



The Bargaining Gap: Explaining the Stability of Domestic Foreign Investment Regimes and the Limitations on State-MNE Bargaining in a Globalized Economy

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Abstract

The 1990s have been characterized by a remarkable lack of state-MNE bargaining and overall stability and further liberalization of foreign investment regimes at the national and international level - a state of affairs that is poorly explained by the liberal bargaining model. The paper considers two cases of state-firm bargaining that occurred in Chile and Argentina in the late 1990s in the mining sector in order to assess the limits to the liberal bargaining model, and the explanatory relevance of recent attempts to re-conceptualize it. This paper develops the concept of the “bargaining gap” to represent the shortcomings of the obsolescing bargaining model. It suggests that host countries determine their bargaining preferences with reference to expectations regarding future FDI inflows, not the single investment in question.

Introduction

Over the last thirty years the rules and regulations which govern foreign direct investment in most developing economies (and in the developed world too) have become increasingly liberal and fixed - regardless of the combination of assets (or lack thereof) held, and strategies pursued by the foreign investor. This is a global trend which began with Chile’s unilateral adoption of its foreign investment statute in 1974, and subsequently has been promoted on a global level by the United States in bilateral investment treaties (BITs) and international organizations such as the World Bank’s Multilateral Investment Guarantee Agency (MIGA), the Organization for Economic Cooperation and Development (OECD), and the General Agreement on Tariffs and Trade (GATT). Such fixed rules have liberalized the investment climate to the extent that there are very few restrictions on foreign direct investors and even less opportunity for host country-multinational enterprise (MNE) bargaining as governments are increasingly tied into a web of international commitments. The global reality is that government policy towards MNEs is now as liberal as it was during the 1950s.¹

However, these changes have only been reflected in the bargaining literature to a limited extent. This paper examines two case studies of host country-MNE bargaining in the mining sector in Chile and Argentina in the late 1990s. Contrary to the expectations of the obsolescing bargain, attempts to renegotiate the investment bargain were frustrated by the central governments in both countries, which preferred to demonstrate their commitment to the stability of the “rules of the game” than extract more surplus from the foreign firms. Building on the insights gleaned from the case studies, the paper proposes the concept of the “bargaining gap” as a way to understand the limited nature of host country-MNE bargaining in the 1990s.

Wither the Obsolescing Bargain?

The liberal bargaining model pioneered by Raymond Vernon (1971) and Theodore Moran (1974) saw the inevitable conflict between the national interest of the host country and the global interests of the multinational enterprise as resulting in state-firm bargaining over the terms of investment at the entry, operational, and exit stage of the investment (how they would share the expected economic rent).²

The bargaining model assumes that there is a potential economic rent (both profits and non-tangible benefits called externalities) from any individual investment by a foreign firm. The TNC and the state determine how they will share the expected rent by bargaining over the terms of the investment. Each determines its bargaining position by assessing what it wants from the other party. Bargaining power is conferred by having some asset that the other party wants, and for which it cannot easily find a substitute. For example the firm may possess capital, technology, managerial expertise, proven access to export markets, while the state may possess human capital, internal market, or unique natural resources. The bargaining outcome that results should be a compromise based on strategy (wants) and structure (power resources and constraints) of the actors.³ Moran assumed that the original bargain granting the firm access to the country would favour the firm, which received a risk and scarcity premium for its investment. With the passage of time, once the firm had sunk its investment, and the government progressively improved its ability to regulate and even run the industry, the pressures to renegotiate the investment terms in favour of the government increased.⁴

The Resourceful Enterprise

Since this thesis was articulated, however, there has been considerable doubt as to whether the bargaining model accurately described the state-firm relationship. There is little doubt that the original view expressed by Moran and others, that the bargain inevitably obsolesced in favour of the state could not be generalized to any industry beyond the mining sector, or the temporal period of Moran's study which ended in the early 1970s.⁵ A series of studies conducted in the 1980s showed that MNEs were particularly innovative in avoiding attempts to renegotiate the original investment bargain.⁶ Manufacturing firms, in particular, had a greater range of policy options than extractive industries when faced with government pressure, including manufacturing new products, adding more value, incorporating more technology and even changing the product.⁷ Furthermore, firms could avoid an effective loss of control, even if forced to become minority shareholders, through a variety of strategies, including retaining control of strategic functions of the firm.⁸ The formation of alliances or links with domestic business groups and government departments or elites could also be an important source of defensive power.⁹

The empirical evidence from the 1990s has further undermined the claims of the liberal bargaining model – the decade was characterized by a remarkable lack of state-MNE bargaining and the further liberalization of foreign investment rules. One the one hand, new research has proven that the period of expropriations was limited both in time and geographically. The “mass” expropriations, which had characterized the 1960s and 1970s, were in fact limited to a small number of regimes (28) and by the 1990s it was possible to claim, without hyperbole, that expropriation was no longer a serious threat to the multinational enterprise.¹⁰ The United Nations *World Development Report* confirmed these observations in its overview of trends in foreign direct investment legislation. Of the 1035 regulatory changes to national legislation governing FDI that occurred between 1991 and 1999 only 5.9% were in the direction of greater restriction on foreign investment.¹¹ The signing of bilateral investment treaties between countries in the 1990s (96 countries signed BITs in 1999 alone) also extended the legal protection enjoyed by MNEs.¹²

To Bargain or Not to Bargain?

