribbean Community consists of a number of small states juxtaposed with micro-nations and economies (Wint, 2003a).[4] (See Table 12.1.) Like many of its CARICOM members, this country's movement towards liberalized trade has been a gradual one. Indeed, the history of the Jamaican government's policy towards trade can be divided into three distinct periods: the immediate post-independence era; the years of state populism; and the years of dependent capitalism to the present day.[5]

The immediate post-independence years (1960 to 1972) were indeed halcyon ones for Jamaica. Spurred by developments in bauxite mining and tourism, the economy achieved spectacular growth: GDP grew at an annual rate of 5.1 percent while inflation averaged 4.5 percent. The development strategy employed during this period was informed by the work of economists such as Arthur Lewis. Thus, the government sought to industrialize the economy in order to absorb the surplus labor from the agricultural sector. However, at this time, the government's role in the economy was passive; it was limited to merely encouraging, through the use of investment

Table 12.1 Selected indicators of CARICOM member states in 2002 (EC$ 2 = US$ 1)

Country	Area (Km²)	Population	GDP at current market price (EC$m.)	GDP per capita at current market price (EC$m.)
Anguilla	91	11 561*	298*	25 776
Antigua and Barbuda	442	76 485	1 947	25 450
The Bahamas	13 939	31 200	8 287*	29 718*
Barbados	431	275 320	7 015	25 906
Belize	22 966	257 310*	2 572	9 700
Dominica	750	71 079	685	9 640
Grenada	345	102 638	1 084	10 560
Guyana	214 970	774 800	1 961	2 531
Haiti	27 750	8 357 000	12 797	1 531
Jamaica	10 991	2 618 600	22 897	8 744
Montserrat	103	4 501	103	22 908
St Kitts and Nevis	269	46 710	953	20 397
Saint Lucia	616	159 133	1 815	11 404
St Vincent and the Grenadines	389	109 164	975	8 931
Suriname	163 820	441 356*	429	1 264*
Trinidad and Tobago	5 128	1 276 000	29 181	22 754

Note: * = 2001.

Source: ECLAC (2001), Table 12.1.

incentives, foreign productive activity. Moreover, the economy was fairly open with only a small number of manufactures subjected to quantitative restrictions. These halcyon years were not to last.

The years 1972 to 1980 witnessed a dramatic change in the ideology of the government to one of state populism,[6] which was realized by a marked increase in the government's intervention in the economy. Indeed, by 1980, nearly 400 productive enterprises were under the government's control. Moreover, in striking contrast to the previous era, the government's trade policies became draconian. An import licensing requirement was introduced, tariffs were raised, and qualitative restrictions were imposed on a wide range of imports, while others were prohibited. The government also established a state-owned enterprise, Jamaica Commodity Trading Company that monopolized the importation of various food products. Further, foreign capital was actively discouraged. Not surprisingly, the performance of the Jamaican economy during the era of state populism was dismal: GDP declined by an average of 2 percent during this period. In addition,

inflation rose to more than 12 percent, while unemployment increased from 22 percent in 1972 to 30 percent by 1979.

The years 1981 to 1989 ushered in a new government and the new ideology of dependent capitalism. However, there seems to be little difference in the economic strategy pursued by the new Seaga regime and that of its predecessor.[7] The only apparent policy change was the return to the active encouragement of foreign investment.

This period also saw the involvement of the World Bank and the IMF in the economy, which resulted in some initiatives towards economic reform. For instance, under IMF supervision, there was a gradual improvement in the fiscal balances and inflation, with the latter averaging 8.4 percent during this period. Yet the economic stagnation which characterized the previous period persisted during this era. During the years 1980 to 1989, the economy grew at an anemic 0.6 percent per year.

However, it was under this regime that the first tentative movements towards liberalizing the trade regime were made. During 1983 to 1985, after Jamaica entered the World Bank Structural Adjustment Agreement of 1983, 180 items were removed from the import license list. Yet, as King (2001) notes, the Seaga regime was initially reluctant to embrace trade liberalization since, in tandem with the removal of those 180 items, import tariffs were imposed on them, and other items were added to the list. Nonetheless, this regime subsequently implemented another round of trade liberalization in 1987, removing a large group of items from the import license list.

These trade reforms accelerated with the return of the Manley regime in 1989. In 1990 to 1991, the third round of trade liberalization was implemented with the import licensing requirement removed for a range of consumer goods, the export licensing lifted for a few products, and the remaining quantitative restrictions as well as the licensing requirements for both imports and exports removed. In addition, a new tariff schedule with lower tariffs on some major imported products was introduced. Further, the Jamaica Commodity Trading Company no longer monopolized the importation of food products.

The fourth round of trade liberalization occurred in 1993 and 1995, where there was substantial reduction in the level of tariffs. The tariff reductions of 1993, 1995 and 1998 occurred under the Common External Tariff (CET) of CARICOM. Under the initiative of the Jamaican government, the CET was standardized and lowered to a range of 5 to 20 percent for products specified in the CET schedule, with capital goods in the range of 0 to 5 percent (World Bank, 2003).

Interestingly enough, King (2001) posits that the Jamaican government used the complexity of its tariff structure to introduce tax levies such as

Table 12.2 Selected macroeconomic indicators of Jamaica, 1990 to 2001

Indicators	1990	1991	1992	1993	1994
Real GDP growth (1986)	3.8	0.7	1.4	1.4	0.8
Unemployment	15.3	15.4	15.7	16.3	15.4
Inflation	29.8	80.2	40.2	30.1	26.7
Fiscal balance (J$b.)	33.5	112.3	215.6	121.7	–97.9
Debt servicing as % of GDP	n.a.	26.7	27.1	22.6	20.0
Trade balance (US$m.)	–522	–424	–476	–805	–652

Source: Planning Institute of Jamaica, *Economic and Social Survey Jamaica* (various issues).

stamp duties, which are de facto import tariffs. Nevertheless, there was a marked decline in the average custom tariff: it decreased from a peak of 25 percent in the 1980s to 14.0 percent in 1995, and finally to 11.8 percent in 1998 (ibid., Table 2). Also, at this time, further attempts were made to open up the economy. Jamaica concluded bilateral trade agreements with several countries outside of the CARICOM region, including China, Costa Rica, Nigeria, Norway and Hungary. Further, Jamaica, together with members of CARICOM, is currently undergoing negotiations to establish the Free Trade Area of Americas (FTAA).

Unfortunately, these trade reforms have not been accompanied by economic growth. The Manley regime accelerated not only the trade reform program but also the economic reform program started by its predecessor. However, this trade reform, together with the other reforms introduced under the structural adjustment and stabilization programs, such as the lifting of capital controls, financial sector liberalization and privatization, only resulted in the macroeconomic instability that characterized much of the 1990s.

Indeed, the performance of the Jamaican economy was poor for most of the 1990s. The growth of real GDP was low or negative; unemployment persisted at a rate of around 15 percent of the labor force; inflation soared to a high of 80.2 percent in 1991 and finally declined to 7 percent in 1999, while the fiscal account remained in deficit for the latter half of this decade. Further, Jamaica's external debt service ratio was over 25 percent for most of this decade, while the deficit in the trade balance grew over this period (See Table 12.2.). The instability in the economy during this period was further exacerbated by a financial crisis, which has had a lasting effect on the economy.[8]

Not surprisingly, the Jamaican economy has experienced a decline in competitiveness. As Table 12.3 shows, Jamaica's share of world merchandise exports decreased from 0.030 percent in 1994 to 0.024 percent in 2001,

1995	1996	1997	1998	1999	2000	2001
0.5	–1.4	–1.7	–0.3	–0.4	0.7	1.1
16.2	16	16.5	15.5	15.7	15.5	15.0
25.5	15.8	9.2	7.9	6.8	6.1	8.8
–67.5	99.3	–66.9	–19.2	–12.6	4.2	–21.4
20.3	25.6	21.7	24.7	32.0	31.1	41.8
–941	–994	–1741	1671	–1657	–2006	–2180

a fall of 33 percent. Manufacturing employment has also been declining since 1995 and manufacturing exports since 1997 (World Bank, 2003).

Interestingly enough, despite the dismal state of the macroeconomic environment of Jamaica, some local firms have still managed to become internationally competitive. As Wint (2003b) notes, they export to an array of countries, engage in foreign direct investment, operate according to

Table 12.3 Merchandise trade in the Jamaican economy

Year	Merchandise Exports (US$ billion)		Share in world merchandise exports (%)	Exports/ GDP (%)	Imports/ GDP (%)	Trade/ GDP(%)
	Jamaica	World				
1985	0.57	1872.0	0.030	27.1	47.8	74.9
1986	0.59	2046.4	0.029	21.4	30.4	51.6
1987	0.73	201.4	0.030	22.1	32.8	54.8
1988	0.80	2401.4	0.033	23.5	32.8	56.2
1989	1.03	2742.0	0.035	23.4	36.8	60.1
1990	1.19	2981.5	0.035	25.9	36.9	62.8
1991	1.20	3395.3	0.034	28.9	38.4	67.4
1992	1.12	3489.1	0.030	30.2	41.7	71.9
1993	1.11	3730.2	0.026	23.3	40.5	63.8
1994	1.55	3677.3	0.036	32.4	43.9	76.3
1995	1.80	4262.4	0.035	31.6	46.1	77.7
1996	1.72	5339.4	0.032	26.9	42.5	69.4
1997	1.70	5529.0	0.031	23.3	38.9	62.2
1998	1.61	5441.0	0.030	21.6	36.7	58.2
1999	1.50	5626.4	0.027	16.0	35.7	55.6
2000	1.56	6353.6	0.024	20.2	39.0	59.1
2001	1.45	6129.9	0.024	18.7	39.5	58.2

Source: World Bank (2003), Table 7.2.

internationally accepted norms of cost, service, operational standards and quality, and earn above average returns in liberalized markets. This study seeks to examine the local manufacturing firms that currently share some or all of the above characteristics. The following section discusses the sampling and data collection methods employed as well as introducing the firms used for this study.

METHOD: SAMPLING OF MANUFACTURING FIRMS AND DATA COLLECTION

The data for this study were obtained from the *Jamaica Exporter Directory 2003*, which provides a comprehensive listing of Jamaica-based firms involved in international business activity. This database identified a total of 415 firms engaging in distribution, exporting and/or foreign direct investment in 2002. However, the objective of this study is to examine locally owned Jamaican companies that are involved in both manufacturing and international business (exporting and/or foreign direct investment). Thus industry analysts drawn from the local investment and export promotion agency, the Jamaica Promotions Corporation (JAMPRO), were used to identify firms in the database that fulfilled these criteria.[9] Thirty-five firms were identified for participation in this study. They were all locally owned entities, which were successfully engaged in both manufacturing and international business (exporting and/or foreign direct investment). A letter was mailed to these 35 firms requesting their participation in this study. A total of nine firms were eventually studied, representing a response rate of 26 percent. Most of them are the dominant producers and exporters in their industry.

The main research instrument employed in this study was a questionnaire consisting of 12 semi-structured questions that required open-ended responses. Face-to-face interviews, which generally lasted one hour, were conducted with top-level executives such as chief executive officers or marketing executives. These firm-level interviews were complemented by face-to-face interviews held with key policymakers. A questionnaire consisting of six semi-structured questions requiring open-ended responses was used for this purpose.

General Characteristics of the Firms Studied

As Table 12.4 illustrates, a diverse group of firms was studied. The age of these firms varied from 11 to 179 years. They also varied in size: the largest employed 2200 persons, while the smallest employed 45 persons.

Table 12.4 General characteristics of sampled firms

Firm	Years of establishment	Size (number of employees in 2004)	Export product	Number of foreign affiliates or subsidiaries	Export market
Firm 1	82	2 200	Food and drink	5 subsidiaries	Caribbean UK North America Central America Asia
Firm 2	179	1 000	Branded spirits	6 subsidiaries 1 strategic alliance	Europe US Canada South America Caribbean
Firm 3	75	740	Fresh and processed foods*	9 subsidiaries 1 joint venture	Europe
Firm 4	15	400	Food and drink	1 joint venture	CARICOM Cuba Central America North America
Firm 5	16	250	Dairy products Fruit juices	—	CARICOM
Firm 6	42	200	Heavy industrial chemicals	1 strategic alliance	CARICOM Cuba Dominican Republic
Firm 7	11	65	Industrial chemicals	1 subsidiary	CARICOM
Firm 8	32	50	Asphalt, flavors, colors, syrups and cordials	1 joint venture	CARICOM US UK
Firm 9	125	45	Flavors, pharmaceuticals, personal hygiene products	—	CARICOM USA Canada UK

Note: * Processed foods are produced in the company's wholly owned plants that are located in Wales.

The majority was in the food and beverage industry, manufacturing and exporting a variety of goods ranging from branded spirits and dairy products to syrups. Others were involved in pharmaceuticals, industrial chemicals and personal hygiene products. Most of the firms studied used third party distributors to enter foreign markets. However, a few had extended their scope of internationalization, owning joint ventures and wholly owned subsidiaries in international markets. Indeed, the larger firms, which are those with more than 700 employees, owned more than four subsidiaries abroad. Further, most of the firms exported their products beyond the CARICOM market. The majority engaged in international business activities in countries such as the UK, continental Europe, USA, and South and Central America. It is also noteworthy that these firms had various motivations for becoming involved in international business activity. They will be examined in the next section.

The Drivers for International Business Activity

The extant literature suggests that less-developed country firms engage in international business activity, with exporting being the main mode of their foreign market participation (for example, Aulakh *et al.*, 2000), for several reasons. Some researchers argue that managerial aspirations for business goals, including growth and market development, determine the propensity for both developed and less-developed country firms to engage in export activity (Cavusgil and Nevin, 1981; Cavusgil, 1984; Christensen *et al.*, 1987). Others posit that the possession of a 'differential firm advantage' such as size, technology or a unique product, which serve as 'attention evokers', initially motivates management to export (Cavusgil and Nevin, 1981; Cavusgil, 1984). Finally, some state that the need to earn rents from export subsidies as well as to overcome government-imposed restrictions induce less-developed country firms, specifically Brazilian firms, to engage in export activity (Christensen *et al.*, 1987).

Some of these propositions were supported by the present study. Indeed, for several of the firms examined, it seems that managerial aspirations for sustained growth propelled their firms' export involvement. In their attempts to achieve sustained growth, some of these firms diversified their activities away from traditional export products to more internationally competitive ones. For example, one firm historically exported bulk rum to the European market where it enjoyed preferential market access. However, with the threat of loss of this preferential market access, the firm de-emphasized the bulk rum segment of its business and has sought to develop branded spirit products that are internationally competitive (Wint, 2003b).

