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Towards a holistic framework of MNE–state bargaining: A formal model and case-based analysis

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ABSTRACT

In this paper, we develop a holistic framework for MNE–state bargaining based on power-dependence theory. We contribute to IB theory by moving beyond a static, bilateral conceptualization of MNE–state bargaining towards a dynamic, multi-party framework. MNEs can shift the power balance in their favor by (a) reducing sunk costs from the investment, (b) improving access to alternative investments, (c) increasing the host government's sunk costs, or (d) impeding the host government's access to alternative investors and buyers. Subsequently, we apply our framework to the Venezuelan oil industry, identifying 12 MNE micro-strategies to achieve a sustainable power balance.

1. Introduction

MNE–state bargaining has been at the core of IB research since its early years. From the seminal works of Vernon (1966) to classic transaction-cost theorists (Teece, 1986; Williamson, 1967) to the obsolescing-bargaining literature (Ramamurti, 2001; Vachani, 1995), all have recognized the potential costs that host governments can impose on foreign MNEs. Whenever specific assets are deployed in a foreign sovereign territory, the literature has argued, the investing MNE is locked into the transaction and is vulnerable to ex-post opportunism by the host government (and other stakeholders) (Makhija, 1993).[1]

At the same time, and in apparent contradiction to the obsolescing-bargaining argument, theorists have pondered over the sovereignty-at-bay phenomenon: a gradual erosion of government power vis-à-vis MNEs (Kobrin, 2001; Vernon, 1971, 1981, 1991). Despite their shared heritage, both arguments have developed somewhat in isolation, without theoretical integration or formalization. As a result, there has been little investment-level research on potential micro-strategies to influence the MNE–state power balance. In this article, we seek to fill these gaps, making two specific contributions.

First, and on the theoretical side, we use the formalized metrics of power-dependence theory (Emerson, 1962) to formulate a dynamic, multi-party *framework of MNE–state bargaining* that addresses three theoretical limitations of existing conceptualizations: First, neither obsolescing bargaining nor sovereignty at bay captures the inter-temporal dynamics of the bargaining process. Second, neither concept sufficiently accounts for the multitude of stakeholders and their socio-economic context (Ramamurti, 2001; Stevens, Xie, & Peng, 2016). Third, both frameworks are MNE-centric and fail to account for possible mutual dependence in power relationships (Emerson, 1962). Our holistic MNE–state bargaining framework fills these theoretical gaps and serves to categorize, frame, and relate novel contributions to the topic.

As a second and more empirical contribution, we apply the bargaining framework to a specific case in the extractive industries, seeking to identify *micro-strategies* that MNEs can use to establish a sustainable power balance. Existing empirical explanations for constraints on host-government bargaining predominantly focus on industry-, or MNE-level, attributes. A thorough exploratory analysis of bargaining strategies on a micro, or investment level, is missing.[2]

We use classic economic analysis in the tradition of Moran (1974), Jenkins (1986), and Woodhouse (2006) combined with an in-depth qualitative case study of the Venezuelan oil industry to identify micro-strategies. Triangulating data from multiple sources, we categorize 12 micro-strategies that have influenced the MNE–state bargaining process and integrate them into our framework. Besides the above-mentioned theoretical contributions, these empirical findings provide valuable practical guidance for MNEs investing in high-risk contexts.

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[1] The relevance of obsolescing bargaining is supported by empirical data. Between 1972 and 2000, on average 1.5 MNE–state disputes were taken to the International Center for Settlement of Investment Disputes (ICSID). Since 2000, this figure has risen to 31 cases per year (ICSID, 2015).

[2] This is surprising since other disciplines have proposed micro-strategies related to finance (Esty, 1999; Hainz & Kleimeier, 2012; M & llner, 2016; Vaaler et al., 2008), international law (Neumayer & Spess, 2005; Poulsen, 2010; Shadlen, 2005), or (non-market) strategy (Blumentritt & Nigh, 2002; Henisz & Zelner, 2003; Henisz, 2000; Henisz, 2011, 2014).

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Table 1
Literature overview of obsolescing bargaining and sovereignty at bay.