The change in state-firm relations and decline in the relevance of the liberal bargaining model has been addressed in the literature through what may be categorized as three major currents which, in terms of their approach to bargaining in state-firm interactions, may be categorized as asserting the irrelevance of bargaining; the displacement of bargaining; and the maximization of bargaining power.

Many theorists assert that bargaining no longer defines the MNE-host country relationship, and that the (relative) *irrelevance of bargaining* is reflected in a shift from a conflictive relationship to a more cooperative one.¹³

Governments and firms are viewed as increasingly interdependent in realizing wealth and competitiveness in the global marketplace.¹⁴ Recent research has also demonstrated that reducing the restrictions on MNEs can help better integrate them into the global competitive strategy of their parent companies. When this occurs, local subsidiaries are more likely to employ the latest technology and managerial techniques – which have greater spillover effects on the local economy.¹⁵ The central argument is that the strategy of both the the government, has changed since the era of “mass expropriations.” Edward Safarian writes, “The key to the new [liberal] approach to TNCs [MNEs] is that policy on FDI and policy on endogenous growth have converged. TNCs are regarded as central to the creation and diffusion of knowledge, within and between firms, and in cooperation with Governments.”¹⁶ That is to say that firms have shifted from resource and domestic-market seeking strategies – contentious with nationalists everywhere - to efficiency (or strategic-asset seeking) strategies, at the same time that countries have rejected the import-substitution model in favour of a more liberal and export-oriented approach.¹⁷

Secondly, the apparent absence of state-firm bargaining in the 1990s may be due to *displacement of bargaining* to other arenas. Ravi Ramamurti argues for a “two-tier” model that takes account of the bargaining which occurs between states in the bilateral and multilateral arena. He suggests that state-state bargaining shapes international investment regimes in such a way that it limits the range of state-firm bargaining options. In this conceptualization, strong states (in the international system) enhance the bargaining power of their firms everywhere.¹⁸ It is true that the aggressive promotion of liberal international rules on foreign direct investment by the United States, and such dominant international agencies as the the IMF, WTO, World Bank’s Multilateral Investment Guarantee Agency (MIGA), and the would-be Multilateral Agreement on Investment (MAI), has been accompanied by the adoption of such rules by developing countries.¹⁹

Furthermore, while national investment rules may be stable, there still exists considerable flexibility in some other areas. Privatization frameworks may be separate from FDI legislation and can demand the fulfilment of specific obligations which vary according to the firm being privatized.²⁰ In addition, the wave of foreign investment in public services since the mid-1980s has meant the government must play a larger regulatory role than when these industries were state-owned firms. Regulation also offers the possibility of significant discretion (and therefore bargaining) over key issues such as pricing policy.²¹ Likewise, other areas of legitimate governmental intervention, such as labour legislation, tariff rates, R&D policy, and subsidies may also be bargaining opportunities.

The third approach explains the failure of bargains to obsolesce through the *dominant bargaining power* of the MNE. In this scenario, either the MNE enjoys greater power resources than the state, or there are constraints which limit the state’s ability to act, or both. In mining and other extractive industries, for example, MNEs have reduced the likelihood of obsolescence through project financing their investments and using “prominent victims” such as international banks or multilateral institutions as financial contributors or guarantors. In such cases, expropriation of property, or renegotiation of contracts would be a “crime” not only against the particular firm involved, but also heavy hitting backers such as the World Bank’s International Finance Corporation.²² The use of cross-fault provisions in project financing mean that a host-country default on a IFC loan or guarantee could put other World Bank disbursements at risk, as well as a loss of reputation in other institutions which share directors with the IFC.²³

Certain structural characteristics of the TNC organization and its particular insertion in the host country economy also strengthen the power of the firm relative to the state. It is a unique source of high technology and knowledge. Global integration of activities may mean that any given investment is an insignificant part of the TNC’s overall structure. Production for export may make the firm more “footloose” and willing to close its operations if the terms of its investment are revised. At the same time the host-country is subject to an expanding web of commitments at the international level, which constrain its domestic actions. As a signatory to sovereignty limiting treaties such as the WTO and MIGA it must abide by certain rules regarding foreign investment. If it runs a deficit which requires stand-by loans, or seeks to renegotiate outstanding debts with creditor banks and countries, it must abide by IMF conditionality. Interestingly, much of the anti-globalization movement, arguing that the state is increasingly hostage to international capital in the era of globalization, accords with this position.