In other instances, it appears that the desire for larger markets induced the firms to engage in export activity. Interestingly enough, it seems that the firms that produce industrial chemicals were compelled to export regionally because of insufficient local demand. Relatedly, excess capacity drove a firm in the beverage industry to become involved in contract manufacturing. This firm produces brand name drinks for several foreign companies.

It is significant that some firms revealed that their export activity was catalyzed by a critical need to earn foreign exchange. It seems that the exchange rate controls that characterized Jamaica between the late 1970s and the early 1990s drove these firms to engage in export. The revenues from product sales in overseas markets were used to help finance the firms' domestic operations. Indeed, the potential to earn critically needed foreign exchange appears to have been the main motivation for these firms' export thrust. As one executive noted: 'Exporting is not really profitable since margins are low and overheads are high . . . but it gives us some US dollars.'

Finally, it is important to note that several of the firms examined were 'born global' (Cavusgil, 1994; Knight and Cavusgil, 2004). They were involved in export activity within three years of their inception. It appears that the small size of the domestic market compelled them to expand into foreign markets at an early stage of their founding.

The firms studied also appeared to have followed two distinct internationalization paths. Most seem to pursue the path suggested by theorists such as Johanson and Vahlne (1977, 1990) and Welch and Luostarinen (1988). Using foreign distributors, they initially exported to the regional market, which is psychically similar and geographically close to their home market, with one later establishing a wholly owned distribution facility in this market. Several have moved beyond the CARICOM market, exporting products produced by the parent company to the West Indian diaspora markets of the USA, UK and Canada as well as to the psychically distant market of Central America.

On the other hand, three firms did not appear to follow a strategy of internationalization similar to that pursued by other less-developed country firms (for example, Yeung, 1997; Barclay, 2005) and their Jamaican counterparts. In fact, their internationalization process was not characterized by experiential learning in markets, which are psychically similar and geographically close to their home market. Rather, two firms initially exported their products to the traditional markets of developed countries (UK, continental Europe and USA) where they later established wholly owned subsidiaries and joint ventures. They subsequently re-entered the domestic and, later, the regional market, in some cases transferring competitive strategies learnt in developed countries to these markets. Another appeared to have entered both the regional and diaspora markets of North America and the

UK simultaneously. In one instance, the firm's return to the domestic and regional market appears to be in response to the competitive threat posed by the increasingly dominant Trinidadian firms in these markets.

It is thus instructive to examine the competitive strategies implemented by the firms studied as they became internationalized. In the following section, we will examine the evolution of these strategies.

STRATEGIES JAMAICAN FIRMS USE FOR INTERNATIONAL COMPETITION

There are few studies on the export strategies used by less-developed country firms (for example, Dominguez and Sequeira, 1991; Aulakh *et al.*, 2000). However, some researchers suggest that less-developed country firms primarily rely on price competition (Christensen *et al.*, 1987) and engage in little market research prior to exporting (Bodur and Cavusgil, 1985). Others posit that the successful exporters have tended to do market research as well as working closely with intermediaries (Christensen *et al.*, 1987). Yet, as Aulakh *et al.* (2000) note, the export success of less-developed country firms depends on their ability to develop and implement unique competitive strategies.

The Jamaican firms studied were generally not participants in global production chains, a strategy that was successfully used by East Asian NICs in their early export thrust (for example, Wortzel and Vernon-Wortzel, 1981). Rather, they sought to enter the export market independently. It is worth noting that competitive strategies employed by these firms were influenced by the internationalization path they followed.

Competing in the CARICOM Market

As was discussed earlier, most of the firms entered the CARICOM market in the first stage of their internationalization process. These firms are involved in a range of activities varying from the manufacture of syrups, cordials and beverages to the manufacture of heavy industry chemicals. They have been operating in the CARICOM market from 10 to 40 years. However, most still use foreign intermediaries to distribute and promote their products in this market.

As Table 12.5 shows, the firms competed on the basis of price. Some of those in the food and beverage industry revealed that they attempt to occupy market niches where they could capitalize on the advantages of being a low-cost producer operating at the low-priced segment of the market. Various methods were adopted to achieve this price competitiveness. Some

Table 12.5 The export strategies of selected Jamaican firms

Characteristics of Export Strategy	CARICOM market	International Market	
		West Indian diaspora market	Traditional market
Product			
• Low price	Firms 4–9	Firms 8, 9	
• Brand name	Firms 1, 4, 8, 9	Firms 1, 8, 9	Firms 1, 2, 3, 4
Marketing			
• None	Firms 4–9	Firms 8, 9	Firm 4
• Use of marketing managers	Firm 1	Firm 1	Firm 1
• Adaptation of standardized marketing program			Firm 2
Channels of distribution			
• Intermediaries	Firms 1, 4–6 & 8–9	Firms 1, 8, 9	Firms 1, 3, 4
• Wholly and/or minority-owned distribution facilities	Firms 6, 7	Firm 1	Firms 1, 2, 3

firms attempted to control the cost and supply of their raw materials by forming strategic alliances or joint ventures with overseas suppliers. Another developed a dedicated cadre of international suppliers while others benefited from easy access to their main input, which is one of the country's natural resources. However, most sought to achieve production efficiencies.

Efficiencies in production were generally attained by consistent improvements to the manufacturing process with several firms achieving ISO 9002 or HACCP (Hazard Analysis and Critical Control Point) certification. In most cases, firms made substantial investment in their human and, to a lesser extent, capital resources. It is noteworthy that several firms emphasized the importance of worker training. In some cases, production managers were sent on site visits abroad where they were exposed to modern production facilities and processes. In another instance, technicians from equipment suppliers trained workers locally. A few firms also offered subsidized training to their workers with one firm mandating that its workers attend at least one training program a year. Another recently introduced a comprehensive 'Performance Management and Evaluation

System', which aims to ensure that the behavior, skills and competencies of its employees are aligned with the strategies and objectives of the company.

It seems that these firms sought to achieve a more sustained presence in the CARICOM market by improving product quality. One firm, which supplies chemical products to multinationals operating in the region, revealed that it always had to maintain high quality standards since its clients had the option of importing the product duty-free. Most stated that quality consciousness is emphasized to production workers. As one executive said: 'There is a strong drive in this company to ensure that the products when they leave our facilities are of a high standard.'

Interestingly, two firms revealed that the product quality is assured by work conducted at company-owned laboratories. It seems that these laboratories are engaged in both pre-production (for example, testing of raw materials) and post-production (that is, the testing of the final product) activities.

It is significant that few of the firms studied sought to develop a differentiated product.[10] The only exceptions were two companies in the food and beverage industry. One company, which has been exporting to the regional market for the last 30 years, developed a widely recognized brand name product. The other, which is of more recent vintage, created a powdered, soya-based drink, which it specifically aims at the low-income segment of the market.

There was also little evidence that the product, that is, its functionality and its aesthetics, was modified to meet the idiosyncratic needs of this market.[11] Moreover, only two firms studied, which were involved in the manufacture of industrial chemicals, exercised control over the distribution and marketing of their exported product. The others, which have been operating in this market for more than 10 years, still used foreign distributors (see Table 12.5). However, several of these firms exported their products to extra-CARICOM markets. The competitive strategies they employed in these markets are one of the issues discussed in the following section.

Competing beyond the CARICOM Market

As Table 12.4 shows, most of the firms export to the extra-CARICOM market. These firms have been operating in this market for 10 to 30 years. It is noteworthy, however, that the strategies they used for competition in the regional market are very similar to those implemented in international ones. They all sought to compete on the basis of a competitively priced brand name product, which is aimed at the lower-income segment of the market. For two of these firms, the products were generally marketed to the West Indian diaspora in the larger cities of the USA, Canada and the UK.

Further, as Table 12.5 illustrates, none of these companies studied owned or operated distribution facilities in these locations. Rather, the products were generally exported from the main production centers in Jamaica and distributed by means of third parties to international markets.

All of these firms made minor modifications to the exported product. The packaging and labeling, as well as bottle sizes, were changed to meet the requirements of the international market. One firm, which produces a powder-based soya drink, recently went so far as to invest in a joint venture operation in the UK to produce a liquefied version of this drink. This investment was made because of import restrictions imposed on the powder-based variety owing to its high sugar content. In addition, a firm changed the labeling of its product and did some focused marketing in an attempt to capture a new market segment. This firm, which has been exporting to the West Indian diaspora market for the last 30 years, is currently trying to create brand awareness among the younger diaspora population. To this end, it secured funds from the local investment agency, JAMPRO, which were used to refocus its marketing strategy.

As was discussed previously, a few of the firms studied pursued a different internationalization path. Their internationalization process was not characterized by experiential learning in markets which are psychically similar and geographically close to their home market. Instead, two of them initially exported their products to the traditional markets of developed countries (UK, continental Europe and USA). Another appeared to have entered the regional and international markets simultaneously. Not surprisingly, the competitive strategies these firms employed in international markets differ from those used by the other firms studied.

Two firms, which enjoyed preferential access to the European market, initially exported products to this market. However, in the early 1990s, they entered into new activities. One currently manufactures and distributes juices, milk-based drinks, yogurt and soups, while the other manufactures, markets and distributes branded spirit products.

It is significant to note that, while these firms have highly efficient operations (one earned 1SO 9002 and ISO 2002 certifications while the other distributes and markets the output manufactured in its production facility located in Wales), they do not compete solely on the basis of production efficiencies like some of their counterparts. Indeed, as Table 12.5 demonstrates, these firms are attempting to exercise greater control over the four Ps in marketing: product, price, promotion, and place (Wortzel and Vernon-Wortzel, 1981). While one firm devotes some of its production capacity to contract manufacturing, it has successfully begun to produce, market and distribute its own brand name products, which can be found at present in 2000 outlets in the UK. Its fresh juices currently

occupy a premier position in the chill cabinet segment of the UK drink industry. Moreover, it recently acquired a London-based food distribution business in order to extend the range of its product offerings as well as to increase the sales of its brand name products. This company continuously conducts extensive market research to ascertain the changing needs of its customers. Accordingly, it recently introduced a new product, which has since won international food awards, and discontinued another. It is also attempting to diversify its market by entering new ones in continental Europe.

Another firm has moved beyond competing on the basis of its comparative advantages (Jamaica possesses the ideal location-specific attributes for the production of rum) to the development of firm-specific advantages. Within a scant 10 years, this firm increased the percentage of its exported spirits from 50 percent of total production to an outstanding 90 percent. The company achieved this impressive export growth by the focused marketing of its brand name spirits. As one executive explained: 'We view marketing as a competitive advantage that has to be nurtured.'

Before engaging in exports, the company conducted extensive market research to ascertain where demand for its product exists internationally. It then sought to build brand awareness through brand positioning and controlling distribution. In an effort to position its branded spirits in the international market, the company developed a 'rum ladder', where its four branded spirits are ranked according to functional and emotional benefits as well as income and sophistication levels. The company uses this 'rum ladder', together with a standardized marketing program, to communicate to its international brand managers how its products should be marketed. Further, the company aggressively advertises its products in various media, including television, where it sponsors programs showcasing the skills of rum experts. In other instances, it hosts rum seminars for its clients and the press.

This firm also sought to control the distribution of its product. It partially owns distribution businesses in Canada, New Zealand, Costa Rica and Italy. It also has a wholly owned company in the UK, which distributes and markets its brand name spirits. The firm also trains its distributors in the company-owned 'Academy'. The training at the Academy seeks to ensure that the distributors are aware of the parameters within which they can operate while still allowing them the flexibility to function within the context of their cultural environment.

Another firm operates four production facilities in Jamaica as well as subcontracts production to manufacturing companies in Canada, the UK, Brazil, Chile and Thailand. The products produced in these facilities are all exported. This firm achieves production efficiencies in its local plants and

benchmarks its subcontractors to ensure their adherence to international standards. However, this firm is not involved in price competition since it believes that its larger rivals, which enjoy economies of scale, would easily outflank it. Rather, it pursues a competitive strategy of differentiation, offering unique products that satisfy the idiosyncratic tastes of Caribbean peoples. To this end, it developed brand name products, which are widely recognized in the domestic, regional and diaspora markets.

This firm has made considerable investment in marketing. It employs six marketing managers who are resident in its major markets. These managers work together with the foreign distributors in managing the company's brand name products. The firm also uses a standardized marketing program, which it shares with its foreign distributors. While the firm uses third party distributors in the majority of markets in which it operates, it has also established a wholly owned subsidiary that markets and distributes its branded products in Canada, one of its largest markets.

The firm's products are specifically aimed at to the West Indian diaspora market. The growth of this market[12] and the widespread recognition of the company's brand name products ensure its future viability. However, one of the company's long-term strategic objectives is to move into the traditional markets where sustainable growth is ensured. To this end, it recently launched a product, which is manufactured in Thailand, into Canada's traditional market. Plans are afoot to implement a similar strategy in the UK market.

The nine firms studied are clearly competitive. They have all emerged from a small, less-developed country and have generally managed to achieve sustained export growth with a few even successfully engaging in foreign direct investment. The sources of their competitiveness varied: for most of the firms, which operated in the CARICOM market and, to a limited extent, in the international markets, efficiencies gained in production afforded them the ability to offer a competitively priced, quality and, in two cases, brand name product to consumers. A few firms, however, have moved beyond competition based on operational effectiveness; that is, the ability to perform similar activities better than rivals (Porter, 1996). They have developed brand name products and are at present attempting to employ 'pull marketing' strategies. These strategies are used to induce consumer brand preferences by controlling distribution and marketing in order to build brand identification and heighten product differentiation (Vernon-Wortzel and Wortzel, 1988). But is it possible for these firms to sustain their competitive performance in an environment that is becoming increasingly liberalized? The answer to this question partly lies in the sustainability of the competitive strategies employed by these nine firms. This is the subject of the next section.

