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## Bargaining with Multinationals: Why State Capacity Matters

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# Bargaining with Multinationals: Why State Capacity Matters

CANER BAKIR

Dominant models of bargaining between states and multinational corporations (MNCs) have widely held that bargaining relations, especially in high-technology manufacturing, have changed from confrontational to cooperative. It is consequently argued that there is little formal entry bargaining among these actors. However, there are three primary weaknesses in this literature. First, the understanding of outcomes is limited to the terms of investment agreements. This static view ignores the dynamics of bargaining processes and decisions not to invest, which also deserve explanation. Second, it is MNC-centric, ignoring state's privileged role in relation to the governance of entry bargaining in domestic policy-making processes. Third, it views state as a monolithic entity, ignoring the bargaining that occurs inside states. To redress these issues, this article offers a state-centric bargaining model. It identifies administrative and institutional capacity as two critical components of state capacity. It chooses the entry bargaining from 2005, when Hyundai Motors Corporation considered establishing a USD1.5 billion car-manufacturing plant in Turkey. It shows that state capacity in the governance of a domestic policy-making process affects the outcome of entry bargaining: When state capacity is weak, an MNC's decision not to invest is a more likely outcome.

**Keywords:** state, government and business relations, state capacity, governance, entry bargaining, multinational corporations, developing countries, Turkey, Hyundai

## Introduction

Does bargaining over entry define host state (HS) and multinational corporation (MNC) relations in a globalising world economy? Do the high relative resources and stakes that HS and MNC have, and similarity of interests between them, in the bargaining always deliver investment outcome? Following the trend of economic liberalisation across national economies in the 1980s, HSs gradually removed restrictions on inward foreign direct investment (FDI) such as screening or

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performance requirements, ownership restrictions and licensing agreements featuring technology transfer (UNCTAD 2000: 6). This removal of restrictions is because states have increasingly considered inward FDI as complementary to their own development objectives. Not surprisingly, from the 1990s onwards, interaction between HSs and MNCs in high-technology manufacturing changed from being ‘predominantly adversarial and confrontational to being non-adversarial and cooperative’ (Dunning 1991, 1998: 280; Stopford and Strange 1991: 1; Vernon 1998; Luo 2001). Thus, it is assumed in international business (IB) research that there are cooperative/non-adversarial bargaining interactions between HSs and MNCs that would eventually deliver investment deals. It is widely accepted in the literature that bargaining does not define HS and MNC relations: ‘... today, few governments restrict inward FDI, either in the form of screening or performance requirements, so that *little formal bargaining over entry occurs* between MNCs and host governments’ (Eden *et al.* 2005: 253, emphasis added; see also Eden and Molot 2002). When the focus is on bargaining at national level, the emphasis is on the relative bargaining resources and stakes of HSs and MNCs, and similarity of interests between them that influence investment outcome (Grosse 2005).

Further, it is also assumed that HSs in developing countries ‘have become so much FDI friendly’ because states in advanced developed countries have used bilateral or multilateral agreements ‘to weaken the hands of [HSs] ... while strengthening that of their MNCs [in bargaining interactions]’ (see also Stopford and Strange 1991: 215–6; Ramamurti 2001: 24). It is argued that FDI-friendly conditionalities imposed by multilateral organisations such as the international Monetary Fund (IMF) and World Bank over developing countries’ governments offer MNCs more protection and bargaining leverage (Ramamurti 2001: 31–3).

The Turkish failure to attract USD1.5 billion investment in a car-manufacturing plant by Hyundai Motors Corporation (HMC) in 2005 challenges these prevailing assumptions in the bargaining literature: if states have been competing with each other since the 1990s for inward FDI in high-technology manufacturing, why was it that the Turkish state was in a conflictual rather than a collaborative interaction with HMC, and the outcome was HMC’s decision not to invest? Despite high resources, relative stakes and similar goals between the two sides at the outset, why was it that HMC withdrew from the bargaining? If multilateral organisations impose FDI-friendly conditionality over developing countries, why was it that the IMF, as an external actor embedded in the Turkish political economy, constrained the government’s policy capacity to offer firm-specific investment incentives during the entry bargaining?

It is also interesting to note that the Turkish and Czech states were in direct competition to host HMC investment during the 2005 entry bargaining processes. The bargaining outcome was investment decision in the Czech Republic (Bakir 2009). Is previous theoretical prediction that an investment outcome is more likely when the state has capacity to steer the entry bargaining process towards investment idiosyncratic to HMC’s experience in the Czech Republic or not?