A Tale of Two Bargains

The limits on state-firm bargaining in a context of globalization, and the explanatory relevance of the approaches identified above will be examined through a comparative study of the obsolescing bargain in the mining

sector in Chile and Argentina in the late 1990s. The mining sector, a long-standing nationalist lightning rod with enormous sunk investments has, since the early work of Theodore Moran, been considered the paradigmatic example of the obsolescing bargain. Mining, and natural resource extraction for export in general, is also likely to be least sensitive to many of the factors identified above as limiting the bargaining power of the state. As the sector in which, according to theory, the obsolescing bargain is most likely to continue to exist, it is an ideal empirical test of its continued relevance.

With the advent of the military governments in 1973 and 1976 in Chile and Argentina, came newly liberalized foreign investment rules. Both Chile's DL600 and Argentina's Law 21, 382 have set the basic rules for foreign direct investment up until the present day. Although the Argentine legislation went through some modifications in the 1980s and 1990s, the stability of Chile's legislation has been unrivalled in the world. It has frozen the rules and regulations regarding foreign investment in Chile for over 26 years. Such fixed rules have liberalized the investment climate to the extent that there are very few restrictions on FDI and fewer opportunities for bargaining. This is even true in mining, which has been the classic example of the obsolescing bargain in state-firm relations.

Nonetheless, there have been occasional attempts to challenge the existing division of economic rent between the state and multinational mining companies. This section discusses two of these attempts: the 1997 tax reform proposal in Chile; and the 1997-2000 royalty dispute between Minera Alumbrera and the provincial government of Catamarca in Argentina. In both cases, renegotiation of the original bargain failed despite an objective increase in the bargaining power of the state since the original contracts were signed. The principal reason in the two countries, was the state's fear of damaging its reputation by changing the "rules of the game."

The Villarzú Tax Reform Proposal

In late 1997, in Chile, there were some indications that the ruling *Concertación* government intended to renegotiate the terms of its investment bargain with foreign firms in the mining sector. The initiative originated with a respected member of the government. In October of 1997, former president of the state-owned copper company, CODELCO, and then Secretary to the President (the second ranked position in the government), Juan Villarzú proposed that a special tax be levied on the "exploitation of non-renewable resources" in Chile.²⁴ This initiative, known as the Villarzú proposal, was a response to a popularly held view that the foreign mining companies operating in the country were not paying sufficient tax on profits to the government. The government's interest in pursuing this matter was later confirmed by the then-Minister of Mining César Díaz Muñoz. Villarzú broached the subject once again in February of 1998 while attending the World Economic Forum in Davos, Switzerland. Nonetheless, the contours of the legislation remained fairly vague, and the government only committed itself to conduct a study into the implications of a new tax, which included an assessment of some of the means used by mining companies to reduce their tax burden (accelerated depreciation, and use of the mining claim fees – *patente* – as a credit against taxes).²⁵ The proposed tax was to be applied only to new investments in Chile, not firms which had already established operations.

The debate around the Villarzú proposal was more than a debate about the suitability or legitimacy of certain kinds of taxes on the mining sector. At its core, it was about the nature of the foreign investment strategy. Was it necessary to channel FDI through instruments such as extra taxes, in order to increase the contribution of mining to economic development (as was believed in Chile prior to the dictatorship)? Or was it more important to establish the basic legal conditions to attract foreign investment? Party for Democracy (PPD) Senator, Sergio Bitar underlined this problem in a debate on the subject organized by the local mining magazine, *Minería Chilena*: "It will be difficult to repeat this mining boom, so the question is how do we transform mining into a lever for economic development which goes further."²⁶ Although some industry leaders recognized the need to increase the contribution of mining to development, mining executives as a whole unambiguously decried the government initiative as uninformed, discriminatory and negative for the industry. Hernán Hochschild, President of the National Mining Society (SONAMI), the association representing privately-owned mining companies, characterized the Villarzú proposal as "the most negative fact of the decade for SONAMI."²⁷

As previously indicated, the logic behind the Villarzú proposal was the need to compensate for the supposed failure of foreign firms to pay profits taxes to the government. This argument emphasized the contribution of state-owned CODELCO to national development, and simultaneously cast great doubt on the current and future

contributions of the private mining industry. In the mid 1990s, CODELCO was contributing more than \$US 1000 million per year to the national treasury, while the private sector contributed much less, approximately \$US 300-350 million (despite producing almost twice as much mineral).²⁸

The mining sector, due to its historical importance in the Chilean economy, and the staggering sums of money invested in the country, had attracted much nationalist attention, and criticism for not meeting the developmental needs of the country. Examples such as Exxon's Disputada de Las Condes, widely understood in media, government and business circles as not having reported profits in a single year between its initial investment in 1978 and 1998 fuelled this resentment.²⁹ Suspicion of foreign firms was also enhanced by the failure of most TNCs to publish their annual financial results. Most mining firms in Chile were not publicly listed companies, and consequently were not required to make their finances public. Mining executives tended to view this criticism as the result of misunderstanding the nature of the industry. One mining executive put it this way,