The Sustainability of the Competitive Strategies Pursued by the Jamaican Firms

This study essentially examines less-developed country firms that use different competitive strategies in international markets. Most compete on the basis of a competitively priced, quality product. They are not involved in the marketing or distribution of their products in the CARICOM and international markets. Rather, they use third party distributors for these activities. However, their limited involvement in marketing and distribution has several consequences, including the loss of profits, the loss of control over how and where their products are sold, and the loss of the opportunity to develop a competitive advantage in marketing. These firms also have a limited opportunity to acquire critical marketing technology, which is best learned by doing (Vernon-Wortzel and Wortzel, 1988). Moreover, the fragile nature of their competitive strategy, which is based solely on offering a competitively priced product to the low-priced segment of the market, makes them extremely vulnerable to the competitive threat posed by the entry of larger rivals in the regional and international markets.

A few firms, however, appear to have developed more sustainable competitive strategies. As previously discussed, these firms are not involved in price competition. Instead, they are seeking to create brand name products and are using pull marketing strategies to strengthen brand awareness and heighten product differentiation. To this end, most have invested in marketing and distribution facilities abroad. They have also developed ingenious strategies to ensure that third party distributors, when they are used, maintain the integrity of their brand name products. For example, as mentioned earlier, one firm has an 'Academy', which trains its distributors while another employs marketing managers to work with them.

As Dominguez and Sequeira (1991) note, developing country firms operating at this advanced stage of internationalization face serious financial challenges. They need to have either a strong cash position or a healthy line of credit (Wortzel and Vernon-Wortzel, 1981). The availability of finance potentially poses a considerable challenge to the sustainability of the competitive strategies implemented by these firms. However, it is worth noting that the firms, which are at a relatively advanced stage of internationalization, may have access to finance in the international markets in which they operate. Indeed, one of them gained access to EU funding to finance the establishment of its production subsidiary that is located in Wales.

Clearly, several of the firms studied are strategically positioning themselves to deal with the onslaught of competition arising from liberalized markets. However, some of them may be unable to do so. This begs the question as to what policymakers *could* and *should* do to enhance the

competitiveness of the home environment in which these firms operate. This issue will be discussed in the following section.

THE ROLE OF THE ENABLING HOME COUNTRY ENVIRONMENT IN INCREASING THE COMPETITIVENESS OF JAMAICAN FIRMS

The firms studied all stated that the business environment of Jamaica is not supportive of their activities. This sentiment is echoed in policy documents produced by various international agencies (for example, World Bank, 2003). The executives complained that the high cost of operating in Jamaica significantly reduces their international competitiveness. They stated that, inter alia, electricity costs are far too high; fees charged by Customs are onerous; and interest rates, which increased to as high as 50 percent in 1994,[13] are prohibitive. Moreover, because of the high levels of crime in the country, firms are forced to incur additional costs implementing security measures both at their production facilities and at the ports. Further, another executive bemoaned the absence of internationally competitive supplier industries, which the government has failed to foster. It seems that most of the intermediate inputs to the manufacturing process, such as glass bottles, labels and even packaging, are currently imported. The imported nature of these intermediate inputs appears to increase comparative operating costs since these firms have to pay higher transportation and inventory costs than their international competitors.[14]

Others cited inefficiencies in the infrastructure, specifically the lack of adequate public transportation, as adversely affecting their competitiveness. In addition, some firms noted that, despite improvements made to the quality of service offered by the bureaucracy, its service is still inefficient. Finally, several of the firms emphasized the need for more institutional support in areas such as finance for the export-oriented manufacturing firms.

Interestingly enough, the policymakers interviewed generally agreed with the above sentiments. Moreover, most of them were doubtful of the ability of the local manufacturing firms to compete in a liberalized trading environment. Accordingly, policy measures are now being implemented to enhance the competitiveness of these firms.

Firstly, measures which aim to provide immediate support to the manufacturing industry were implemented. These include indirect tax exemptions on the purchases of capital equipment, accelerated depreciation allowances, duty-free importation of raw materials and intermediate goods, and financing programs geared specifically to small and micro-enterprises. However,

several of these incentives, while critical to increasing the competitiveness of local manufacturing firms, are not WTO-compliant. Hence, a team of foreign consultants has been employed to review the investment incentive program.

Secondly, attempts are being made to address the prohibitive cost of electricity. To this end, a government agency is currently designing an energy policy, with the objective of offering a specialized and differentiated pricing regime, which conforms to multilateral trade rules, to the local manufacturing firms.

Thirdly, increased institutional support is now being offered to this industry. One local agency not only provides market information to exporters, but also offers two loan facilities that are funded by international agencies. Another institution, through the EU-funded Trade Development Project, assists successful exporters with the development of 'soft management practices'. This institution has successfully provided business support to 48 export clients in areas such as the implementation of accounting systems, the improvement of plant layout and overseas marketing assistance. In addition, through its 'Flavors of Jamaica' program, this institution is currently attempting to help companies which possess export-ready products that do not yet have brand names, to develop more sustainable export strategies. To this end, this program aims to develop the individual brand of firms of selected industry clusters by introducing their new brand name products to the international market through well-designed marketing programs. In this way, these firms may potentially develop a differentiated product, which could be successfully marketed internationally.

It is interesting to note, however, that several of the policymakers stated that the present level of support given to the manufacturing industry is inadequate. They said that there is need for greater assistance to firms in such areas as the provision of timely and relevant market information, the protection of intellectual property rights, research and development, and the access to relatively low-cost utilities and finance.

CONCLUSION

This chapter has sought to examine the future viability of local manufacturing Jamaican firms in the context of an increasingly liberalized trading environment. It concludes that, while a few of these firms may withstand the onslaught of competition arising from trade liberalization, many of the smaller ones will not be able to do so. This chapter suggests that there are several reasons for this.

First, the trade liberalization initiatives implemented by the Jamaican government have been accompanied by macroeconomic instability. It is indeed laudable that the firms studied, which operate in this environment, have successfully managed to engage in international business activities. However, continued macroeconomic instability, as partly evidenced by the prevailing high interest rates, would have adverse consequences for the competitiveness of local manufacturing firms, which may not have access to alternative sources of finance.

Further, as discussed previously, although the government has implemented policy measures to improve the competitiveness of Jamaica's business environment, these initiatives are inadequate. The government needs to improve the quality of service offered by its bureaucracy, reduce utility and finance costs, provide greater access to timely and relevant market information, and possibly, stimulate the development of supplier industries. Evidently, the resource-constrained Jamaican government is facing a serious 'managerial' challenge (Wint, 1998, p. 297). It needs to implement that mix of policies which, while being WTO-compliant, still enhances the competitiveness of its local manufacturing firms that are at different stages of internationalization. This has tremendous implications for the capabilities (education, skills and training) of present policymakers.

Yet, while enhancing the enabling environment is necessary for the local manufacturing firms to achieve sustainable international competitiveness, it is not sufficient. As this chapter has shown, most of the firms need to implement competitive strategies that would allow them to survive in a liberalized trading environment. They are involved in price competition, concentrating on the low-priced segment of the regional and domestic markets. However, these firms, which export small volumes, are extremely vulnerable to rivals offering lower-priced products. Moreover, as this chapter has demonstrated, they do not control their marketing and distribution activities. Instead, they use third party distributors with whom they tend to have low bargaining power (for example, Aulakh *et al.*, 2000). In consequence, these firms have no control over how and where their products are sold and, most importantly, they are unable to acquire critical marketing technologies, which are best learnt by doing.

These firms may possibly need to move to strategic niches where they could employ a competitive strategy of differentiation. Local institutions, which offer programs oriented to enhancing productivity, cost control, product quality, market research utilization and customer service may assist these firms in making this difficult transition (Dominguez and Sequeira, 1991). Indeed, the 'Flavors of Jamaica' program, discussed above, is a government-led initiative that is currently attempting to help companies to make the transition from a low-price strategy to a differentiated one.

A few of the firms have broadened and deepened their sources of competitive advantage beyond those obtained from solely operating in the domestic market. They employ a strategy of differentiation to compete in global markets. Further, they are exercising control over marketing and distribution by implementing pull marketing strategies. In this way, they are able to build brand awareness and heighten product differentiation in overseas markets. However, the sustained competitiveness of these firms depends on the competence of the Jamaican government in designing policies that improve the quality and stability of the home environment.

From the foregoing analysis, it is evident that, in an increasingly liberalized trading environment, the future viability of local manufacturing firms in Jamaica rests on the purposeful and concerted actions of both firms and government.

NOTES

1. The Papageorgiou *et al.* study is one that has been challenged by other researchers. For example, Greenaway (1993) has found weaknesses in the methodology used in this study.
2. Small countries, as measured by population, landmass or national income, have open economies as seen in the share of trade in their GNP or GDP, which is often over 100 percent. This high degree of trade means that these countries are extremely vulnerable to exogenous shocks in the international environment, and thus are highly sensitive to changes in global trading environment. Hence, they would be extremely vulnerable to the increasing liberalization of trade. For further discussion on this issue, see Armstrong and Read (1998).
3. CARICOM, which was formed in 1973, grew out of the Caribbean Free Trade Association (CARIFTA), created in 1968. CARICOM currently includes the following member states: Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago. Anguilla, the British Virgin Islands, and the Turks and Caicos are associate members of the Caribbean Community.
4. The commonly used measure of country size is population because it is the most easily available variable (Armstrong and Read, 1998). However, it is the threshold to be used that is the subject of debate. Some researchers use an upper limit of three million (ibid.), while others use less than five million (Demas, 1965). Countries with populations of less than one million are invariably characterized as microstates (Caldwell *et al.*, 1980).
5. This section draws heavily on King (2001).
6. King (2001, p. 8) notes that one of the main objectives of state populism was social equity. He posits that, given the strong performance of the economy during the previous decade, the then administration under the guidance of the Prime Minister, Michael Manley, was less preoccupied with achieving sustained economic growth than with achieving social equity during this period.
7. The Seaga regime, which ruled Jamaica from 1980 to 1989, was publicly committed to a free market, private enterprise-based development model. Prime Minister Edward Seaga and the then US President, Ronald Reagan, 'teamed up to make Jamaica the showcase of capitalist development in the Caribbean to demonstrate to the world the merits of the free market model' (Stephens and Stephens, 1989, p. 1). However, despite US$1 billion in development assistance and the close friendship of the Reagan administration, the Seaga regime failed to transform Jamaica's economy (Ashby, 1989).

8. The 1997 financial crisis is one of the internal factors that determined the evolution of the Jamaican economy in the latter half of the 1990s. The government's attempts to resolve this crisis resulted in the cumulative cost of 37 percent of GDP by the end of 1998 (King, 2001). For an illuminating discussion of the factors leading to Jamaica's 1997 financial crisis, see Campbell and Barclay (2004).
9. The *Jamaica Exporter Directory* provides a listing of both foreign and local firms that are involved in international business activities in Jamaica. It also includes firms that are *solely* involved in foreign distribution activities. Hence, the author sought the assistance of industry analysts in identifying wholly locally-owned firms, which were engaged in production, exporting and/or foreign direct investment. Unfortunately, the use of these analysts may have resulted in some bias in sample selection.
10. It should be noted that one of firms studied manufactured heavy industrial chemicals, which are inputs to other manufacturing processes. It will be very difficult for this company to differentiate its product since it is manufactured according to its client's exacting specifications.
11. It could be argued that the small size of this market (approximately three million people) prevents firms from attempting to change their product to match the needs of this market. Moreover, one could assume that the composition and character of the regional and home markets are fairly similar.
12. Jamaica and the rest of the Caribbean continue to experience high rates of international migration. For example, Adams (2003) estimated that the number of Jamaican immigrants in the US in 2000 was 117 199, almost 5 percent of Jamaica's total population.
13. Since the early 1990s, policymakers have used restrictive monetary policies to manage the Jamaican economy. For further discussion of this issue, see King (2001).
14. Some scholars note that the small size of the local market affects the availability of local supplier industries. Others argue that supplier industries in developing countries do not operate at internationally competitive levels, hence liberalizing trade in this area would allow domestic exporters access to intermediate supplies at lower cost and higher quality than obtained prior to trade liberalization. However, the members of the local business sector of Jamaica posit that, when compared to their international competitors, the lack of a local supply capability increases their operating costs since they have to pay higher transportation costs for intermediate inputs and raw materials as well as incurring higher inventory costs because of the need to hold higher levels of supplies than would be necessary if supplies were available locally. The author thanks Alvin Wint for his assistance in clarifying this issue.

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13. Home country governance quality and the 'bonding' hypothesis: evidence from industrialized, emerging-market and less-developed countries

Paul M. Vaaler and Burkhard N. Schrage

This study empirically examines support for an emerging theoretical perspective linking country institutional quality to firm decisionmaking about where globally it should establish legal and financial presence.[1] The so-called 'bonding' hypothesis (Coffee, 2002) argues that firms domiciled in countries with poor-quality laws, regulations and policies related to governance may cross-list[2] their securities on share markets located in countries with more rigorous governance standards. Typically, firms with poor home country governance quality (HCGQ) will cross-list in the US. 'Bonding' to more rigorous governance standards improves access to investor capital, particularly from non-controlling minority shareholders. This, in turn, lowers capital costs and increases firm value.

This hypothesis is important because it may help academic researchers, public policymakers, investors and managers understand how and why there has been a flood of new cross-listings by foreign firms in US securities markets since the 1990s. The number of foreign firms listed on the New York Stock Exchange and NASDAQ grew from 170 in 1990 to 750 in 2000, with trading volume in these firms reaching more than $750 billion (Coffee, 2002; Bank of New York, 2002). The proliferation of new cross-listings in US securities markets has coincided with the proliferation of different explanations for the trend, including overcoming local capital market segmentation and increasing liquidity (Foerster and Karolyi, 1999), advertising to customers (Dieckhaus, 1992), enhancing foreign employee benefits (Rock, 2001), and facilitating overseas mergers, acquisitions and other major corporate transactions with private and local sovereign counterparties (Saudagaran, 1988, 1990). The bonding hypothesis offers yet another explanation for the cross-listing trend.

As recent literature reviews by Karolyi (2004) and Benos and Weisbach (2004) show, the bonding hypothesis derives from a multidisciplinary research heritage encompassing economics (La Porta *et al.*, 1997), finance (Mitton, 2002; Reese and Weisbach, 2002; Doidge *et al.*, 2004), management (Siegel, 2003) and law (Licht, 2003). The main assumptions of the hypothesis apply to foreign firms from all countries with poor HCGQ relative to the US. Fanto (1996), Benos and Weisbach (2004) and others (King and Segal, 2004) suggest that the prime targets of this hypothesis are foreign firms from neither the most nor the least developed countries, but from countries often characterized as 'emerging-market' or 'emerging-economy', or 'transition' or 'frontier'.[3] Cross-listing by firms from such countries with mid-range HCGQ may show greater potential to enhance firm value through credible bonding to US securities laws without offsetting bonding costs to key firm insiders.

