WORKING PAPER

The Multinational Corporation and the Nation-State System:
On the Matter of Control

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Franz Schurmann in Ideology and Organization in Communist China discussed at length the problems of control in the Chinese People's Republic and in the Soviet Union. It is our intention to borrow from this provocative work his classifications of control and to adapt them to the MNC. It is hoped that this framework will yield insight into the problems which confront those actors that interact with the multinational corporation. The use of such a framework is based on this author's assumption that the tensions which arise between the multinational corporation and the home government, the home and host governments, and the host government and multinational corporation are inspired by the perceived loss of control of one actor over the activities of the other actors.

"Every organization must assure that its members are loyal and perform in the way expected of them."¹ States are not unlike other organizations in this respect. They too seek loyalty from their citizens as well as respect from their visitors. States are sovereign, "A state occupies a definite part of the surface of the earth, within which it normally exercises, subject to the limitations imposed by international law, jurisdiction over persons and things to the exclusion of the jurisdiction of other states."² In addition, "National leaders are committed to preserving the authority of their state. National security, territorial integrity and non-intervention... express many of the crucial guidelines for international behavior."³
The multinational corporation is a relatively new actor in international politics. Although there has been much debate with regard to its "multinational" quotient\(^4\) it is an international actor, the power and influence of which remains to be determined. The multinational corporation operates in a nation-state system—a system in which the territorial space has been subdivided into a multitude of national units. This corporation is not sovereign with regard to any of its activities. It is incorporated in one country (the home) and operates in another (the host). It does not occupy a definite part of the earth’s surface.\(^5\) Although some might argue that it is sovereign in theory, we would argue that it is quasi-sovereign in fact. It seems that the main sources of MNC power stems from its discretion not to invest, that is, to withhold direct foreign investments from a particular state. Its power also stems from its ability to elude home and host government controls.

The problem of control is the focus of our paper. This problem arises in our "model" because there are at a minimum three international actors—the home government, the host government and the multinational corporation—each pursuing a different set of goals, tactics and strategies.

The home country is the state in which the parent company resides and is incorporated. Because the multinational corporation is incorporated there, it is the home country’s laws to which it must ultimately respond.

The host country serves as the field of action for the multinational corporation. It is the country in which the corporation makes its direct foreign investment.
The multinational corporation is defined as a corporation with headquarters in one country and a number of manufacturing subsidiaries in other countries. 6

Much concern has been expressed about the multinational corporation's power and influence. This paper is based on the assumption that, because the multinational corporation lacks sovereignty, its operations can be controlled by the home and the host. Whether such controls are enforced is another question. One might argue that the "myth" of corporate power, measured in terms of control over its own affairs, exists because the home and the host governments fail to exert total control over the corporation. The lack of such control by home and/or host makes available to the multinational corporation a degree of flexibility with regard to its operations. Whereas states seek sovereignty, the MNC seeks flexibility. The lack of control on the multinational corporation leads to a power vacuum which the multinational corporation could exploit. 7 This seems to be where the "myth" of multinational corporate power has its origin.

It is a myth because the apparent power of the multinational corporation will have to be relinquished to the home and/or the host whenever they seek to reassert their authority.

Controls

Control is apparently something which is desired by each of the three actors. Each of these actors in theory seeks to maintain control over its activities and over the activities of those who operate within what it perceives to be its territorial (or functional) jurisdiction. Yet total
control often cannot be achieved without sacrifice. The three actors interact with each other in such a way that interdependence among them occurs. The interdependence may be based on either political (more broadly, non-economic) or economic benefit or both. The sacrifice by the actor for such benefit or gain may be a loss of control over its own free action.

Control can be defined as the power to direct or to regulate the activities of others. In order to exercise some degree of control, an actor must cause others to act with restraint. Control can be used by states as a direct, as well as an indirect, means of assuring loyalty and compliance from the MNC. There are at least four types of control which a state can place on a corporation—economic or political, external or internal.

(a) **Economic Control**

Economic control aims at measurable corporate performance, at the result of decisions. Economic control checks the tangible results of the multinational corporation's economic actions against a standard imposed by the State. For example, a host government might require that a fixed percentage of profits be reinvested, or the home government might require the multinational corporation to repatriate a fixed percentage of its profits in order to achieve a favorable balance of payments.

(b) **Political Control**

Political control is directed against the multinational corporation, its political actions, decisions and behavior. This type of control pressures a multinational corporation to act "correctly" or punishes it if it acts
"incorrectly."

Correct (and incorrect) actions are to be judged by the governmental leaders of the host and of the home governments. The ultimate intent of this control is political.