This industry is not as high margin as people think, but it moves massive amounts of money... Everything is enormous, contracts, etc, and that mesmerizes people, they forget how much you invest, and that sometimes copper is at \$1.20 and sometimes 70¢, which makes a big difference on the return.³⁰

The Villarzú proposal faced an immediate reaction the mining sector. Representatives from the largest companies organized a powerful lobby group with the assistance of Senator Ignacio Pérez Walker, a member of the congressional Mining Commission and the right-wing party, Renovación Nacional (RN). A three-pronged strategy was designed in which separate efforts targeted the internal fractures between the parties composing the governing *Concertación* including Ricardo Lagos, leader of the Party for Democracy (PPD); the highest ranking members of the Christian Democrats including the Minister of Economy Eduardo Aninat and then-President Eduardo Frei; and consensus was sought among mining firms and the regional centres of mining activity. Mining firms also agreed among themselves (once checking that the numbers supported their argument) to open their accounts to public scrutiny. This was a key element in making the technical argument that extra taxes were unnecessary and inadvisable. The lobbying effort culminated in a personal meeting between Ignacio Pérez Walker and President Eduardo Frei on December 29, 1998.³¹

The Villarzú proposal was opposed by all the mining executives interviewed for this study on 2 bases: a technical argument, that payment of the profits tax had only been deferred until amortization payments were completed; and secondly, a philosophical argument, that the reform "changed the rules of the game" and threatened to undermine Chile's reputation as a good investment climate.

On the first point, the Chilean legislation permitted accelerated depreciation of the amount invested. Only when enough financial profits had been earned to pay down the investment will real (taxable) profits be generated. Such accelerated amortization rules are common to many countries including Canada and Argentina, and are intended to act as an incentive for investors. When combined with taxation rules that specify a higher rate for repatriated profits (in Chile it is 15% on tax base, and an additional 20% on repatriated profits), it is a strong incentive for companies to reinvest in the country (instead of taking profits out). Thus, in Chile, mining companies were simply responding to the investment incentives created by the government - although admittedly, the military one. Since most mining investment in Chile was relatively new (within the last five to ten years), many companies were still amortizing their investments. With huge investments such as Escondida at \$US 2050 million, Collahuasi at \$US 1860 million, or Los Pelambres at \$US 1300 million, it would obviously take some time to pay down the debt and amortize the initial investment.³²

According to mining executives, comparison with the revenue generated by CODELCO, was also unfair. Taxation on CODELCO is significantly higher than on the rest of the industry in Chile (as it includes both profits tax and the special military tax on sales for a total of 55%) In addition to a higher rate of taxation, the state collects the rest of the surplus due to its ownership of the company. Furthermore, CODELCO had already amortized most of its assets, and was thus unable to use the principal deduction against profits used by other companies.³³ SONAMI commissioned and circulated a paper on taxation in the mining industry. It suggested that there was likely to be a significant increase in profits tax collected by the national treasury between 2000 and 2008.³⁴

However, perhaps the most compelling argument from the point of view of the government was the claim that the Villarzú proposal changed the "rules of the game."³⁵ Opponents of the Villarzú proposal argued that it would seriously damage the reputation of the country, and the foreign investment flows upon which it depended.

Over the 1990s, Chile had developed a well-earned reputation as the most stable and professional business climate in Latin America. This reputation had been fundamental in attracting foreign investment in the mining sector, but also in other sectors of the economy. The extent to which Chilean development in the 1990s was based on huge FDI flows made changing the rules of the game a risky proposition.

Furthermore, the international context was not propitious for following up the proposal. The Asian crisis and its effects on the price of metals, especially copper which fell below US 70¢ a pound in 1998, threw the entire mining sector into crisis, and the country into recession. Many firms, including foreign MNEs had to close unprofitable mines (such as Barrick Gold's El Indio, and Phelps-Dodge's Ojos del Salar). In this context, Chile's bargaining strength was low, and government efforts were focussed on maintaining existing employment levels in the industry.

The government abandoned the project due to a number of reasons: political opposition (within and outside the PDC); the lobbying efforts of the mining firms and Ignacio Pérez Walker in the Chamber of Deputies, Senate, and Congressional Mining Commission; and the low price of copper in 1998.³⁶ On February 18, 1998, President Eduardo Frei publicly reprimanded Juan Villarzú for his proposal, and stated that the government had no plans to increase the taxation rate on the private sector and was committed to stable rules of the game.³⁷

Minera Alumbrera Royalty Dispute

At \$US 1.2 billion, the Minera Alumbrera mining project was the largest single mining investment in Argentine history. Many considered it to be the test case for mining in Argentina. It was a test, above all, of whether the revision of Argentina's mining legislation in 1993 had really changed the investment conditions and attitudes of provincial governments in such a way as to make the country an attractive destination for foreign investors. Enrique Loncan, President of Barrick Explorations expressed it as follows,

Bajo la Alumbrera is the first megaproject established under the new mining legislation, and as a result puts to the test the consistency of the legal and fiscal framework that will determine its feasibility. As a consequence, the international community considers this investment to be a reference point.³⁸

However, the Bajo de la Alumbrera project became a "reference point" for the first major round of state-firm bargaining in Argentine mining. In this case, the Radical government of the province of Catamarca under Governor Arnoldo Castillo, where the mine was located, sought to increase the value of royalties paid by the foreign company. Unlike the Villarzú proposal, which never really got off the ground, the royalty dispute pitted both the federal government and Minera Alumbrera against the province of Catamarca. However, the principal argument against the changes was the same as that used in Chile - changing the rules of the game undermined the country's reputation as a good business climate.