Given the great interest in this hypothesis, it is surprising that there is, to date, little published empirical research indicating a direct link between HCGQ and US cross-listing levels. What evidence there is suggests only indirect and sometimes tepid general support for the bonding hypothesis (Reese and Weisbach, 2002; Doidge *et al.*, 2004; Doidge, 2004). Several recent papers argue that the expectation of legal enforcement of protections important to minority investors through bonding is greatly exaggerated, thus undercutting a central tenet of the bonding hypothesis (Fanto, 1996; Licht, 2001a, 2001b, 2003; Siegel, 2003).

Our study seeks to reconcile the basic concept of bonding with the mixed empirical results and criticism it has generated to date. In line with the basic concept, we, too, hold that the quality of a firm's HCGQ provides incentives for it to cross-list its shares in US markets in order to signal credibly that it will provide greater protection to minority shareholders, raise capital at a lower net cost and create firm value. At the same time, the value-enhancing aspects of bonding to foreign firms must be balanced against the constraints bonding may impose on firm managers, dominant shareholders and other firm 'insiders' seeking to appropriate such value. These insiders may have substantial disincentives to cross-list if they perceive that bonding will decrease their ability to appropriate firm value – legally or otherwise – relative to the broader firm value creation bonding permits. We argue that the tradeoff between firm value creation and firm insider value appropriation leads to quite different net incentives to cross-list across countries with varying governance quality. Specifically, we propose that firm insiders in countries with both very low (for example, Nigeria) and very high (for example, Switzerland) HCGQ are likely to perceive a tradeoff with net disincentives to cross-list and bond. Countries with mid-range

HCGQ (for example, India, Thailand, Argentina), however, may provide these same insiders with substantial net incentives to cross-list and bond. Thus, we predict a negative relationship between HCGQ and US cross-listing levels but only for countries with mid-range HCGQ measures. Panel data and related analyses of countries with varying levels of HCGQ and US cross-listing levels from 1996–2002 provide consistent support for this prediction as well as more precise identification of mid-range countries where firm insiders are most likely to cross-list for bonding purposes.

To make these points in greater detail, we divide the remainder of this chapter into five sections. Section 2 below defines basic concepts, including governance and HCGQ, and reviews key background literature on cross-listing and bonding. Section 3 develops the reasoning underlying our prediction of a negative relationship between HCGQ and US cross-listing levels for countries with mid-range (but not low or high) HCGQ measures. Section 4 details the empirical models, estimation approach, and data and sampling used to test our prediction. Section 5 discusses results from parametric and non-parametric analyses. Section 6 restates central research issues and results, and discusses their implications for academic research, managerial and investment practice, and public policy.

BASIC CONCEPTS AND LITERATURE

Governance and Cross-listing

Two concepts central to our study merit brief explanation at the outset: governance, and cross-listing. Rising interest in the bonding hypothesis among academic and policy researchers (Shleifer and Vishny, 1997; Kaufmann *et al.*, 1999a) and greater scrutiny by investors and regulators in US and foreign corporations have coincided with a marked increase in definitions of the governance concept, especially governance definitions focused on firms. Some are descriptive and others carry rather specific prescriptions for improved corporate governance in firms.[4] Perhaps the most influential recent guidelines for governance principles are those developed by the OECD in 1999 and applying specifically to firms. OECD (1999) describes governance as a system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those

objectives and monitoring performance. Some academic researchers, such as Shleifer and Vishny (1997), define corporate governance more broadly as ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.

Yet other definitions aggregate corporate governance with broader institutional notions of governance. World Bank researchers led by Daniel Kaufmann (Kaufmann *et al.*, 1999a, 1999b, 2003) describe the governance of firms as well as public organizations in terms of the formal and informal structures, policies and conventions directing the flow of valuable resources and providing oversight to assure their efficient use. Not surprisingly, this broader governance definition examines the integrity of broader political, legal and social institutional arrangements linked to these structures, policies and conventions. Recent international business research following Kaufmann's approach (Globerman and Shapiro, 2003) uses the term 'governance infrastructure' to highlight the broader (that is, private corporate governance and public organizational governance) scope of the governance concept. Our study also adopts this broader governance concept and related institutional assessments. We discuss the relative advantages of this approach in our methods section below.

The other key concept in this study is cross-listing. It refers to the additional listing by a firm on a stock exchange outside the home country, or to the less common situation where a firm bypasses its home market altogether and lists exclusively abroad. Academic and professional literatures (Coffee, 2002; Bank of New York, 2002) also use synonyms for this, including 'international listing' or 'foreign listing' or 'overseas listing'. If the foreign listing happens on a single foreign stock exchange in addition to the domestic market, it is often referred to as 'dual listing'. A multiple listing describes an international listing on more than one additional exchange.

Our study examines evidence of the bonding hypothesis. In recent research, the bonding hypothesis implies that the level of US cross-listing by firms from *any* foreign country should be negatively related to the quality of the foreign country's governance. We predict that the bonding hypothesis has more limited scope: it implies a negative link between US cross-listing and HCGQ but only for firms from foreign countries with mid-range HCGQ. After briefly reviewing other motivations for US cross-listing, we detail the basis for our own more limited formulation of the bonding hypothesis.

Factors Influencing the US Listing Decision

Since bonding is not the only motivation for cross-listing, we briefly note these other motivations and related empirical evidence. These motivations are described in great detail in a recent working paper by Karolyi (2004).

Market segmentation/investor recognition hypothesis for cross-listing

Perhaps the most often cited motivation for cross-listing securities is that investors want to avoid cross-border barriers to investment. These barriers could arise from regulatory restrictions, informational problems, or simply from lack of knowledge about a security (Merton, 1987). In recent studies, Foerster and Karolyi (1999) and Errunza and Miller (2000) estimate returns before and after US cross-listing through the establishment of an American Depositary Receipt (ADR) program. ADRs permit individuals in US markets to invest in non-US firms in US dollar-denominated receipts redeemable by specialized US financial institutions (depositaries) in the underlying shares. Strikingly, Foerster and Karolyi (1999) find that firms cross-listing through ADR issuance experience an unexpected increase in their stock price of 19 percent in the year *before* the listing. This unexpected increase is followed, however, by a *decrease* of 14 percent in the year after listing. Their finding suggests that ADR issuance does not necessarily improve firm value, but that firms with better value expectations simply tend to issue ADRs.

Liquidity hypothesis for cross-listing

Cross-listing may also be motivated by the need for greater share liquidity. Here, think, for example, of the bid–ask spread demanded by traders dealing in foreign firm shares. The greater the liquidity, the smaller the spread. Thus, US cross-listing will increase liquidity and lower the cost of capital to firms. Amihud and Mendelson (1986) provide a theoretical framework for controlling effects from changes in liquidity resulting from exchange listings. In their analysis of asset pricing and the bid–ask spread, they measure illiquidity as the cost of immediately executing a trade. They test the predicted spread–return relationship and find the empirical evidence consistent with increased liquidity from multiple exchange listings. Moel (2001) analyzes the role ADRs have in the liquidity and other attributes of domestic stock markets. He finds that ADR listings decrease liquidity in domestic stock markets owing to increased ADR order flow in US markets.

Other hypotheses for cross-listing

Aside from investment barriers and trading volumes, there are without doubt other motivations for cross-listing. They include marketing and employee relations (Saudagaran, 1988, 1990), and broader political and global strategy motivations (Licht, 2000). These motivations are distinct from the bonding hypothesis, which rests on legal and institutional protections associated with listing on a share market, rather than that market's size, trader profile and the like. This legal and institutional

bonding motivation is likely to be important across the globe – what investor would not want contract and property rights to be enforced – but particularly important in emerging-market countries seeking to strengthen these rights as part of their broader political and economic development.

Empirical Evidence of US Cross-listing and the Bonding Hypothesis

As mentioned above, voluntarily binding a firm to more stringent governance arrangements via cross-listing might be an important factor in the listing decision of firms. As La Porta *et al*. (1997, 1998, 2000) and others suggest, governance is, to a large extent, simply a mechanism by which investors can protect themselves against expropriation often by insiders like majority owners or top managers. Bonding to stringent laws and practices lessen that expropriation probability and lowers the risk premium minority investors require.

If the bonding hypothesis matters as motivation for cross-listing in countries with tougher laws and institutions to protect investors, then the dynamic it implies will also have public policy implications. Coffee (1999b) argues that it will contribute to a functional convergence among different country corporate governance regimes. Foreign firms can grow despite weak home country corporate governance quality by migrating to US laws and institutions. Unless the home country upgrades its own governance institutions and practices, growth in its share market will suffer. Coffee predicts a 'race to the top' benefiting both US and foreign-domiciled firms.

This novel hypothesis, with important implications for firms, investors and public policy, has to date found only scant supporting empirical evidence. A recent review of the literature by Benos and Weisbach (2004) concludes that results from empirical study of the bonding hypothesis are, at best, ambiguous. Biddle and Saudagaran (1989) and Saudagaran and Biddle (1995), for example, find evidence that stringent disclosure requirements *deter* the listing of foreign companies. Fanto (1996) notes several cases of foreign firm regulatory shortcomings to argue that Securities and Exchange Commission (SEC) disclosure requirements are not meaningful, and do not confer any truly exercisable rights on minority shareholders.[5]

Licht (2000, 2001a, 2001b, 2003) raises many alternative motivations for US cross-listing related to foreign firm 'opportunism' rather than bonding interests. US cross-listing, for example, provides foreign firm insiders with a chance to claim that they endorse more stringent standards of conduct just long enough to place debt and/or equity with US investors. Only afterwards do US investors uncover insider misdeeds with few remedies available at law to make investors whole. At best, firms may cross-list to signal their intent to improve conduct in the short term.

Siegel's (2003) study of US cross-listing by Mexican firms also leads to skepticism about the bonding hypothesis, at least where the hypothesis relies on legal enforcement mechanisms. He shows that cross-listed Mexican firms engaged in gross illegalities in Mexico attract no SEC investigation let alone regulatory sanctions, civil or criminal actions. Indeed, he shows that the SEC rarely if ever brings criminal actions against foreign firms. With such evidence and arguments, Siegel and others criticize the practical relevance of the bonding hypothesis based on legal enforcement; they suggest, however, that a more limited formulation of the bonding hypothesis based on cross-listing and the gradual reputation building by foreign firms in US share markets may be more useful.

Coffee (2002) responds to critics noting the paucity of SEC investigations and enforcement actions by arguing that, though few, SEC investigations and actions have been high-profile with substantial deterrence value (SEC enforcement action against the German firm, Veba AG, SEC Docket 974, September 2000). Additionally, many threatened regulatory, civil and criminal actions are settled before formal commencement. Though not publicly reported, these threatened actions represent robust enforcement of governance arrangements consistent with the assumptions of the bonding hypothesis.

Perhaps the most important empirical studies potentially supporting broad application of the bonding hypothesis come from Reese and Weisbach (2002), Doidge *et al*. (2004) and Doidge (2004). Reese and Weisbach (2002) examine links between the number of US cross-listings and the level of investor protection in the cross-listed firms' home countries using a sample of 2038 firms from 1985–95. Univariate statistics show that, on average, a higher proportion of firms from French civil law countries with weaker investor protections cross-list on the New York Stock Exchange or NASDAQ than firms from English common law countries (10.1 percent versus 7.4 percent). These market listings matter because they require foreign firms to register with the SEC while other 'over the counter' (OTC) listings do not. While these univariate results suggest support for the bonding hypothesis, related multivariate analyses do not. Addition of controls for firm size, home country size, and level of home equity market develop as well as additional governance-related controls reverse the legal origin effects: French common law country firms are less likely to cross-list than English common law country firms. On the other hand, their multivariate analyses do suggest that the same French common law country firms are more likely to issue secondary offerings of debt and equity in the US, once cross-listed. Reese and Weisbach surmise that the initial decision to cross-list in the US may not be driven by bonding interests. Once cross-listed, however, foreign firms gain an appreciation of the value bonding may confer, and exploit it through secondary offerings.

Doidge *et al.* (2004) take a different approach to investigating empirical support for the bonding hypothesis. With a sample of 714 cross-listed and 4078 non-cross-listed firms in the 1990s from 40 countries, they examine links between firm value and cross-listing status. They find that US cross-listed firms enjoy significantly higher valuations than non-cross-listed peers, a result that proves robust to the inclusion of various controls in multivariate analyses. Doidge (2004) takes yet another approach to investigating evidence of bonding when he estimates relationships between US cross-listings and the private benefits to insiders controlling the firm. His sample includes 745 firms domiciled in 20 countries over the period 1994–2001. 137 of these firms are cross-listed on US markets. He finds that private benefits to insiders are negatively related for certain US cross-listed firms (those cross-listed through Level II or III American Depositary Receipt programs). Both studies provide results consistent with the basic argument of the bonding hypothesis, yet they do not represent direct evidence linking HCGQ to higher cross-listing levels and/or likelihood.

Overall, this empirical work indicates only indirect and inconsistent evidence supporting the general prediction that HCGQ is negatively related to US cross-listing levels. Fanto (1996) and King and Segal (2004) suggest that the logic of (though not necessarily supporting evidence for) the bonding hypothesis applies with more force in the case of firms from emerging-market countries with mid-range institutional development. Benos and Weisbach (2004) echo this point in opining that firm insiders from emerging-market countries may perceive greater incentives to give up some private benefits of control for more than offsetting overall firm value creation through cross-listing. Among these countries, HCGQ is below the US standard but close enough to permit exploitation of the bonding opportunity. By contrast, firm insiders from less developed countries with HCGQ far below the US standard may not perceive the same favorable tradeoff of some private benefits from firm value appropriate for firm value creation from cross-listing. The costs of bonding with outside (US) governance regimes are too great. Firm insiders from industrialized countries generally have well-developed capital markets as well as institutions constraining insider value appropriation. The costs of bonding are not substantial, but neither is the additional value generated.