(c) **External Control**

The control agencies (either individuals or groups) are not part of the multinational corporation which they are to control. Supervision is undertaken by a body not formally connected with the multinational corporation. Such an agency might be the United States Congress which passes laws relative to the economic performance of its multinational corporations.

(d) **Internal Control**

Internal control means supervision of the multinational corporation by individuals and groups that are a part of the organization itself. Such supervision might take the form of nationals on the Board of Directors of the parent corporation and in the management staff of the subsidiaries; equity ownership by nationals at a percentage fixed by the host; joint-ventures.

* * *

The following combinations show the types of control the home and the host governments can place on the multinational corporation.

(a) **external economic control**

(b) **external political control**

(c) **internal economic control**

(d) **internal political control**

For examples of these controls, please refer to the following chart.
A. External Economic Control
(i) "The objective of the 1968 foreign investment controls has been declared to be a reduction of foreign investment outlays so as to improve U.S. international payments," 11
(ii) Antitrust Extraterritoriality
(iii) If capital outflow affects general welfare climate in U.S.

B. External Political Control
(i) Export Control Act, can be used by the President "to further the foreign policy of the U.S. and to aid in fulfilling its international responsibilities" and "to exercise the necessary vigilance over exports from the standpoint of their significance to the national security of the U.S."
(ii) Trading with the Enemy Act of 1917-
"The Office of Foreign Assets Control regulates the exports of American subsidiaries abroad whether or not the commodities they produce incorporate American components or technology. (The American parent is criminally liable for its subsidiaries' activity.)" 13

C. Internal Economic Control
(i) U.S. government in theory does not seek direct involvement in the corporate decision making process.

D. Internal Political Control
(i) U.S. government in theory does not seek direct involvement in the corporate decision making process.
(ii) The radical view - there no longer exists private industry. The government is involved in at least some aspects (e.g., R & D, investment guarantees and the like) of MNC life. In support of such a view, some authors cite the 1954 United Fruit Company affair in Guatemala: "That John Foster Dulles, the United States Secretary of State at the time, was the legal representative of the UFC; that his brother Allen Dulles, Director of the CIA at the time, had been president of the UFC; that Henry Cabot Lodge, the United States Ambassador to the United Nations at the time, was on the board of directors of the UFC; that John Moors Cabot, then Assistant Secretary of State for Inter-American Affairs, was a large shareholder of the UFC; that Walter Bedell Smith, Director of the CIA before Dulles, became president of the UFC after the 1954 venture - probably had no relation to the United States involvement in the overthrow of Arbenz." 14

A. External Economic Control
(i) Not applicable.

B. External Political Control
(i) Not applicable.

C. Internal Economic Control
(i) The MNC's main source of power is its ability not to invest.
(ii) If one of the Common Market countries fails to meet a MNC's requirement, the MNC might choose to locate in another EEC country without loss of benefit.

D. Internal Political Control
(i) In theory, the MNC is not directly concerned with political activities,

A. External Economic Control
(i) France required Libby to maintain a certain minimum level of exports to help the host's balance of payments, 15
(ii) The Brazilian government attempts to restrict by the use of penalty taxes, the repatriation of earnings in excess of 12% of the registered capital, 16
(iii) Colombia convinced Renault to build and market abroad an amount of Colombian products equal in value to the auto components that it imports, 17

B. External Political Control
(i) All host states set aside certain sectors or industries in which there can be no foreign investment. "For each country, its key sectors tend to be rooted in its history and its politics and to be associated with a public sensitivity that may seem irrational to foreigners but none-the-less real." 18 For example,
   - United States: Banking, communication, and transportation,
   - Canada: Banking, railways,
   - Britain: Shipping, shipbuilding,
   - Japan: Autos, electronics,
   - France: Aeronautics,
   - Scandinavia: Wood products

C. Internal Economic Control
(i) In Australia's 1976 policy statement on foreign investment, it was stated that "Whilst there are no legislative provisions requiring local participation, both in the capital or management of companies set up in Australia by overseas interests, we want some local participation both in ownership and management." 19
(ii) "The contractual joint venture... is designed to be a continuing cooperative venture, a partnership in which the foreign investor and the host country share the cost of the investment, the risks, and the long-term development aims." 20

D. Internal Political Control
(i) "In some cases, public enterprises and powerful quasi-public private groups are entering into joint ventures with foreign investors, thus equilibrating bargaining power between nations and foreigners." 21
(ii) The political implications of host internal economic controls should not be underestimated. Once economic control has been imposed by the host, such control can be used for political ends.
The preceding chart shows that there exist a variety of controls which the home and the host can place on the MNC. Yet for each case there may be an optimum set of home/host controls which might enable all three actors to gain benefits in a trade-off for control. In other words, there may be a point of stable equilibrium at which all three actors will willingly accept restrictions on their sovereignty (or, for the MNC, flexibility). Such a point would lead in all probability to a reduction in tension and conflict which might otherwise continue to be the rule in home/host/MNC interactions. Refer now to the combinations of home/host controls on the MNC in order to determine if there might exist a (relatively) optimal set of controls.