Shortly after Minera Alumbrera had sunk half of its \$1.2 billion dollar investment, the government of Catamarca announced that it would be charging the company a royalty of 3% on the mine-head value of its production. However, unlike the firm's definition of "mine-head value" which included a deduction of all costs incurred between the extraction of the mineral and the first stage at which it was priced, Catamarca would not allow any deductions. This added significantly to the value of the royalty. Firm executives calculated that it effectively doubled the royalty to 6%, or an extra \$US 8-9 million per year.³⁹

However, the government of Catamarca found itself opposed by both Minera Alumbrera and the national executive.⁴⁰ From the viewpoint of the Nation, Catamarca's royalty stance undermined the rule of law, and put in jeopardy the entire structure of stable rules which was to make possible the development of Argentina's mining potential. It was an attitude emphasized by the President of Minera Alumbrera,

The uncertainty that exists as a result of the current situation, presents other entry barriers to those who wish to invest, not only in Catamarca, but also in Argentina... If the consensus falls apart at the first opportunity, independent of who is correct and who is mistaken, the victim is the confidence of those who contribute the capital and financing.⁴¹

The royalty issue was thus part of a larger problem faced by Argentina, the problem of the “rule of law” – and the fact that foreign investors (and local investors for that matter) perceived that they could not count on the impartial, effective rule of law.⁴²

The dispute had emerged out of the federal division of powers, which allowed the federal government to define national mining policy and legislation, but which gave the provinces the right to apply and enforce it. In May 1993, as part of its renovation of the national mining legislation, the federal government passed the Mining Investment Law 24,196, which limited the royalties that could be charged by the provinces to 3% of the mine-head value (*valor boca mina*). The Federal Mining Accord Law 24,228 then secured provincial agreement for these changes. Since Argentine legislation is made effective through its later regulation, it was assumed that “mine-head” value would be defined in more detail when the law was regulated. Mining executives claimed that the term was widely recognized in international mining circles, as meaning the value of the mineral at its first stage of commercialization (first stage at which a price can be attributed to it) minus the costs incurred between its extraction and that stage, including amortization.

However, Catamarca adhered to the federal legislation regarding royalties, on 17 November 1993, but not before passing its own law on royalties in October. The Catamarcan law accepted the 3% royalty, but failed to define the calculation of mine-head value - thus leaving space for its own interpretation of the formula. On December 28, 1993, the federal government issued Decree 2686 which regulated the Mining Investment Law, and defined *valor boca mina* as the price of the mineral at the first stage of commercialization with the deduction of costs incurred between extraction and sale. However, Catamarca’s regulation of its own royalty law did not accord with the federal definition, and neglected to add the deductions to the calculation of mine-head value.⁴³ According to the Catamarcan authorities, the fact that its royalty law predated its adherence to the federal law, and that it had the constitutional right to regulate its own laws, meant that its own interpretation of the *valor boca-mina* took precedence.⁴⁴ Since Catamarca had previously accepted the federal definition of “mine-head value” in its 1994 contract with another foreign company operating in the province (FMC Lithium), its stance seemed particularly opportunistic.

Catamarca was following a traditional bargaining strategy. Once the investment was sunk, it changed the rules of the game to extract more rent from the firm. From the province’s point of view, the firm would have little choice but to pay the relatively paltry surcharge demanded by the province. Interviews revealed that the government of Catamarca made the move because it thought its bargaining power was strong, and it could get away with it. Catamarca was the province with the hottest prospects for new mining development, with dozens of foreign exploration companies (juniors) operating in the region, and many deposits already identified and owned by the province. The province viewed the payment of royalties as legitimate compensation for the extraction of a non-renewable resource. In addition, it believed there was extra surplus to be gained at the Bajo de la Alumbrera site, which unlike many other sites, had a high mineral grade and relatively easy conditions of access (low altitude), and was therefore assumed to be highly profitable. At the core of the argument was the assumption that there were profitable opportunities in the province, and a little extra bargaining by the province would not change those fundamentals.⁴⁵

There were also political calculations behind the conflict. Catamarca had one of the highest unemployment rates among all the Argentine provinces, and by the start of operations in mid-1997 the development at the Alumbrera site had already frustrated high local expectations regarding its economic impact on the surrounding regions. Facing gubernatorial elections in March 1999 the governing party (a provincial variant of the Radical party, the Unión Frente Cívico) found it useful to portray Minera Alumbrera, the federal government, and the Peronist party governing at the federal level, as deliberately preventing Catamaricans from cashing-in on their birthright.