This more nuanced view of the bonding hypothesis corresponds with other research by Rodrik (1999) and Edison *et al.* (2004) finding that emerging-market countries with mid-level institutional development are more likely than either less developed or fully industrialized countries to benefit from trade liberalization, exchange rate decontrol and a host of other policies designed to give countries and their citizens access to international regimes promoting investment and economic growth. Without some minimal level of domestic institutional development, countries are

not able to exploit potential benefits related to changes in international regimes. With very high domestic institutional development approaching international regime standard, the potential benefits become trivial and incentives to exploit remaining differences from the domestic regime only marginal. Emerging-market countries with mid-range institutional development have the ability and the incentives to exploit these differences. Applied to the bonding context, it is only emerging-market countries with mid-range HCGQ quality that give firm insiders both the ability and the incentives to cross-list and exploit the net benefits of adhering to more rigorous US governance standards.

CONCEPTUAL FRAMEWORK AND HYPOTHESIS

Figure 13.1 illustrates this point. The x-axis measures HCGQ and the y-axis measures the level of US cross-listing by insiders for firms domiciled elsewhere. For less-developed countries located to the left of *HCGQ** and for industrialized countries to the right of *HCGQ*** we do not expect to observe the bonding hypothesis's negative relationship between HCGQ and US cross-listing levels. But for mid-range countries between *HCGQ** and *HCGQ*** we do predict this negative relationship:

> *Hypothesis: for countries with mid-range HCGQ we will observe a negative relationship between HCGQ and the level of US cross-listing by their firms.*

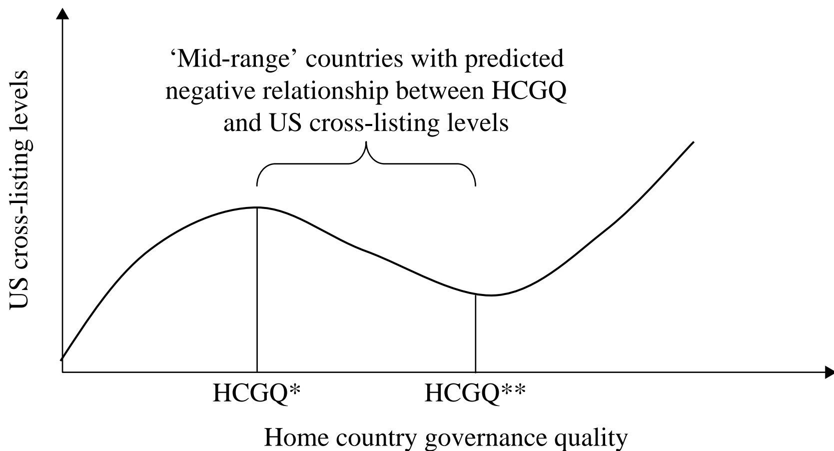

Figure 13.1 Conceptual relationship between home country governance quality and US cross-listing levels

We make no explicit prediction regarding the relationship between HCGQ and US cross-listing levels for firms from countries either with very low (less than *HCGQ**) or high (greater than *HCGQ***) HCGQ levels, though the analysis above suggests that the relationship may, in fact, be positive rather than negative. Insiders require some minimal HCGQ level before they are able to cross-list and exploit the potential benefits from bonding. For insiders from less-developed countries, increasing HCGQ may therefore be associated with slight increases in US cross-listing levels. Insiders from countries with HCGQ levels very close to the US standard see both trivial cost and trivial net benefits from cross-listing shares in the US. Even so, increasing (toward convergence with US) HCGQ in these countries may be associated with even lower barriers to cross-listing and adhering to US standards, and thus a positive rather than negative link between HCGQ and cross-listing levels. Accordingly, we present the broader relationship between HCGQ and cross-listing in less-developed, emerging market and industrialized countries as a cubic sigmoid or S-curvilinear relationship. It has upward slopes at either extreme and a downward slope in the mid-range as predicted in our more nuanced formulation of the bonding hypothesis.

METHODOLOGY

Empirical Model Terms and Tests

To understand whether US cross-listing patterns follow the S-curve illustrated in Figure 13.1 and to test our hypothesis regarding the negative trend between HCGQ and US cross-listing levels in mid-range countries, we define two empirical models. The first permits examination of the S-curve proposition:

$$USLISTING_{it} = \beta_0 + \sum_{j=0}^{7} \beta_{1+j} CONTROLS_{it} + \beta_9 HCGQ_{it} + \beta_{10}(HCGQ_{it})^2 + \beta_{11}(HCGQ_{it})^3 + \sum_{k=1}^{5} \phi_{1+j} REGION_i + \sum_{l=1}^{3} \phi_{1+j} YEAR_t + \varepsilon_{it}. \quad (13.1)$$

Model (13.1) permits investigation of the proposed S-curvilinear relationship between HCGQ and cross-listing. The dependent variable is *USLISTING*. It is the level of US cross-listing by firms from country *i* in year *t*. The *i* is an index running from one to 74 for each country in our sample. The *t* is an index running from one to four for each time period (year) in our sample

(1996, 1998, 2000, 2002) where comparable HCGQ measures are available. *USLISTING* is defined as a ratio. For each country *i* in year *t*, we divide the number of firms cross-listed in the US, either as American Depositary Receipt (ADR) listings or as direct listings, by the number of firms listed in home share markets. ADRs are the most common means by which foreign firms list their shares on US share markets. An ADR is actually a certificate entitling the holder to a claim on the firm's domestically listed shares at the value in US dollars of the ADR. Qualified US financial institutions are the typical custodians of these certificates. This arrangement permits US investors to 'hold' foreign shares priced in US dollars, trading on US markets, and available through US custodial institutions.

We measure *USLISTING* in two ways. The first broad measure is based on all ADR and related direct cross-listing measures ('All ADRs'). A second, more restricted measure is based on all direct cross-listings and ADRs at Level II or Level III but not at Level I. As Coffee (2002), Karolyi (2004) and Benos and Weisbach (2004) point out, ADRs of any type impose US regulatory requirements engendering greater transparency of firm behavior and standards of conduct providing more protection to minority investors. Level I ADRs impose fewer such requirements than Levels II and III. Indeed, there is the useful adage that Level I ADRs force foreign firms 'to put their toe in the water' of US securities regulation. Level II ADRs force foreign firms 'to wade' and Level III ADRs force them 'to swim' in those waters, as Level III imposes on foreign firms virtually identical regulations to those imposed on publicly listed and traded domestic US firms.[6]

On the right-hand side of (13.1) we first include eight control variables to capture variance in US cross-listing related to factors other than HCGQ specifically. The literature review above notes market presence, market segmentation, market liquidity, economic strength and legal institutional origin as other factors driving cross-listing levels. Accordingly, we first include a market presence control (*Market Presence*) measured as the dollar value of goods and services exported to the US from a country in a given time period divided by the number of countries from that country. US cross-listing levels should increase with greater US market presence. A second market segmentation control (*Market Segmentation*) assesses the availability of capital for entrepreneurs in a country for each time period on a scale of 1 (low availability) to 6 (high availability). US cross-listing should decrease with greater availability of capital in the home country. A third market liquidity control (*Market Liquidity*) is the dollar value of shares traded in a country's equity markets divided by the country's average market capitalization for the time period. Average market capitalization is calculated as the average of the end-of-period values for the current period and the previous period. Insiders from countries with more liquid home

equity markets will cross-list less in the US. A fourth economic strength control is proxied by average GDP growth for a country in a given time period (year) and the previous year. Insiders from wealthier, faster-growing economies have less need for cross-listing.

Four additional legal origin (0–1) variables categorize countries into either English (*English Origin*), French (*French Origin*), German (*German Origin*), Scandinavian (*Scandinavian Origin*) or Other (*Other Origin*) (for example, certain countries in the former USSR or Soviet Bloc). The French category is omitted. Countries with French legal origins are assumed to permit greater firm insider value appropriation and to deter minority investment. Thus, US cross-listing levels for firms from these countries should be higher. Insiders for firms domiciled in English common law countries will have the opposite incentives and lower US cross-listing levels. These eight controls follow previous recent empirical work controlling for cross-listing drivers other than those specifically focused on HCGQ (Reese and Weisbach, 2002; Doidge *et al.*, 2004). In addition, we include dummies for three of our four time periods (*Year*) (1998, 2000 and 2002, thus omitting 1996) and for five of the six geographic regions (*Region*) (Latin America, Western Europe, Central and Eastern Europe, Middle East–Africa and Asia, thus omitting North America and the Caribbean).[7]

The key independent variables in (13.1) are *HCGQ* and its higher ordered squared ($HCGQ^2$) and cubic ($HCGQ^3$) forms. HCGQ is a standardized measure $(0, \sigma)$ of a country's governance institutional quality relative to the US for a given time period. This measure can and does vary from year to year across the countries in our sample. While previous tests of the bonding hypothesis predict that *HCGQ* alone (linear) should be sufficient to explain cross-listing based on bonding, we propose that the relationship is not linear but follows an S-curve consistent with a positive cubic term. Accordingly we expect the coefficient for $HCGQ^3$ to be positive ($\beta_{11} > 0$).

$$
\begin{aligned}
USLISTING_{it} = \beta_0 &+ \sum_{j=0}^{7} \beta_{1+j} CONTROLS_{it} + \beta_9 HCGQ_{it} \\
&+ \beta_{12} QUARTILE2_{it} + \beta_{13}(QUARTILE2 * HCGQ_{it}) \\
&+ \beta_{14} QUARTILE3_{it} + \beta_{15}(QUARTILE3 * HCGQ_{it}) \\
&+ \beta_{16} QUARTILE4_{it} + \beta_{17}(QUARTILE4 * HCGQ_{it}) \\
&+ \sum_{k=1}^{5} \phi_{1+j} REGION_i + \sum_{l=1}^{3} \phi_{1+j} YEAR_t + \varepsilon_{it}. \qquad (13.2)
\end{aligned}
$$

A second empirical model (13.2) permits closer analysis of trends within the S-curve by partitioning it into four linear segments. In (13.2) all controls

are identical to those in (13.1) and the linear measure of *HCGQ* is the same. We then drop the quadratic ($HCGQ^2$) and cubic terms ($HCGQ^3$) and replace them with three dummies and three interactions with *HCGQ* permitting the assessment of the predicted negative relationship between *HCGQ* and *USLISTING* for four quartile segments. Quartile 1 represents countries with the highest (76–100 percent) *HCGQ* measures. Quartiles 2 (*QUARTILE*2) (51–75 percent) and 3 (*QUARTILE*3) (26–50 percent) represent the mid-range countries, while Quartile 4 (*QUARTILE*4) (0–25 percent) comprise countries with the lowest HCGQ measures. There is no separate dummy for Quartile 1, so in (13.2), *HCGQ* now proxies the relationship between HCGQ and US cross-listing for countries with the best quality governance institutions. *QUARTILE*2***HCGQ*, *QUARTILE*3***HCGQ* and *QUARTILE*4***HCGQ* capture differences in the relationship for countries from the other three quartiles. The test for Hypothesis 1 in (13.2) reduces to examination of linear combinations of *HCGQ* and its interaction with either of the two 'mid-range' quartiles (*QUARTILE*2***HCGQ* or *QUARTILE*3***HCGQ*) ($\beta_9 + \beta_{13} < 0$ (for 'mid-range' quartile 2) or $\beta_9 + \beta_{15} < 0$).

Estimation

The data for this study are organized as a balanced panel with both a time-series (1996, 1998, 2000 and 2002) and cross-sectional (76 countries) dimensions. We first estimate the model based on cross-listing levels for all ADR types (Levels I, II and III) using ordinary least squares (OLS) for preliminary examination and investigation of possible outliers. OLS estimation, however, may be problematic, particularly when analyzing a more restricted subsample of country cross-listings based on Level II and III ADRs only. Twenty of the 292 observations based on all ADR types show no US cross-listings; 151 of 292 observations based on Level II and III ADR types only show no US cross-listings. Accordingly, we choose an alternative panel Tobit estimator ('xttobit') available in Stata Version 8.0 (Stata Corp, 2003) to handle the possibility of estimation problems related to 'left-hand' censoring in the dependent variable. In addition to the multivariate panel Tobit analyses, we present additional parametric and non-parametric bivariate analyses, including scatterplot and linear estimates of HCGQ and cross-listing levels for countries in each of the four quartiles and related Lowess (locally weighted scatterplot smoother) estimates described in more detail below.

Data Sources and Sampling

Data for our sample come from several sources. ADR data for the *USLISTING* dependent variable in 1996, 1998, 2000 and 2002 come from the Bank

of New York's (2004) ADR department, and the websites of the NYSE and the NASDAQ. The number of listed domestic firms at year-end for 1996, 1998, 2000 and 2002 come from the World Development Indicators (WDI) of the World Bank (World Bank, 2004b). Countries were included in our sample if they had any cross-listings on US share markets in the 10 years prior to 1996 or during 1996–2002. This rule guards against sample selection bias related to censoring. If countries did not have any listings during the period of study or in the 10 years prior, they were deemed not to have firms able and willing to cross-list and, therefore, did not pose a censoring problem.

Our HCGQ measures come from the World Bank's Corporate Governance Project headed by Daniel Kaufmann (World Bank, 2004a; Kaufmann *et al.*, 1999a, 1999b, 2003). This source provides governance measures on a standardized scale covering 175 countries and four time periods (1996, 1998, 2000, 2002). The governance measures for each country and year have six components:

1. Country voice, political freedom and civil liberties;
2. Political stability, terrorism and violence;
3. Rule of law, crime, contract enforcement and property rights;
4. Level of graft, corruption in public and private institutions;
5. Extent of regulation and market openness, including tariffs and import controls; and
6. Government effectiveness and efficiency.

We take the simple average of these six components, and transform that average so that, in each case, a higher standardized measure corresponds to higher *HCGQ* (stronger rule of law, less corruption). Previous research by Globerman and Shapiro (2003) used these same measures to explain foreign direct investment based on governance institutional quality. Indeed, they refer to such measures as indicators of broader 'governance infrastructure' though Kaufmann and the World Bank also describe them as corporate governance or simply governance measures. Consistent with Globerman and Shapiro (2003), we assume that these *HCGQ* measures capture the impact of both specific policies (that is, corporate law protection for minority shareholders) and broader institutional assessments (that is, the reliability of domestic courts at fair adjudication of disputes involving such corporate law protections).

This *HCGQ* measure yields advantages not available in previous studies, including Reese and Weisbach (2002), Doidge *et al.* (2004) and Doidge (2004). In these studies, HCGQ-related measures were limited to one time period (1998 in Reese and Weisbach, 2002), while our *HCGQ* measure is

available across four time periods for most countries in our sample. More recent work on the link between HCGQ and cross-listing by Wójci *et al.* (2004) utilizes measures available for multiple years, but for firms from only a handful of countries, mostly OECD members, while our *HCGQ* measure is available for virtually every country on the planet.