State capacity refers to ‘the state’s ability to mobilise societal and economic support and consent for the achievement of public-regarding goals’ (Painter and Pierre 2005: 2). The current IB research ignores this pivotal role of the state in the governance of entry bargaining in domestic policy-making processes.

Rather, it focuses on the terms of investment agreements (generally the ownership percentage maintained by MNCs). This is a narrow and static view: it is outcome-oriented where the understanding of outcome is limited to the terms of the investment agreement. It ignores both the dynamics of bargaining processes and decisions not to invest, which also deserve explanation. Further, it is MNC-centric where the state is a monolithic entity and its role in this process is delegated to a residual category.

In a similar vein, to date, scholars of international political economy (IPE) and comparative public policy (CPP) have also neglected bargaining interactions between HSs and MNCs in domestic policy-making processes, by which investment decisions or decisions not to invest are made. This neglect may reflect the fact that IPE scholars who study bargaining outcomes of international or bilateral trade agreements have paid little attention to the role of state capacity in influencing such outcomes. This is the case when political economists looked at domestic political economy, while CPP scholars who study state capacity have tended to ignore inward FDI issues and entry bargaining. The result is an important gap in past literature: both sets of literature have overlooked the importance of the link between state capacity and bargaining outcomes.

Economic geographers have also benefited from the bargaining literature and have examined the nature of relationships between MNCs and states (Phelps 1997; Phelps and Raines 2003; Iammarino and McCann 2013). One of the main concerns of this literature has been the links between economic geography and development with special reference to ‘spillovers’ from MNCs to the local/regional economy. There are two main valuable theoretical and empirical insights derived from this literature to the entry bargaining and state capacity discussion for the rest of this paper. First, economic geographers remind us of the non-monolithic nature of the state (that is, national, regional and supra-national actors), inter-regional and intra-regional competition and collaboration among public-sector actors, and multiple actors involved in state and MNC bargaining (Phelps *et al.* 1998; Tewdwr-Jones and Phelps 2000; MacKinnon and Phelps 2001a). Second, they emphasise the significance of institutional capacity building. This included common bureaucratic agendas and collaboration ‘to attract and embed’ FDI in the context of regional governance and economic development (MacKinnon and Phelps 2001b: 255). Specifically, such institutional capacity contributes significantly towards customising incentives (Peck 1996; Phelps and Tewdwr-Jones 1998). It also offers ‘innovative and competitive packages’ to the needs of key MNCs that contribute to collaborative interactions and partnerships between MNCs and public-sector actors (Phelps and Tewdwr-Jones 2001: 1253). Economic geographers have also recognised ‘[t]he asymmetrical bargaining position of MNCs over states’ in the context of ‘information asymmetries’ and ‘coordination failures on the part of governments’ at regional levels (Phelps 2008: 469). However, they do not explicitly deal with the state-led governance of entry bargaining processes at national level.

This article seeks to fill these gaps in the IB, IPE, CPP and economic geography literatures. It offers a state-centric bargaining model. This process-based model has mobilisation, conflict and resolution stages. It shows that HS and MNC entry bargaining is a multi-level and multi-actored process where strong state

capacity in resolving conflicts and steering this governance process towards agreement is fundamental. In the context of developing countries, strong state capacity promotes the conclusion of bargaining processes with an investment outcome, whilst weak state capacity generates non-investment outcomes.

This article is divided into five sections. The first offers a literature review. The second introduces the state-centric bargaining model. The third justifies the explanatory case study method, the adopted research design and method of data collection. The fourth presents and discusses the HMC case. The final section concludes that a decision not to invest by an MNC is most likely when HS has weak capacity to steer an entry bargaining process towards an investment deal. It also considers the research and practical policy implications of this finding.

## Literature review

This section reviews the theoretical models of entry bargaining and state capacity, allowing the paper to describe state capacity in an entry bargaining context. The review is therefore divided into two parts. The first introduces the main bargaining models in the IB and IPE literatures, which are also recognised by the economic geography literature. The second reviews the CPP literature on state capacity.

### *Bargaining models*

Different models of bargaining interactions between HSs and MNCs have been advanced in the IB and IPE literature. Among those are the obsolescing bargain, political bargaining, Behrman–Grosse, triangular diplomacy and two-tier bargaining models.