The national executive, Minera Alumbrera, and the government of Catamarca entered into negotiations to resolve the issue. All parties rejected taking the issue to the Supreme Court, although it clearly fell within the Court’s competence. The firm thought a political solution would offer more enduring stability, while the province recognized that a lengthy court battle would delay its ability to collect its royalty payments - if it could win in a court dominated by the appointees loyal to the President. The national executive on the other hand feared the damage to Argentina’s reputation that the publicity surrounding a court case might cause.⁴⁶

Negotiations took place through the Federal Mining Council at which all the provinces were represented, and the Bicameral Commission on Mining (of the Argentine Congress). The Commission consulted with the private

sector, the Council, and the province of Catamarca. As a result of these consultations, it proposed a definition of *mine-head value* which was to allow all deductions except amortization.⁴⁷ The new deal was to cost Minera Alumbreira 25-30% more than the original royalty law.⁴⁸

In addition, a Compensation Fund For Development was to be established. Paid for by federal monies, the fund was intended to compensate the province for the income lost from adopting the new definition of mine head value. The changes required modifications to the original Mining Investment Law, which had to be passed by both houses of Congress, and the provincial governments. The project law was passed by the Senate in June 1998, but without the support of the Catamarcan representative.⁴⁹ The final version of this law, sanctioned in November 1999 also failed to get the necessary provincial approval. By mid-2000 the conflict remained unsolved.⁵⁰

Interestingly, the solution to the royalty issue was not pursued through state-firm bargaining, but rather inter-governmental bargaining, in which the federal government of Argentina took the side of a *foreign* firm against a recalcitrant provincial government. The fundamental argument which motivated the federal government to move decisively against the actions taken by the province of Catamarca, was the fear that changing the rules of the game would negatively impact foreign investment flows if investors thought that their investments were vulnerable due to political and judicial insecurity. This was confirmed by the efforts made by the political authorities (both federal and provincial – other than Catamarca) to underline their commitment to the rules of the game, and condemn Catamarca for breaking them.

Is There A “Bargaining Gap?”

The “bargaining” experiences of both the Bajo de la Alumbreira royalty dispute, and the Villarzú proposal reveal the extremely limited nature of bargaining in the epoch of neoliberalism. Not only was the bargaining in those cases limited to relatively insignificant issues, but in both cases the attempt to extract more surplus out of the foreign firms failed (in significant part) because the central government realized that the country’s reputation as a good investment climate was worth more than what it would gain from the bargaining.

Curiously, the explanations for the apparent lack of bargaining in the 1990s summarized in the literature review do not seem to explain well the outcome in Chile and Argentina. On the one hand it is clear, that the liberal bargaining model does not adequately explain these truncated bargaining experiences. The Chilean case is perhaps more striking. In 1974, the military government in Chile promulgated a new statute on foreign direct investment, Decree Law 600. At the time, DL 600 was almost unique in the developing world for its liberal and permissive approach to foreign investment. It also marked a radical shift in Chilean policy. Under democratic governments since the mid 1960s, investment policies had become increasingly restrictive towards MNEs, culminating in Chile’s adherence to the Andean Pact’s FDI regime (Decision 24) and nationalization of the foreign copper companies under Salvador Allende.

What is particularly interesting about DL 600, however, is that (apart from some very minor adjustments) it froze the rules and regulations regarding foreign investment in Chile for 26 years. That is to say that changes in the relative bargaining power of the state and MNEs (which must have fluctuated over the last quarter century) have apparently not been reflected in the legal norms that govern foreign investment (which have remained constant). This defies all expectations of the liberal bargaining model. When Chile promulgated DL 600 in 1974 the country was in a deep recession, the government was running a large deficit and desperately needed foreign exchange, and foreign direct investment had all but dried up following the nationalization policy pursued by the Allende government between 1970 and 1973. In this context, it was reasonable to expect that Chile’s bargaining power was at an all-time low, and that the massive liberalization envisioned by DL 600 reflected these circumstances. By 2000 however, Chile had experienced fifteen years of solid growth, persistent balance of payments surpluses, and huge inflows of foreign direct investment. It would be pure nonsense to suggest that Chile in 2000 had the same or less bargaining power than Chile in 1974 - and yet DL 600 remained basically unaltered. Contracts signed in the 1970s did not obsolesce – even in the mining sector, the classic example of the obsolescing bargaining literature.

But it is not clear that the three alternative views, the irrelevance of bargaining, the displacement of bargaining, and the maximization of bargaining power offer much more compelling explanations for the stories of the Villarzú proposal and the Minera Alumbreira dispute. In terms of the irrelevance of bargaining – the strategy of host country may be more in tune with that of the firm (at least in terms of encouraging larger FDI flows) but in the natural resource sector where mines often operate as enclaves, we should not exaggerate the spillover effects

(beyond employment multipliers). The host will never have the kind of strategic symbiosis in this sector than it would in high-technology manufacturing for export. Therefore we cannot explain the failure of bargaining in terms of such a synergy. While it is true that the general relationship between host country and MNE is vastly improved over the 1970s, we also see that conflict and the desire to extract a greater share of the rent from the investment persists.