On the other hand, their measurement of governance quality is arguably more directly related to corporate (firm) governance than our broader measures capturing both policy and institutional dimensions. These three previous studies, for example, include country-by-country measures of so-called 'anti-director rights' directly influencing the ability of minority shareholders to challenge firm policies and insiders (La Porta *et al.*, 1998, 2000). Yet these strictly corporate governance quality measures are few – from three to four depending on the study – and are available for only a single year, thus limiting analyses to cross-sectional designs. Our *HCGQ* measure is aggregated across a broader array of six governance-related components, and is available for four time periods, thus permitting cross-sectional time-series panel analyses. In addition, our *HCGQ* measure from review of multiple informants is validated through meta-study, and provides broader country coverage.

Data sources for the other controls came from several sources. They include the US International Trade Commission (2004) (*Market Presence*), the World Bank (2004b) (*Market Liquidity*, *GDP Growth*), the Milken Institute Capital Studies Group Capital Access Index (Milken Institute, 2004) (*Market Segmentation*) and LaPorta *et al.* (1998, 2000) (*Legal Origin* dummies).

The final sample comprises 76 countries. Two countries in the sample (Czech Republic and Slovakia) have observations for only two time periods (2000, 2002). All other countries have four (1996, 1998, 2000, 2002) observations, thus the gross sample size is 300. We rank and divide these 300 observations into quartiles in Table 13.1. Recall that the World Bank measures cover 175 countries while our initial sample includes only 76 countries with some history of US cross-listing since 1986. Not surprisingly, most of the countries excluded from our sample have had no US cross-listings since 1986 and had very low *HCGQ* measures. Their elimination moves the mean for this group from 0 for the 175 countries to 0.49 for our sample of 76 countries. Quartile 3 of our sample straddles the zero mean of the larger population of 175 countries. Thus, we focus our attention on this quartile of the sample for evidence of the negative relationship between HCGQ and US cross-listing for countries near this mid-range HCGQ measure.

Quartile rankings for the 76 countries in our initial sample generally conform to intuition. Quartile 1 roughly corresponds to industrialized democracies, while Quartiles 2 and 3 are made up largely of mid-range

emerging-market countries. Quartile 3 substantially comprises less-developed countries. Of the 76 countries, 24 exhibit different quartile rankings across time periods, with the bulk of such movement between Quartiles 2 and 3.

RESULTS

Descriptive Statistics and Preliminary Analyses

Descriptive statistics for our sample are presented in Column 1 of Table 13.2. Of particular interest are the means for the legal origin dummies. The omitted French legal origin category comprises the largest number of countries with approximately 39 percent. English common law countries are second with 30 percent, while German and Scandinavian legal origin countries sum to slightly less than 15 percent of the sample. Countries with other legal origins comprise the balance. Recall that French legal origin countries are relatively less favorable to minority investors. Thus, we expect to find that these countries will have higher US cross-listings as Reese and Weisbach (2002) found (did not find) in their univariate (multivariate) analyses.

Analyzing the sample of 300 observations based on Level I, II and III ADRs (All ADR), we find that there are only 21 potentially censored (zero cross-listing country) observations. We first estimate effects using models (13.1) and (13.2) using ordinary least squares. This permits us to obtain Cooks D measures of individual observation influence. In both estimations, the same eight Cooks D measures exceed 0.02 and are of an order greater than other Cooks D measures. These eight include all four observations for the Dominican Republic, three Mexico observations (1998, 2000 and 2002) and one observation for Ireland (2002). These three countries stand out qualitatively since there are special bilateral (Dominican Republic and Ireland) or multilateral (Mexico through NAFTA) treaties with the US substantially lowering the costs of cross-listing on US share markets. Given this combination of qualitative (that is, special treaty arrangements) and quantitative (that is, Cooks D) factors, we exclude these eight observations from the sample, leaving us with 292 observations covering 75 countries in 1996, 1998, 2000 and 2002.

Columns 2 and 3 report results from panel Tobit estimation of model (13.1), but without the squared and cubic *HCGQ* terms. These estimations provide a more general test of the bonding hypothesis and also provide insight on the behavior of our controls. The *HCGQ* term is positive in column 2 (All ADRs) and positive and significant in column 3 where we

Table 13.1 Home country governance quality scores (quartile membership) for each country, 1996, 1998, 2000, 2002[a]

Country	1996	1998	2000	2002
Argentina	0.36 (3)	0.37 (3)	0.24 (3)	−0.57 (4)
Australia	1.49 (1)	1.67 (1)	1.71 (1)	1.65 (1)
Austria	1.47 (1)	1.60 (1)	1.64 (1)	1.63 (1)
Bahrain	0.02 (3)	0.27 (3)	0.29 (3)	0.53 (2)
Belgium	1.23 (1)	1.17 (1)	1.22 (1)	1.44 (1)
Bolivia	−0.24 (4)	0.06 (3)	−0.17 (3)	−0.37 (4)
Brazil	−0.03 (3)	0.05 (3)	0.14 (3)	0.02 (3)
Bulgaria	−0.15 (3)	−0.07 (3)	0.10 (3)	0.26 (3)
Canada	1.45 (1)	1.70 (1)	1.70 (1)	1.64 (1)
Chile	1.03 (2)	1.05 (2)	1.16 (2)	1.28 (1)
China	−0.23 (4)	−0.25 (4)	−0.28 (4)	−0.33 (4)
Colombia	−0.24 (4)	−0.40 (4)	−0.57 (4)	−0.66 (4)
Croatia	−0.23 (4)	0.09 (3)	0.23 (3)	0.29 (3)
Cyprus	0.87 (2)	1.04 (2)	0.99 (2)	0.87 (2)
Czech Republic	0.78 (2)	0.76 (2)	0.69 (2)	0.80 (2)
Denmark	1.64 (1)	1.82 (1)	1.75 (1)	1.82 (1)
Dominican Rep.	−0.18 (3)	−0.20 (4)	0.08 (3)	−0.17 (3)
Ecuador	−0.40 (4)	−0.38 (4)	−0.67 (4)	−0.65 (4)
Egypt	−0.19 (4)	−0.14 (3)	−0.04 (3)	−0.36 (4)
Estonia	0.58 (2)	0.69 (2)	0.91 (2)	0.93 (2)
Finland	1.63 (1)	1.87 (1)	1.94 (1)	1.94 (1)
France	1.28 (1)	1.27 (1)	1.23 (1)	1.28 (1)
Germany	1.49 (1)	1.64 (1)	1.59 (1)	1.58 (1)
Ghana	−0.21 (4)	−0.17 (3)	−0.08 (3)	−0.15 (3)
Greece	0.60 (2)	0.72 (2)	0.85 (2)	0.86 (2)
Hong Kong	1.18 (1)	1.23 (1)	1.14 (2)	1.15 (2)
Hungary	0.63 (2)	0.97 (2)	0.91 (2)	0.95 (2)
India	−0.14 (3)	−0.04 (3)	−0.01 (3)	−0.18 (4)
Indonesia	−0.32 (4)	−0.88 (4)	−0.88 (4)	−0.84 (4)
Ireland	1.45 (1)	1.67 (1)	1.65 (1)	1.55 (1)
Israel	0.87 (2)	0.79 (2)	0.79 (2)	0.55 (2)
Italy	0.72 (2)	1.05 (2)	0.88 (2)	0.93 (2)
Jamaica	0.08 (3)	0.01 (3)	0.16 (3)	−0.02 (3)
Japan	1.08 (2)	1.15 (2)	1.22 (1)	1.14 (2)
Jordan	0.06 (3)	0.31 (3)	0.30 (3)	−0.01 (3)
Kazakhstan	−0.58 (4)	−0.52 (4)	−0.53 (4)	−0.67 (4)
Kenya	−0.56 (4)	−0.80 (4)	−0.79 (4)	−0.81 (4)
Korea, South	0.52 (2)	0.44 (2)	0.57 (2)	0.67 (2)

Notes: [a]The number in parentheses indicates quartile (highest quartile HCGQ score is 1 = 76–100%, 2 = 51–75%, 3 = 26–50%, 4 = 0–25% lowest quartile HCGQ score). Quartile 1 is typically composed of developed countries, whereas Quartile 4 is composed of less developed countries.

Country	1996	1998	2000	2002
Latvia	0.20 (3)	0.35 (3)	0.41 (2)	0.63 (2)
Lebanon	−0.19 (4)	−0.03 (3)	−0.23 (4)	−0.43 (4)
Lithuania	0.22 (3)	0.30 (3)	0.46 (2)	0.69 (2)
Luxembourg	1.53 (1)	1.72 (1)	1.85 (1)	1.81 (1)
Malawi	−0.43 (4)	−0.24 (4)	−0.26 (4)	−0.42 (4)
Malaysia	0.61 (2)	0.53 (2)	0.30 (3)	0.44 (2)
Malta	0.56 (2)	0.92 (2)	0.79 (2)	1.15 (2)
Mexico	−0.11 (3)	−0.08 (3)	0.04 (3)	0.13 (3)
Morocco	−0.12 (3)	0.09 (3)	0.14 (3)	−0.04 (3)
Netherlands	1.70 (1)	1.93 (1)	1.90 (1)	1.83 (1)
New Zealand	1.72 (1)	1.85 (1)	1.67 (1)	1.80 (1)
Nigeria	−1.17 (4)	−1.12 (4)	−0.98 (4)	−1.19 (4)
Norway	1.65 (1)	1.82 (1)	1.59 (1)	1.74 (1)
Pakistan	−0.70 (4)	−0.62 (4)	−0.71 (4)	−0.84 (4)
Panama	0.075 (3)	0.29 (3)	0.31 (3)	0.16 (3)
Peru	−0.25 (4)	−0.12 (3)	−0.13 (3)	−0.22 (4)
Philippines	0.01 (3)	0.18 (3)	−0.07 (3)	−0.21 (4)
Poland	0.51 (2)	0.76 (2)	0.67 (2)	0.69 (2)
Portugal	1.16 (2)	1.38 (1)	1.24 (1)	1.31 (1)
Romania	−0.14 (3)	−0.08 (3)	−0.18 (4)	0.01 (3)
Russia	−0.57 (4)	−0.53 (4)	−0.83 (4)	−0.54 (4)
Singapore	1.62 (1)	1.73 (1)	1.80 (1)	1.66 (1)
Slovak Republic	0.27 (3)	0.28 (3)	0.46 (2)	0.62 (2)
Slovenia	0.69 (2)	0.85 (2)	0.90 (2)	0.98 (2)
South Africa	0.20 (3)	0.21 (3)	0.37 (2)	0.38 (2)
Spain	0.96 (2)	1.35 (1)	1.39 (1)	1.26 (1)
Sri Lanka	−0.28 (4)	−0.35 (4)	−0.38 (4)	−0.11 (3)
Sweden	1.61 (1)	1.76 (1)	1.76 (1)	1.79 (1)
Switzerland	1.71 (1)	1.98 (1)	1.92 (1)	1.88 (1)
Thailand	0.18 (3)	0.18 (3)	0.25 (3)	0.25 (3)
Tunisia	0.03 (3)	0.26 (3)	0.55 (2)	0.10 (3)
Turkey	−0.16 (3)	−0.21 (4)	−0.28 (4)	−0.26 (4)
Ukraine	−0.51 (4)	−0.63 (4)	−0.76 (4)	−0.59 (4)
United Kingdom	1.52 (1)	1.80 (1)	1.72 (1)	1.64 (1)
Uruguay	0.60 (2)	0.62 (2)	0.88 (2)	0.70 (2)
Venezuela	−0.40 (4)	−0.39 (4)	−0.60 (4)	−0.87 (4)
Zambia	−0.40 (4)	−0.18 (4)	−0.40 (4)	−0.57 (4)
Zimbabwe	−0.28 (4)	−0.45 (4)	−1.13 (4)	−1.33 (4)

Table 13.2 Descriptive statistics and panel Tobit regression results [a,b]

Estimator Variable	(1) Mean (Std. dev.)	(2) All ADRs	(3) Level II, III ADRs
Constant [β_0]		−0.095	0.026**
		(0.059)	(0.012)
Market Presence [β_1]	25 486.56	0.009***	0.003***
	(38 582.73)	(0.001)	(0.001)
Market Segmentation [β_2]	4.179	0.044***	−0.010***
	(0.691)	(0.014)	(0.003)
Market Liquidity [β_3]	48.692	−0.017	0.000***
	(59.775)	(0.000)	(0.000)
GDP Growth [β_4]	3.106	0.002	−0.001***
	(3.575)	(0.001)	(0.000)
English Legal Origin [β_5]	0.308	−0.019	0.004
	(0.462)	(0.018)	(0.004)
German Legal Origin [β_6]	0.082	−0.032	−0.015***
	(0.275)	(0.033)	(0.004)
Scandinavian Legal Origin [β_7]	0.054	0.008	0.037***
	(0.227)	(0.024)	(0.005)
Other Legal Origin [β_8]	0.184	0.014	−0.012
	(0.388)	(0.031)	(0.025)
HCGQ [β_9]	0.499	0.009	0.008***
	(0.840)	(0.015)	(0.003)
HCGQ^2 [β_{10}]	0.919		
	(1.105)		
HCGQ^3 [β_{11}]	1.180		
	(2.081)		
Quartile 2 [β_{12}]	0.250		
	(0.433)		
HCGQ * Quartile 2 [β_{13}]	0.186		
	(0.3557)		
Quartile 3 [β_{14}]	0.250		
	(0.433)		
HCGQ * Quartile 3 [β_{15}]	0.021		
	(0.089)		
Quartile 4 [β_{16}]	0.250		
	(0.433)		
HCGQ * Quartile 4 [β_{17}]	−0.133		
	(0.268)		
Control Premium [β_{18}]	0.141		
	(0.159)		