The literature's traditional model of entry bargaining is widely known as the 'obsolescing bargain model' (OBM). It reflects *conflictual* bargaining between HSs and developed country multinationals in natural resource industries in the 1960s and 1970s (Vernon 1971, 1977; Moran 1978; Kobrin 1980, 1987; Mytelka 2000). The bargain is expected to obsolesce over time as the HS is likely to have new demands from the relatively immobile MNC following its sector-specific investments. The key vulnerabilities of MNCs include expropriations, adverse regulatory changes, renegotiation of contracts and performance requirements imposed by the HS. However, Bennett and Sharpe (1979) argue that the balance of bargaining power, especially in high-technology manufacturing, shifts in favour of the MNC. For example, once car manufacturers have access to a market, they become integrated into the local economy and establish relationships within the host country, strengthening their bargaining power vis-à-vis HSs. Moreover, HSs increasingly pursue cooperative relations with MNCs as economic globalisation intensifies by realising the potential contribution of inward FDI to national economic growth and development. Thus, 'the widely held view among [IB] scholars is that the OB model has outlived its usefulness' (see also Ramamurti 2001: 23; Eden and Molot 2002: 362; Eden *et al.* 2005: 253). In contrast to this view, recent research has shown the viability of the OBM in the oil industry (Stevens 2008; Vivoda 2009: 520). Similarly, between 2002 and 2010, there was a partial return to more restrictive FDI policies:

‘more regulatory policies in *extractive industries*, including nationalization, expropriation or divestment requirements as well as increases in corporate taxation rates, royalties and contract renegotiations’ guided by ‘industrial policy considerations’ (UNCTAD 2012: xx, see also 79–81, emphasis added).

The ‘political bargaining model’ (PBM) is an upgraded version of the OBM. It recognises minimal formal bargaining between HSs and MNCs. Here, ‘MNC-state relations are modelled as iterative political bargains between MNCs and governments over a wide variety of government policies at the industry level’ (Eden *et al.* 2005: 254). The PBM focuses similarity on ‘goals, resources and constraints as a theoretical lens through which to examine MNC-state relations over time’ (Eden *et al.* 2005: 268). Like the OBM, the relative bargaining power of HSs and MNCs occupy centre stage in explaining the bargaining outcome in the PBM. Specifically, the primary focus is on HSs’ and MNCs’ economic sources of relative bargaining power as an ability or capacity to achieve their respective ends in investment deals (Vachani 1995). It is assumed that an MNC’s bargaining power *resources* include ownership advantages, such as capital and technology, while an HS’s bargaining power *resources* include its location-specific advantages, such as access to home markets, natural resources and cheap and skilled labour (Poynter 1985; Boddewyn 1988).

Following this perspective, the ‘Behrman–Grosse’ model (Behrman and Grosse 1990; Grosse 2005) offers the ‘three-dimensional view of government–business relations’. The first dimension includes *relative resources* ‘that are of interest to the other actor in the bargaining context’ (‘whichever side had greater resources would obtain the better “deal”, in the sense of more favourable treatment’). The second includes the relative *stakes* that HS and MNC ‘have in a given bargaining situation’ (‘the possible losses that each side could incur if a successful bargain were not achieved’). The third refers to *similarity of interests* between them (‘the more similar the goals of a company and the government, then a successful relationship between them are less likely’) (Grosse 2005: 276–82).

In addition to these bargaining models, the ‘triangular diplomacy’ model is an earlier work focusing on competition between states and firms for world market share (Stopford and Strange 1991). This model moves beyond the OBM and describes the triangle of bargaining among states (in terms of trade policy, bi- and multilateral treaties and domestic policies), between states and firms (in terms of attracting inward FDI) and among firms (in terms of enhancing their global success).

More recently, the ‘two-tier bargaining model’ offers a novel insight into the OBM and the triangular diplomacy model by incorporating Tier-1 bargaining between developing countries’ host governments and developed countries’ home governments (Ramamurti 2001). In this model inter-state bargaining occurs bilaterally or through multilateral institutions, producing macro rules on FDI that affect micro negotiations in Tier-2 (per the traditional bargaining model). It is argued that home governments of developed-country MNCs provide additional bargaining leverage to their MNCs over developing-country HSs through bilateral or multilateral agreements and/or organisations.