In this case, we cannot say that bargaining had been displaced to the international level. Taking Ramamurti's hypothesis as an example, that weak firms with the backing of strong states will triumph over host governments (and strong firms backed by weak governments will fail) – because of the influence of these home countries at the international level – we find it is falsified. Minera Alumbrera is an example of a weak firm (because of its sectoral location) backed by relatively weak governments – at that time it was owned by Australian and Canadian companies. Minera Alumbrera should have been the paradigmatic example of a bargaining player that would lose, instead, it lost very little. Nonetheless, a curious and unexpected displacement of bargaining did occur when the government of Argentina took the side of the firm against its own provincial government. This is probably explained by the executive's concern that the Catamarca-Minera Alumbrera conflict had implications far beyond the single firm itself. It was this concern that caused the displacement of bargaining and ultimately the relatively favourable outcome for the firm, not the displacement itself that was causal – as in Ramamurti's thesis.

Nor does it appear that the mining firms in both stories triumphed because their bargaining power was maximized. With the low price of copper in 1998, and the overall dependence of the Chilean economy on mining, there is little doubt that the bargaining power of the government was not at its highest point. Nonetheless, as the history of the foreign investment statute indicates, it was much improved over the time when DL 600 was promulgated. Perhaps most importantly however, the ability to tax (the issue of the Villarzú proposal) is not usually restricted by foreign investment regimes at the international or bilateral level. In Chile's case, the Foreign Investment Committee signs contracts with foreign firms committing the government to a certain tax rate for a certain period of time. But even this was not violated by the Villarzú proposal, which envisaged a tax on future investments. In this respect, neither the maximization of firm bargaining power, nor the web of international investment treaties, which may have constrained Chile's actions, can be viewed as explanatory.

Learning from the Case Studies

The two case studies of host country – MNE bargaining discussed in this article shed some light on the reasons behind the limitations on state-firm bargaining in the 1990s. In terms of the examples often provided in the literature, they are unique for three principal reasons:

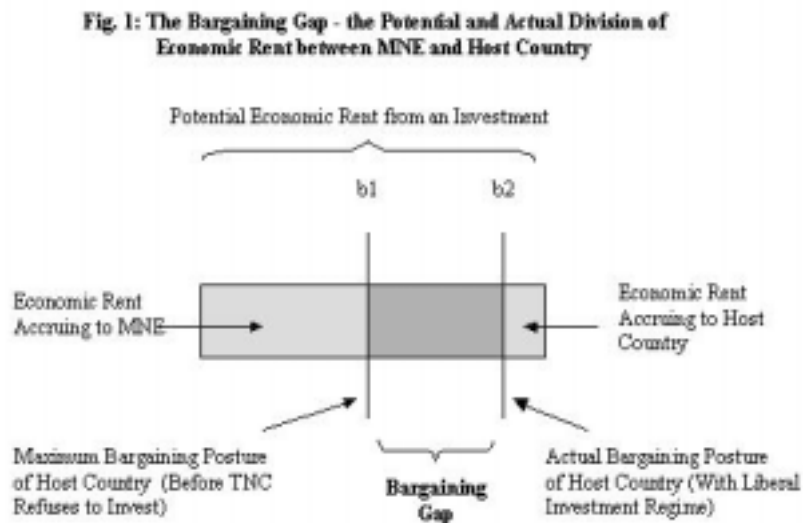
- 1) They demonstrate both bargaining attempts and the failure of those attempts in liberal economies with a history of openness towards foreign investors.
- 2) They show the importance of political factors in bargaining attempts and outcomes – particularly that firm-specific advantages (such as technology, changing product mix, etc.) usually considered to be determining in bargaining outcomes due to their effect on firm bargaining power were less important than political factors ostensibly unrelated to the firm. In Chile, the political strength of the right and its determination to resist regulatory encroachment was fundamental to the outcome. In Argentina, the federal-provincial division of powers and responsibilities played an important role.
- 3) The importance of the national strategy for economic development to bargaining. In particular, the dependence of both the Chilean and Argentine economy on large FDI inflows made both governments wary of doing anything to prejudice those flows.

Modeling the Limits to Host Country-MNE Bargaining

This section represents the limits on bargaining graphically in Fig.1 and uses the observations above to seek a theoretical explanation – that may be used to supplement the liberal bargaining model. The core of the problem is

viewed as the state's unwillingness to push its bargaining advantage in any one particular investment. When investment terms for a particular foreign investment are agreed upon, most bargaining theory assumes that both the state and the firm make an assessment of the advantages it wants from the other. Based on this assessment, the two parties bargain over the division of economic surplus, or rent, the parties expect will be generated by the investment. The entire theory is contradicted by the existence of fixed investment rules in countries like Chile and Argentina. This stability means that the host country does not make any assessment of the advantages brought by a single MNE or change its bargaining posture from one MNE to another.