(4) All ADRs	(5) Level II, III ADRs	(6) All ADRs	(7) Level II, III ADRs	(8) All ADRs	(9) Level II, III ADRs
−0.034	−0.036***	0.076	−0.065***	−0.052	−0.056**
(0.103)	(0.012)	(0.078)	(0.016)	(0.088)	(0.026)
0.009***	0.003***	0.003***	0.003***	0.006***	0.002***
(0.001)	(0.001)	(0.002)	(0.001)	(0.002)	(0.001)
0.031	0.007**	0.014	0.015***	0.032	0.014**
(0.025)	(0.003)	(0.013)	(0.003)	(0.022)	(0.006)
0.000	0.000	0.000	0.000	0.000**	−0.003
(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
0.001	−0.001**	0.002	−0.001***	−0.001	−0.001***
(0.001)	(0.000)	(0.001)	(0.000)	(0.001)	(0.000)
−0.044	−0.009**	−0.005	−0.004	−0.003	0.008
(0.030)	(0.004)	(0.017)	(0.004)	(0.010)	(0.006)
−0.050*	−0.041***	−0.066***	−0.025***	−0.006	−0.031***
(0.026)	(0.004)	(0.019)	(0.003)	(0.009)	(0.004)
−0.037	−0.032***	0.002	−0.011***	−0.008	−0.002
	(0.004)	(0.023)	(0.004)	(0.016)	(0.005)
−0.011	−0.009	−0.010	−0.007	0.195***	−0.009
(0.034)	(0.018)	(0.022)	(0.016)	(0.027)	(36 171.860)
0.020	−0.019***	−0.025	0.019**	−0.019	0.015*
(0.032)	(0.004)	(0.041)	(0.007)	(0.020)	(0.008)
0.003	0.000				
(0.022)	(0.005)				
−0.007	0.010***				
(0.014)	(0.002)				
		−0.195***	−0.045***	−0.114***	0.000
		(0.072)	(0.014)	(0.011)	(0.016)
		0.174***	0.042***	0.096	0.007
		(0.057)	(0.011)		(0.014)
		−0.094	−0.010	−0.070***	0.025**
		(0.063)	(0.012)	(0.023)	(0.013)
		−0.070	−0.123***	−0.056	−0.127***
		(0.068)	(0.017)	(0.037)	(0.021)
		0.009	0.014	−0.040	0.057***
		(0.064)	(0.012)	(0.025)	(0.014)
		0.161***	0.007	0.013	0.023
		(0.053)	(0.012)	(0.030)	(0.017)
				0.174***	0.035***
				(0.033)	(0.012)

Table 13.2 (continued)

Estimator Variable	(1) Mean (Std. dev.)	(2) All ADRs	(3) Level II, III ADRs
Number of Observations	292	292	292
Wald Chi-Squared Statistic		115.50***	503.83***
Slope for Quartile 2 (Linear Combination of $\beta_9 + \beta_{13} = 0$)			
Slope for Quartile 3 (Linear Combination: $\beta_9 + \beta_{15} = 0$)			
Slope for Quartile 4 (Linear Combination: $\beta_9 + \beta_{17} = 0$)			

Notes: * $p<0.10$; ** $p<0.05$; *** $p<0.01$; [a] Robust standard errors in parentheses; [b] results reported in columns 2–9 include year and regional dummies, most of which are individually significant at $p<0.05$ and are jointly significant at $p<0.05$. Preliminary regression analysis of full sample (All ADRs) identifies eight outliers with Cook's D values >0.02 (i.e., all observations of Dominican Republic; Mexico, 1998, 2000, 2002; Ireland, 2002). There are 292 observations to analyze after excluding these eight outliers. Results robust to the inclusion of country (not regional) dummies. Additional results are available from authors on request.

recalculate US cross-listing levels based on Level II and III ADRs only ('Level II, III ADRs'). These findings contrast with the bonding hypothesis's predicted negative relationship between HCGQ and US cross-listing. If ending with these results, we might conclude, as many critics have, that the bonding hypothesis lacks any direct evidentiary support. Recall that Level II or Level III ADRs require firms to make a greater commitment to US governance institutions: they are wading or swimming rather than merely toeing the waters of US regulations. Accordingly, we focus on the results in column 3 (Level II, III ADRs) to assess whether our control terms enter with predicted signs and significance. Five of the eight controls exhibit the predicted sign and four of these five are significant at $p<0.01$. Countries with firms having greater market presence, less capital access, less economic strength and/or German legal origin tend to have higher US cross-listing levels.

Panel Tobit Estimates with Cubic and Quartile Model Specifications

Results from panel Tobit estimation of model (13.1) in full are given in columns 4 (All ADRs) and 5 (Level II, III ADRs) in Table 13.2. Column 4's results yield no significant governance effects, which may again follow from noise introduced by measuring US cross-listing levels based on All

(4) All ADRs	(5) Level II, III ADRs	(6) All ADRs	(7) Level II, III ADRs	(8) All ADRs	(9) Level II, III ADRs
292	292	292	292	144	144
	630.15***		912.22***		471.97***
		0.149***	0.061***	0.077***	0.022*
		(0.044)	(0.009)	(0.020)	(0.012)
		−0.095	−0.105***	−0.075**	0.112***
		(0.059)	(0.017)	(0.038)	(0.021)
		0.135***	0.026***	−0.006	0.038**
		(0.036)	(0.010)	(0.026)	(0.015)

ADRs. When in column 5 we calculate US cross-listing levels based on Level II, III ADRs the coefficient estimate for $HCGQ^3$ (β_{11}) is positive and significant at $p < 0.01$ consistent with the Hypothesis.

This parametric result is confirmed with non-parametric bivariate Lowess analysis. Lowess computes a linear regression around each observation, x_i, with neighborhood observations chosen within some bandwidth (0.4 default bandwidth in Stata Version 8.0 'Lowess' procedure) and weighted by a tricubic function. Based on the estimated regression parameters y_i values are computed. These x_i, y_i combinations are connected yielding a Lowess curve. A higher bandwidth results in a smoother Lowess curve. Results from Lowess analysis of column 3 (All ADRs) and column 4 (Level II, III ADRs) are presented below in Figure 13.2. The figure indicates an S-curve with the second part (Level II, III ADRs) providing the predicted S-curve between HCGQ and US cross-listing levels most clearly. HCGQ relates positively to US cross-listing levels for both low *HCGQ* (less developed countries) and high *HCGQ* (industrialized countries), but relates negatively at mid-range *HCGQ* measures (emerging-market countries).

Model (13.1) estimates strongly suggest but do not formally test for the predicted negative relationship between HCGQ and US cross-listing for mid-range countries. Model (13.2) permits such formal testing by breaking up the S-curve into separate segments based on quartiles. Results from panel Tobit estimation of model (13.2) are given in columns 6 (All ADRs) and 7 (Level II, III ADRs). Results are again ambiguous when the estimate includes cross-listing levels based on All ADRs. Quartiles 1 (β_9) and 3 ($\beta_9 + \beta_{15}$) exhibit negative signs but are not significant at commonly acceptable levels. Quartiles 2 ($\beta_9 + \beta_{13}$) and 4 ($\beta_9 + \beta_{17}$) are positive and significant at

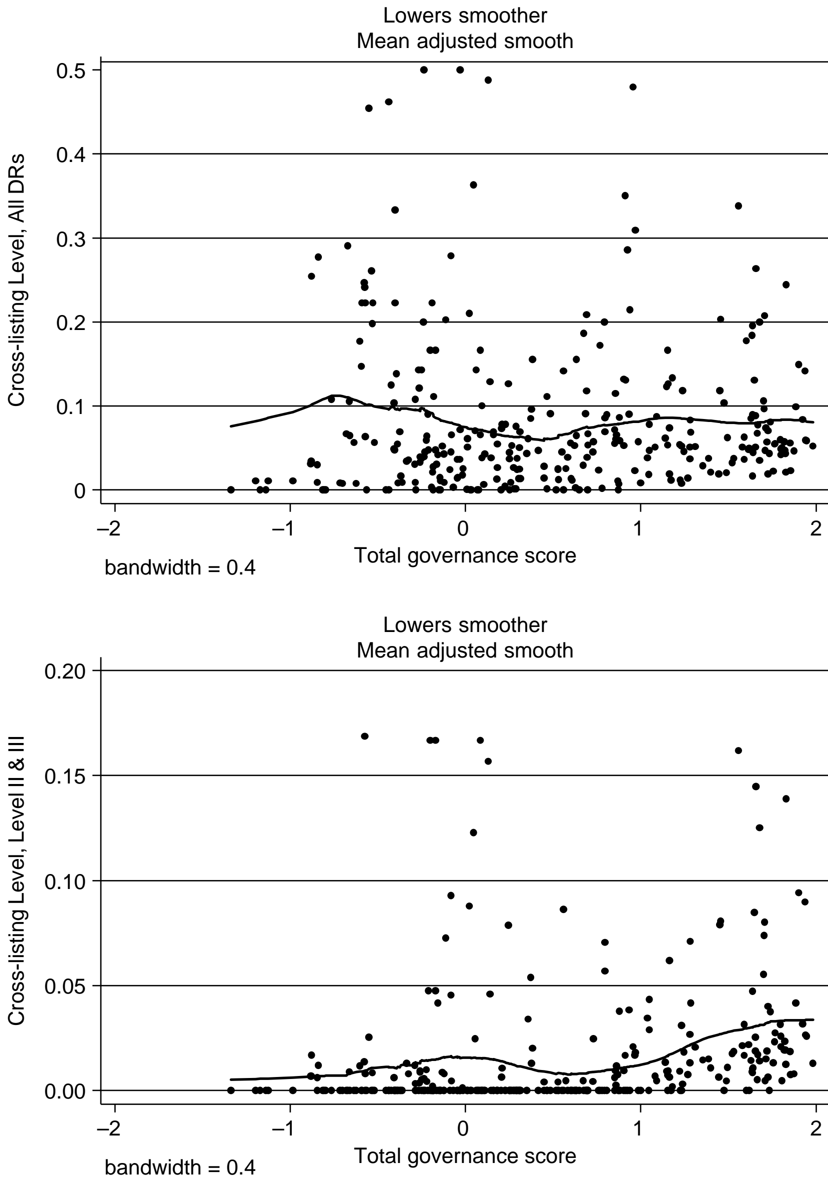

Figure 13.2 Non-parametric regression curve of US cross-listing levels on home country governance quality

$p < 0.01$. Together, they suggest some variation but no clearly negative and significant slope in either mid-range quartile as predicted in the Hypothesis.

This changes in column 7, in which measurement of US cross-listing based on Level II and III ADRs. Quartiles 1, 2 and 4 now exhibit positive and significant slopes, but quartile 3, which straddles the overall HCGQ population mean, exhibits a negative slope significant at $p < 0.01$. These results provide clear support for the Hypothesis and the bonding hypothesis for countries with mid-range HCGQ. Firms from countries with some minimal though not necessarily high level of HCGQ provide firm insiders with incentives to cross-list in the US for bonding purposes.

We confirm support for Hypothesis 1 through bivariate analyses. Figure 13.3 illustrates results from scatterplot and linear trend estimates of HCGQ and US cross-listing levels for each quartile using All ADRs (3A) and Level II, III ADRs (3B). Both parts confirm results reported in column 7. Quartiles 1, 2 and 4 exhibit positive slopes while quartile 3's slope is negative, slightly so in the first part (All ADRs) and decidedly so in the second (Level II and III ADRs). Cross-listing patterns consistent with the bonding hypothesis is significant, and it appears substantial for the mid-range HCGQ countries in quartile 3.

It is interesting to look more closely at quartile 3's membership. Several countries in quartile 3 correspond to intuitive emerging market categorization: Argentina, Brazil, Bolivia and Peru from Latin America; Croatia, Latvia, Romania and Slovakia from Central and Eastern Europe; Egypt, Morocco, South Africa and Tunisia from the Middle East–Africa; and India, Malaysia, Philippines and Thailand from Asia. Several of these countries make up popular emerging-market indices such as the Morgan Stanley Emerging-Market Bond Index, or Standard & Poor's (2001) Emerging Market Indices. On the other hand, several other arguably 'classic' emerging market countries do not fall into quartile 3: Chile (Q1–2) and Colombia (Q4) in Latin America; Poland (Q2) and Hungary (Q2) in Central and Eastern Europe; Israel (Q1) and Kenya (Q4) in the Middle East–Africa; and Singapore (Q1) and South Korea (Q2) in Asia. Results providing clear support in column 7 disappear if these countries are added to quartile 3. Such sensitivity suggests that governance quality differences play an important part in distinguishing emerging-market countries that show strong similarities along other institutional dimensions.

Robustness Tests

When cross-listing is measured using Level II, III ADRs we find results consistent with our broader research proposition and our specific hypothesis regarding the negative relationship between HCGQ and US cross-listing

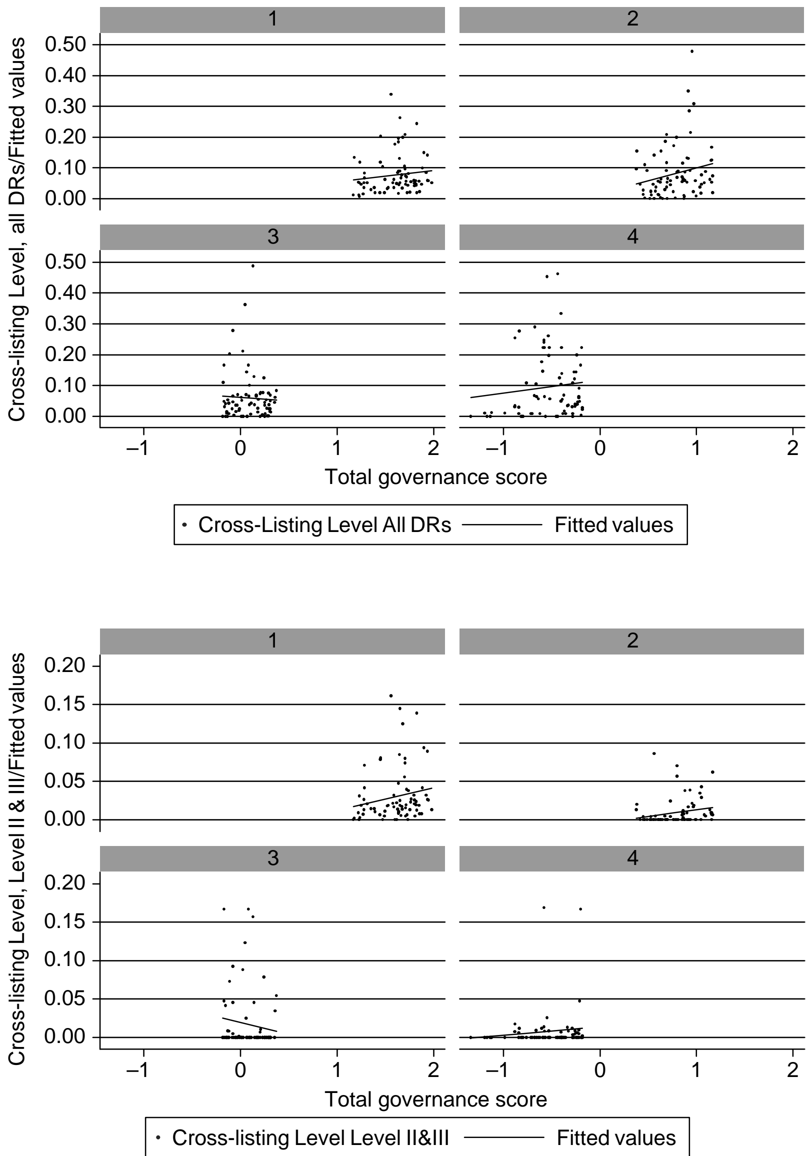

Figure 13.3 Scatterplots with linear estimates of US cross-listing levels on home country governance quality, by quartile

levels for firms from countries with mid-range HCGQ (that is, quartile 3). When cross-listing levels are measured using All ADRs, significance and even signs can change. As stated earlier, this contrast may follow from differing levels of bonding to US institutions facilitated by different ADR types.