These bargaining models have several common weaknesses. First, they concentrate on terms of investment outcome (that is, agreement) rather than the bargaining process itself. Their main focus is on the relative economic resources and stakes, and similarity of HS and MNC interests in the bargaining. Second, their main unit of analysis is the MNC rather than the state. They are MNC-centric because they focus on the relative influence of MNCs' economic power resources and their country-specific locational preferences as drivers of investment decisions. Thus, they are less concerned with the capacity of states to influence bargaining outcomes with numerous administrative and institutional tools at their disposal in the domestic policy-making processes. Third, they focus on the first face of bargaining (that is, bargaining between HSs and MNCs), ignoring the 'second face of bargaining' (that is, intra-state bargaining). This is bargaining relations among public-sector actors in HSs. As Encarnation and Wells (1985: 51) observed, they view a state 'as a monolithic, undifferentiated whole'. These common weaknesses ignore not only multi-level and multi-actored political economic and bureaucratic struggles in domestic policy processes, but also decisions not to invest that also deserve explanation.

IPE literature is currently interested in international negotiations in trade, finance and investment. It focuses on the international bargaining power of developed-country states (the USA in particular) and domestic political conflicts to explain bargaining outcomes of international and bilateral trade agreements, and trade and service liberalisation (Putnam 1988; Odell 2000). In addition, it examines the structural power of mobile MNCs over immobile states in interstate diplomacy to influence bargaining outcomes in international negotiations (Stopford and Strange 1991; Strange 1991; Crystal 2003). It notes that capital mobility, as a central determinant of trade policy, increases the relative bargaining power of MNCs vis-à-vis immobile states and labour (Thomas 1997).

Although 'bargaining with multinationals' has been subject to extensive research in the IPE literature (Loewendahl 2001), we have limited knowledge on how a state's capacity to steer various actors towards a deal can affect investment decisions. On this course, Encarnation and Wells (1985) offer a pioneering study on how state organisation for negotiations is critical to bargaining outcomes: 'The establishment of appropriate decision making arrangements and processes has profound impact not only on the outcome of bargaining with foreign firms but also on the domestic political economy' (Encarnation and Wells 1985: 49). They offer a portfolio of four organisational responses available to a state (Encarnation and Wells 1985: 55–9). The first is *abstention from individual negotiations: reliance on rules* ('nonselective policies with respect to private investors, be they foreign or domestic'). The second is *diffusion of decision-making* ('difficult negotiations dispersed across several ministries, agencies and enterprises whose operations and interest would be affected by the proposed investment'). The third is *coordination of decision-making* (the creation of new decision-making structures whose operations cut across the existing functional divisions of government). The fourth is *delegation of decision-making* ('decision-making units [have] complete authority to negotiate'). In this view, the choice of organisational structure is determined by 'general development strategy and resulting attitude toward foreign investment, the salience of the project



being proposed, and the degree of competition with other governments for the kind of investment being sought' (Encarnation and Wells 1985: 78). However, despite the government's favourable approach to the FDI, the salience of the investment proposed, and the direct competition with the Czech state, the Turkish state did not offer customised incentives and desired-land-for-free to HMC. The Turkish state relied on non-selective policies. This article proposes that developing-country states are least likely to depart from their general approaches and successfully adopt and implement special organisational responses amongst alternatives when state capacity is weak.

### *State capacity and state-centric governance models*

The state capacity concept is 'at the heart of governance narrative' (Matthews 2012: 280). Indeed, governance is defined as 'a goal-directed', state-led steering activity, 'with the need to establish collective goals and develop the means of reaching those goals' (Pierre 2000; Peters and Pierre 2006: 215). Thus, state capacity constitutes the main attribute of state-centric governance models (Bakir 2009). In terms of the theoretical focus, this article focuses on these models, 'because the state, despite persistent rumours to the contrary, remains the key political actor in society and the predominant expression of collective interests' (Pierre and Peters 2000: 25).

Although considerable work exists on state capacity in CPP, relatively little work refines administrative and institutional capacity as its key interrelated dimensions. An appreciation of these dimensions adds to understanding of how and why they can be vital for the state-led governance of domestic policy-making. This section refines these concepts by specifying relevant prior knowledge.