If the host country makes no attempt to extract the maximum benefits from a foreign investment, then the its actual bargaining posture (none) falls significantly short of the maximum position it could hold before the MNE decides it is no longer profitable to invest. The difference between the potential bargaining position of the state (b1) - up to the maximum point where the MNE determines the investment is no longer profitable - and the actual posture (b2), I call the "bargaining gap." It is illustrated by Fig. 1.



Proposition 1: thus we can conceptualize the absence of (or limits on) host-MNE bargaining, as the difference between the maximum and actual bargain, or the value of b1-b2.

The two case studies also revealed the importance of political factors. This is not a new observation, for example, Moran's 1974 classic suggested that the 1954 *Nuevo Trato* in Chile (the first major liberalization of mining legislation) was part of a broader political deal to strengthen the political right. At this time the government traded lost economic rent (extra taxation on the foreign mining firms) for other political objectives. Other theorists have noted the general failure to consider political factors in bargaining models, Rhys Jenkins observed, "What is common to these [both liberal and dependency] approaches is an inadequate theorization of the state, and a tendency to view the state as unproblematic."⁵¹ In contrast, we assert that the state has both political and economic interests (it is never wholly autonomous from domestic social forces).

Proposition 2: economic rent may be traded for political goals.

The case studies also identified the principal motivation behind the host country's decision to fight against the bargaining efforts of its subnational jurisdiction in Argentina, and to abandon a controversial tax proposal in Chile, as fear of changing the "rules of game" and the impact that would have on future foreign investment inflows. It seems clear then, that a host-country does not define its bargaining posture towards a particular foreign firm,

without considering the effect of that posture on other (yet imaginary) foreign investors. When the development strategy of the country is dependent on FDI inflows and when there are few alternatives, it is hypothesized that the host country will give even greater consideration to its present decisions on imaginary future investors.

Proposition 3: host country bargaining posture is not only determined by reference to a particular state-firm relationship but also to the value (both economic and political) of a hypothetical future-projected series of bargains (fut-b).

Proposition 4: the host country also considers the value of a hypothetical future-projected series of second-best alternatives (fut-alt).

Based on these propositions, we can come to some conclusions regarding what conditions increase or decrease the limits on host country –MNE bargaining. As the value of the future-projected series of second-best alternatives (fut-alt) approaches the value of the future projected series of bargains (fut-b) the host country will strike a harder bargain and its actual bargaining posture (b2) will approach its maximum bargaining posture (b1). When the value of alternatives is equal or more than the value of future bargains, the bargaining gap will be zero, and the host country will maximize its bargaining power. When the bargaining gap equals zero, the calculation of the host country's bargaining posture will follow the normal logic of the liberal model. In contrast, the bargaining gap will approach its maximum size when there are almost no second-best alternatives (fut-alt=0).

It must be remembered that political factors are integrated into the determination of the state's bargaining posture. Political factors are therefore included in the calculation of value that can be attributed to a series of investments. Some vested economic interests with influence over the government may be willing to trade a lot of the potential economic rent from future foreign investment flows if more liberalized flows will damage their opponents politically and economically. Political factors may be more or less important depending on the context and perceptions of value associated with the hypothetical investment flows and hypothetical second-best alternatives. A neoliberal government supported by the country's largest conglomerates – as was the case in Argentina, and to a lesser extent Chile in 1998, would find the second-best alternative of increased state involvement in the economy as having very little value – thus tending to increase the size of the bargaining gap.

This means that the objective assessment of whether certain MNE or host country characteristics increase or decrease bargaining power or likelihood of regulation of a particular investment - indeed a table of such assets and powers is *de rigueur* in most books on bargaining - is influenced by other concerns: namely the calculations made by the government regarding the hypothetical future value of all FDI flows, and the alternatives which exist to those flows.

Conclusion

As economic crisis and declining FDI inflows have gripped Latin America over the last two-three years, and new left-leaning governments such as Argentina's Néstor Kirchner, Brazil's Luiz Inacio "Lula" da Silva, Ecuador's Lucio Gutiérrez, and Venezuela's Hugo Chávez seem to herald a new era in state-firm confrontation, it may be asked what the implications of the "bargaining gap" model are for predicting how the pendulum of host country-MNE bargaining will swing – towards more liberalization of foreign investment rules, or towards less?

On the one hand, declining FDI flows to the region, and the new-left ideology of many of Latin America's new leaders have undoubtedly reduced the hypothetical future value that governments attribute to these inflows. However, as a result of the crisis, the alternatives are also greatly reduced. It is unlikely that inflows of portfolio capital will reach 1998 levels for many years, and the ongoing fiscal crisis of the state, and completed privatization of many state-owned enterprises has not left governments in any position to re-start a nationalization process. As a result, the balance continues to weigh in the favour of less regulation, not more.

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