<table>
<thead>
<tr>
<th>Home Control</th>
<th>Host Control</th>
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<tbody>
<tr>
<td>1</td>
<td>external economic A</td>
</tr>
<tr>
<td>2</td>
<td>external political B</td>
</tr>
<tr>
<td>3</td>
<td>internal economic C</td>
</tr>
<tr>
<td>4</td>
<td>internal political D</td>
</tr>
</tbody>
</table>

**Home**

Nos. 3 & 4 - Generally, these are not applicable to the United States. The United States does not seek as a matter of policy internal economic or political control.

No. 2 - This is the source of most home host tension and conflict. Hosts fear extraterritoriality of political laws such as the Trading with the Enemy Act of 1917. The continued existence of such laws tends to perpetuate suspicions concerning home/MNC interactions. Such laws tend
to feed host fears of the political nature of multinational corporation activities.

No. 1 - Most states are aware of the need for the home government's external economic controls on the multinational corporation. This awareness reflects the internationally accepted national priority of maintaining a favorable balance of payments. Generally speaking, the home country can maintain external economic controls on the multinational corporation's activities without arousing the fear that such controls will impinge on the host country's sovereignty.

Host

A. - These controls are the least effective. Although they might require, for example, a multinational corporation to reinvest a fixed percentage of its profits, such controls leave the multinational corporation with a maximum degree of operational flexibility within the host country.

B. - This is an escalation of host control. It might prohibit, for example, direct foreign investment in certain sections of the economy. Yet, the host has little or no control over the multinational corporation's activities and is often not privy to important decisions which might affect the host government's economic planning.

C. - This control enables the host to participate in the economic decision making process. It can be carried out by having nationals on the Board of Directors and in management positions. It might take the form of national ownership of equity or the joint venture. (The ultimate degree of internal economic control would be nationalization, but the economic
losses might be greater than the politico-economic gains.

This type of control enables the host to have representation in the economic decision making process and would tend to reduce the host's fear of home/MNC interactions because it would have had some degree of national representation in those interactions.

D. - Internal political controls are similar to internal economic controls in that decisions of the multinational corporation might not only be of an economic nature but of a political nature as well.

This type of control greatly reduces the host's fears of MNC/home interactions because now the host's representatives are a part of the multinational corporation. They are relatively more confident that the multinational corporation will be a "good citizen" and will operate in the interests of the host.

* * *

From this discussion, one might surmise that home external economic control tends to minimize misunderstanding between it and the host government as well as between the host and the multinational corporation. Non-reliance on external political control by the home government could only serve to reduce the stigma attached to the MNC that such controls might bear. Coupling this home control with the host's internal political control might tend to minimize misunderstanding and misperception because the host would have some degree of influence within the MNC's decision making body. In effect, each actor relinquishes some control and receives in return some benefit. For example, the home trades off external political control and gains the benefit of an improved image among
host countries. The host country minimizes its option to nationalize and gains political and economic influence in the corporate decision-making process. The multinational corporation trades off high profits in exchange for a relatively more secure investment environment. The fact that the home government gives up its external political control should reduce host suspicion of perceived home/MNC complicity to exploit the host country.

Although there exist various methods to which the host government might resort in order to maintain internal political control over the multinational corporation, its selection of a method of control can best be made in a situational context. Therefore, one might conclude that the home/MNC/host control mechanism might best be determined case-by-case. For example, not all host governments seek to achieve a fixed percentage of ownership of equity any more than they would all want to engage in joint ventures. Some hosts would be satisfied with a national on the Board of Directors, while others would not.

To strive for a reduction of tension in the international system, it will be necessary for the home government to relinquish some control. It will be just as necessary to expect a greater degree of involvement in the internal affairs of the corporation by the host government.
Footnotes


5. One author recently attempted to overcome on behalf of the multinational corporation the problem of its lack of earth's surface by suggesting a new multinational business enterprise—the anational corporation, one which owns the island where it is incorporated.


10. Ibid., p. 313.


17. Ibid., p. 49.

18. Ibid., p. 39.


22. "The United States-owned Arabian American Oil Company, or Aramco, has agreed to allow [six countries] in which it operates [Saudi Arabia, Iraq, Iran, Kuwait, Abu Dhabi and Qatar] to buy some of its stock. . . . There are some members [however] who are aiming at more than 20 percent, like Nigeria and Libya." See, the New York Times, March 12, 1972, p. 9.