Author (year)	Methodology & perspective	Contributions relevant to paper
(Vernon, 1971)	Book	Origin of sovereignty at bay and obsolescing bargaining.
(Moran, 1974)	Multiple case study; Chilean copper industry	Technological capabilities as a source of MNE bargaining power.
(Vernon, 1981)	Theoretical paper; macro-economic perspective	Globalization, technological advantage, communication and transport efficiency improve bargaining power of MNEs. Governments respond by creating multilateral governance structures.
(Fagre & Wells, 1982)	Descriptive analysis; U.S. subsidiaries in Mexico	Technology, product differentiation, exported intensity as sources of bargaining power for MNEs. Industry competition as a source of bargaining power for states.
(Jenkins, 1986)	Case study; Canadian National Oil Energy Program	Local allies and home-government political support as sources of MNE bargaining power.
(Kobrin, 1987)	Empirical analysis; U.S. manufacturing subsidiaries in developing countries	Technological advantages and global integration of host country can prevent obsolescing bargaining.
(Vernon, 1991)	Theoretical paper; macro-economic perspective	Obsolescing bargaining and sovereignty at bay are co-evolutionary, dynamic processes in which both actors cooperate, conflict, and compromise.
(Dicken, 1994)	Theoretical paper; macro-economic perspective	MNEs' relational networks and competition between nations as sources of MNE bargaining power.
(Thomas & Worrall, 1994)	Formal model using game theory for sequential bargaining episodes	Future investments as a source of MNE bargaining power (repeated games).
(Vachani, 1995)	Large sample empirical study; U.S., U.K., and European subsidiaries in India	MNE-level determinants on bargaining success and the role of the country context. Introduces home–host-country ties and provides evidence for MNE-level sources of bargaining power.
(Moon & Lado, 2000)	Theoretical paper: Integration of resource-based view in obsolescing bargaining	Firm-specific resources provide the basis for a sustainable bargaining power for the MNE.
(Ramamurti, 2001)	Theoretical paper; introducing two-tier bargaining	Obsolescing bargaining is not a dyadic process but a two-tier, multi-party bargaining process (home countries of MNEs, multilateral institutions).
(Kobrin, 2001)	Theoretical paper; macro-economic and legal perspective	Jurisdictional asymmetry (local governments vs. global MNEs). International investment law as a source of MNE bargaining power.
(Doh & Ramamurti, 2003)	Multiple case study; power projects in India	Introduces financial approaches (project finance, financial engineering), multilateral agencies, and contractual strategies (trade agreements, fixed-term contracts) as sources of power.
(Woodhouse, 2006)	Multiple case study; multinational energy investments	Legal and financial tools to counter obsolescing bargaining. Financial markets and project creditors as sources of bargaining power.
(Gould & Winters, 2007)	Case study; state–World Bank bargaining in the Chad–Cameroon oil pipeline project	Access to outside options are key to bargaining outcomes for parties. Dynamic bargaining process with different power imbalances between different episodes.
(Nebus & Rufin, 2010)	Theoretical paper; Integration of network theory & Case study;privatization energy utility in Dominican Republic	Participants in international bargaining include nation-states, MNEs, NGOs, and multilateral organizations. Introduces coalitions as strategic instrument.
(Li et al., 2013)	Multiple case study; natural resource investments in Tanzania	Documents home-country support for Chinese MNEs (loans, social and financial investment programs). Two-tier and one-tier bargaining strategies.

2. Obsolescing bargaining and sovereignty at bay: two sides of a coin

Two partially conflicting streams of literature that date back to Vernon (1971) dominate IB discourse on MNE–state bargaining. The *obsolescing bargaining* argument describes the fundamental shift in power to a host-country government once an investment is made in a foreign territory. As soon as irreversible assets are deployed, the host government can subsequently engage in hold-up (Woodhouse, 2006). The decisive sources of power imbalance in obsolescing bargaining are the potential *sunk costs* for an investing MNE. This sunk-cost argument is implicitly static in that it does not consider potential changes in bargaining power over the lifetime of an investment, or across several rounds of investments. Also, obsolescing bargaining is dyadic and disregards other parties that might affect the power balance between the focal actors (Li, Newenham-Kahindi, Shapiro, & Chen, 2013; Ramamurti, 2001). Finally, the framework implicitly assumes that the host government is not dependent on the investing MNE and thus ignores possible mutual dependencies in the MNE–state power relationship.

These restrictive assumptions have somewhat impeded IB research from theorizing on MNE bargaining strategies, especially on a micro, or investment, level. Some boundary conditions to host-government bargaining identified in early literature were related to industry- or MNE-level aspects such as technological intensity (Kobrin, 1987; Moran, 1974), product diversity, market access, capital availability (Fagre & Wells, 1982), ties to local business community (Jenkins, 1986), and home-country political support (Jenkins, 1986; Li et al., 2013). Other authors extended obsolescing bargaining to include dyadic elements such as home–host-country ties (Vachani, 1995), repetitive investment rounds (Thomas & Worrall, 1994), or additional actors such as multinational organizations and home-country governments (Ramamurti, 2001). Collectively, the obsolescing-bargaining literature has identified a variety of boundary conditions, but none of the frameworks amounts to a holistic perspective, and, more importantly, there is a scarcity of evidence on micro-strategies on an investment level.[3]

Vernon (1981, 1991) initiated a second stream of literature often referred to as *sovereignty at bay* that is somewhat juxtaposed with obsolescing bargaining. The core argument is that the supra-territorial nature of MNEs allows them to bypass the risk emanating from a local sovereign. Unlike host governments that are tied to their sovereign territory, MNEs can invest in alternative locations, which results in superior bargaining power. In sovereignty at bay, the primary source of power for MNEs is *access to alternative investment* locations. This access constitutes the theoretical counterweight to the sunk-costs argument in obsolescing bargaining.

The sovereignty-at-bay literature remained even more on a macro or conceptual level, with little empiricism (Vernon, 1981, 1991). After its early successes, Vernon (1981) proclaimed a reemergence of the sovereign state brought about by inter-governmental cooperation in the 1980s. Later, Kobrin (2001) picked up the discussion and introduced international legal frameworks as an important counterbalance to the sovereign-power advantage.

Table 1 summarizes the obsolescing-bargaining and sovereignty-at-bay literatures. Overall, studies on boundary conditions in both

[3] Notable exceptions are Doh and Ramamurti (2003) and Woodhouse (2006), who argued that financial and contractual strategies on an investment level can protect from obsolescing bargaining.