Alternative explanations for this inconsistency are that certain control variables are missing from our models or are included but should be respecified. Such changes might result in a closer correspondence between results with the All ADR sample and the Level II, III ADR subsample. We investigate these alternative explanations in three ways. In our first investigation we replace the regional dummies with separate country dummies. Even with the substantial increase in right-hand side terms this change entails, results from estimation of models (13.1) and (13.2) are consistent with those reported in Table 13.2.

Our second investigation involves changes to model (13.2) terms. We replace the quartiles with quintiles. Again, we obtain the negative and significant slope observed in column 7 for the fourth of five segments where that fourth segment straddles the broader population mean (0) of *HCGQ* values.

Our third investigation involves the addition of new controls related to the basic logic of our research proposition. We proposed earlier that the bonding hypothesis would hold for countries with mid-range HCGQ (but not for countries with very low or very high HCGQ) because firm insiders in the mid-range were more likely to perceive a favorable tradeoff between increasing firm value and decreasing firm value appropriation capability when bonding to US governance institutions through cross-listing. Put another way, firm insiders should experience a net increase in overall insider wealth from bonding.

If so, then our results might benefit from inclusion of some right-hand side term that explicitly controls for the ability of firm insiders to appropriate firm value in different countries. One such explicit control is provided in a recent study by Dyck and Zingales (2003). They argue that countries where firm insiders have greater ability to appropriate firm value will also see would-be insiders (acquirers) paying larger premiums to take control of such firms and enjoy those same benefits. Countries with substantial constraints on firm insiders and their ability to appropriate firm value will not see as high a control premium when firms are acquired by others. Using this reasoning, Dyck and Zingales examine 393 control-transfer transactions in 39 countries from 1990 to 2000. On the basis of these transactions, they calculate a country-by-country measure of the premium acquirers pay for a controlling block of shares in firms.[8]

Using their control premium (*Control Premium*) measure of insider ability to appropriate firm value, we implement yet another panel Tobit

estimation of model (13.2) with 37 countries in our sample. This sample has 144 total observations. When cross-listing is measured with All ADRs, only one of the 144 observations exhibits zero cross-listing. When measured with Level II, III ADRs only 21 of the 144 observations exhibit zero cross-listing. Results appear in columns 8 and 9 of Table 13.2. The *Control Premium* term enters the equation positively and significantly at $p < 0.01$ in both cases. Countries where insider value appropriability is greater exhibit higher cross-listings in the US. Interestingly, inclusion of this new control does not change the negative sign on HCGQ effects for quartile 3 ($\beta_9 + \beta_{15}$) but now makes it significant at $p < 0.05$ when cross-listing is measured with All ADRs (column 8) and at $p < 0.01$ when cross-listing is measured with Level II, III ADRs. Whether we measure US cross-listing broadly or narrowly, we obtain results consistent with the bonding hypothesis for these mid-range countries, yet another indication of robustness.[9]

DISCUSSION AND CONCLUSION

Central Results

The central findings from our study of HCGQ, US cross-listing and the bonding hypothesis are clear. The predicted negative relationship between HCGQ and cross-listing levels does not have general application to firms from all countries. This negative relationship does find substantial empirical support when applied more narrowly to firms from emerging-market countries with mid-range HCGQ levels. This negative relationship is clearest when cross-listing is measured with Level II, III ADRs requiring greater commitment by firms to more rigorous US governance standards.

Results from estimation of model (13.1) yield evidence of the positive, then negative, and then positive S-curved relationship between HCGQ and cross-listing. Results from estimation of model (13.2) reveal where among the mid-range countries the negative slope linking HCGQ to cross-listing is located. Firms from countries with mid-range HCGQ cross-list consistent with bonding purposes. Firms from countries with very low or very high HCGQ do not. We reason that countries in this mid-range segment provide firms with minimal institutional development necessary as well as substantial incentives to exploit a potentially beneficial tradeoff from listing abroad in US share markets: substantial increases in firm value related to the commitment to honor minority shareholder rights through US listing more than offset constraints on firm insider ability to appropriate firm value. We find evidence consistent with that reasoning across our different parametric and non-parametric analyses, including robustness

tests where we explicitly control for insider ability to appropriate firm value in their home country.

Implications for Research, Practice and Policy

These results give rise to several implications for research, practice and public policy. For researchers, our methods and results suggest that previous empirical work would benefit from nuanced formulation and empirical study of bonding within specific groups of firms and countries. This study split up and examined bonding trends in countries based on HCGQ. Future research might examine support for the bonding hypothesis based on more fine-grained groupings, including HCGQ ranking among firms from particular geographic regions and cultures. Firms from, say, Latin America may not exhibit the same negative relationship between mid-range HCGQ and US cross-listing levels as we observed here more generally. Other moderating factors linked to geographic or cultural distance may be important. Alternatively, moderating factors may be linked to US treaty arrangements or related histories of political cooperation. Exploration of more fine-grained country groupings and linkages may also prompt firm insiders to perceive the cross-listing tradeoff between firm value creation and value appropriation differently from the way it was observed in this study.

Practitioner implications also follow from our results. For instance, our results suggest that firm insiders in select emerging-market countries with mid-range HCGQ enjoy flexibility in terms of governance institutional choices and the firm value creation and appropriation these choices promote. Unlike their counterparts in less developed or industrialized countries, they have flexibility to 'rent' better governance regimes consistent with wealth maximization incentives. This means that some emerging-market firms can engage in a new sort of 'governance regime arbitrage'. Firms can relocate their legal and financial presence without necessarily locating actual operations in these countries. For these emerging-market firms, advantages of multinationality no longer require physical location abroad. Legal and financial presence through cross-listing and bonding may also convey substantial competitive advantages.

Policymaking in these emerging-market countries might also draw important implications from our results. Cross-listing may help firm insiders select emerging-market countries, but it can also impede the development of local share markets (Moel, 2001). Firm insiders interested in listing abroad to gain the benefits from bonding may have less interest in building up their domestic shareholding and debt-holding base. Policymakers and financial regulators should be aware of these incentives, and consider

developing policies to upgrade and enforce more stringently domestic governance arrangements so as to lower the incentives of domestic firms to cross-list shares and drain liquidity from domestic capital markets.

Limitations and Future Research

We think these results make a substantial contribution to empirical research on the bonding hypothesis specifically and to emerging literatures on cross-listing and governance more generally. The study also has its limitations. One limitation pertains to the broader definition of HCGQ used in this study compared to more specific corporate governance measures used in previous recent work by Reese and Weisbach (2002), Doidge *et al.* (2004) and Doidge (2004). Our measure aggregates assessments of both specific governance policies and the institutions from which those policies come forth. They also required us to examine cross-listing patterns at the aggregate country-level rather than examine the likelihood of cross-listing for individual firms as in these previous studies. We weigh these methodological disadvantages against advantages of using standardized, validated and broadly available HCGQ measures for countries across multiple time periods. The panel structure of our study permits more fine-grained analysis across countries in a single time period and across time for each country. This methodological advantage seems especially important in a context where many of these countries are experiencing significant change in the quality of their governance institutions.

Going forward, we see many research opportunities. Follow-up work might look at the role of specific private and public organizations linked to governance institutional development. We have already mentioned the role that treaty arrangements or historic patterns of political cooperation might play in encouraging firm insiders from one country to bond through US cross-listing. Activities by other private organizations linked to governance development in emerging-market countries (investment funds, credit-rating agencies, specialized consulting companies) may also influence firm insider perceptions regarding the costs and benefits of bonding through US cross-listing. How do these governance-related private players influence firm insiders seeking additional wealth through cross-listing? Future work along this avenue and others should contribute further to research, practice and policy linked to bonding in mid-range and perhaps other countries with differing quality of governance institutions.

NOTES

1. Please contact Paul M. Vaaler regarding this chapter. The authors received helpful comments, criticisms and suggestions for this research from Sushil Vachani and other participants at the 'Transformations in Global Governance' conference held at Boston University School of Management in October 2004. The authors gratefully acknowledge financial support for this research from the Center for Business and Government at the Kennedy School of Government, Harvard University, from the Hitachi Center for Technology and International Affairs at the Fletcher School of Law & Diplomacy, Tufts University, and from the Academic Dean's Office of the Fletcher School.
2. Cross-listing is a process whereby a firm issues equity securities in another than its home jurisdiction. Academic and professional literatures (e.g., Coffee, 2002; Bank of New York, 2002) also use synonyms for this including 'international listing' or 'foreign listing' or 'overseas listing'. If the foreign listing happens on a single foreign stock exchange in addition to the domestic market, it is often referred to as dual listing. A multiple listing describes an international listing on more than one additional exchange.
3. Definitions for such countries abound but commonly include, as does Standard & Poor's (2001) definition, countries with income/GDP and stock market capitalization/GDP ratios below OECD country levels but above OECD country growth rates for the same.
4. Since corporate governance guidelines and codes of best practice arose mainly in the context of, and are affected by, differing national frameworks of law, regulation, and stock exchange listing rules, and differing societal values, there are many national institutions devising them. Davis Global Advisors, Inc. is a prominent US-based private sector organization establishing best practice guidelines and publishing cross-country analyses on corporate governance at individual firm, sectoral and country levels (see, e.g., Davis Global Advisors, 2001). Deminor Rating S.A. (Deminor Rating, 2003) is a European-based private sector organization providing similar services, which are described most recently in Wójcik *et al.* (2004). These organizations and others provide information on the corporate governance characteristics of a limited number of publicly listed companies domiciled in a handful of countries, mostly OECD members.
5. Taneda (2003) notes new regulatory obligations on foreign firms and renewed SEC interest in vigorous enforcement arising from passage of the Sarbanes–Oxley Act.
6. Benos and Weisbach (2004) provide a succinct description of differences in reporting requirements and liability issues distinguishing foreign firms using Level I, II and III ADRs. ADRs at all three levels expose the firm to risk of securities litigation under anti–fraud rules (*e.g.*, Rule 10b5). Level I ADRs are designed to give US investors access to existing securities of foreign issuers and cannot be used to raise capital (Palmiter, 2002). They exempt issuing firms from periodic reporting requirements under SEC Rule 12g 3–2(b). Thus, Level I ADR firms do not have to comply with US Generally Accepted Accounting Principals (GAAP) or with full SEC disclosure requirements; the firms need only furnish the SEC with copies of reports, shareholder communications and other materials required to be prepared under their home country regulations. The costs of setting up a Level I ADR program average about $25 000. Level II ADRs are traded on the NASDAQ, NYSE or AMEX and are usually used by firms seeking greater liquidity and investor recognition. Level II ADR firms are not exempted rom SEC Rule 12g 3–2(b), must register with the SEC under Section 12(b) of the 1934 Securities and Exchange Act, and must periodically disclose information consistent with Section 13 of the 1934 Securities and Exchange Act. This means firms must comply with US GAAP, report quarterly and annually, file SEC Form 20F and meeting listing requirements of the US exchange where they trade. Level II ADR programs average about $1 million to set up. Only Level III ADRs permit foreign firms to raise new equity capital in a public offering in the US. Consequently, it requires compliance with all Level II ADR rules (and permits listing on exchanges permitted with all Level II ADRs), and also forces compliance with strict liability provisions of Section 11 of the Securities Act of 1933 dealing with share offerings. Public offerings require issuers to prepared detailed registration statements

(usually Form F-1) which typically provide more current information than the typical Form 20-F. Level III ADR programs related to public offering in the US typically cost in excess of $1.5 million. (Palmiter, 2002; Coffee, 2002).

7. We also replace region with individual country dummies in analyses of our full (292 observations) sample using models (13.1) and (13.2) and obtain consistent results. These results are available from the authors on request.
8. Benos and Weisbach (2004) provide an excellent summary of the Dyck and Zingales (2003) approach. The block premium is defined by the equation: Block Premium $= \lambda B_b + (1-\lambda)B_s - \alpha(1-\lambda)(Y_b - Y_b)$. $B_{s,b}$ is the level of firm value extracted by the seller (buyer). $Y_{s,b}$ is the seller's or buyer's level of cash flow benefits per share. $\lambda \in [0,1]$ represents the bargaining power of the controlling shareholder (insider) selling his shares and $\alpha \in [0,1]$ are the cash-flow rights emanating from holding the controlling block. This number is the aggregate price differential that the buyer pays the seller. For the case where $\lambda = 1$, i.e., the seller has all of the bargaining power, the block premium reduces to B_b, implying that the buyer pays the seller the entire value of the private benefits. Dyck and Zingales rely on this case, implicitly assuming $\lambda = 1$, and estimate a regression: block premium/$Y_b = \alpha$(country dummy) + β(deal characteristics) + γ(buyer–seller characteristics) + δ(industry characteristics) + ε. The coefficient on the country dummies, α, is the estimate of the value appropriability associated with a typical firm insider in that country. Benos and Weisbach (2004) compare this control premium approach to alternative measurements of insider ability to appropriate firm value (e.g., Doidge, 2004).
9. In addition to these three robustness investigations, we repeated all of our estimations above after including in our calculation of US cross-listing levels so-called 'direct listings' (not ADRs) on US share markets by foreign firms. Direct listings are commonly used by Canadian, and to some extent, Israeli firms. Our results are completely consistent with those reported in this study. All of these results are available from the authors.

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