### *Administrative capacity*

Administrative capacity is composed of interrelated relational, policy and fiscal capacities. Here, 'state strength is a function of *bureaucratic centralisation* [that is, relational capacity], *the quality of bureaucratic elites* [that is, policy capacity] and the *degree of control* exercised by the state over financial resources' (that is, fiscal capacity) (Atkinson and Coleman 1989b: 54, emphasis added; see also Atkinson and Coleman 1992).

Bureaucratic centralisation relates to the relational aspect of administrative capacity. It includes autonomy (that is, the degree to which politicians and bureaucrats act autonomously from societal organisations) and concentration (that is, the degree to which ultimate decision-making power is concentrated in the hands of a relatively small number of officials). Accordingly, the emphasis is on balance rather than conflict, cooperation rather than competition and concentration rather than fragmentation amongst public-sector agencies in an economy. Moreover, institutionalised mechanisms facilitating coordination and cooperation, and resolving conflicts among public authorities, are fundamental properties of the bureaucratic structure. It is assumed that 'the more centralised, autonomous and elitist [is] a state bureaucracy and its administrative core, the greater [is] this [relational] capacity' (Skocpol 1985; Atkinson and Coleman 1989b: 52).

Strong states are regarded as *capable* states. They are able to realise their goals in the face of opposition from other actors, while weak states are not (Katzenstein 1978; Skocpol 1985; Atkinson and Coleman 1989a, 1989b; Coleman 1996). State strength here means a state's capacity to accomplish its objectives, which may be in conflict with other actors whose interests are harmed by the state's actions.

Although strong state behaviour has been a topic of much interest to CPP and IPE scholars, little work has been done that links various forms of power to a state's relational capacity. This paper suggests that the *relational* aspect of administrative capacity concerns the state's utilisation of various forms of power. As Bacharach and Lawyer (1981: 200) note, 'power is not simply a part of bargaining, it is the essence of it'. Thus, it is important to consider whether states have resources and the will to use those resources by utilising various forms of power during entry bargaining processes.

There are three types of power in this context: 'power to' accomplish one's ends, 'power with' others to achieve one's goals through collaboration and 'power over' others by getting other parties to act despite resistance (for various types of power, see Lukes 2005, Mann 2008; in the context of bargaining with MNCs, see Loewendahl 2001: ch: 6). More recently, '[g]overnance from a *state-centric relational* perspective' is defined as '*the tools, strategies and relationships used by governments to help govern*' (Bell and Hindmoor 2009: 2, emphasis in original). Here, the emphasis is on 'power with', which is about cooperative or consensual forms of resource mobilisation and allocation by states such as public–private partnerships (see Greve and Hodge 2013). However, states can exercise power over society and impose their will on society to achieve desired objectives. This power *over* is derivative of power *to* because it refers to a state's capacity to impose its will on antagonists (Lukes 2005). As such, how effectively a state is able to apply the various dimensions of power becomes a vital issue in state-led governance of entry bargaining.

In addition, the quality of bureaucratic elites, the availability of financial resources and the state's power over these resources also contribute to its administrative capacity. The former relates to *policy capacity*. It includes 'high-quality information, forums of active policy debate, and especially expert, dedicated, and experienced staff in key areas of policy formulation and implementation, [which] are also a vital component of state capacity' (Bell and Carr 2003: 307). The latter includes not only national budget surpluses and resources from external budget support programmes (for example, European Union, EU, financial support), but also state autonomy to allocate these resources which are vitally important to a state's *fiscal capability*.

### *Institutional capacity*

Institutional capacity is an integral part of state capacity. Institutions consist of formal rules (that is, legal/regulatory) and informal norms (that is, ideational) that influence the behaviour of agents. They do so through the 'logic of instrumentality' (that is, material environment) and/or the 'logic of appropriateness' (that is, cultural environment) (Campbell and Pedersen 2001; Campbell 2004).

The formal institutional foundation relates to the legal framework, such as laws and regulations governing the inward FDI regime and investment incentives.

In the context of informal institutions, Mehta (2011: 27) notes that ‘ideas can function as *public philosophies*...’. Public philosophy refers to ‘an idea about how to understand the purpose of government or public policy in light of a certain set of assumptions about society and the market’ (Metha 2011: 27). This structural idea is in the background of formal institutions and agency behaviour (for the role of ideas in guiding state behaviour, see Hall 1993; Blyth 2002; Hay 2004). An idea that state has a superior position in its relations with society and markets is an example. This public philosophy may guide state behaviour and institutions of FDI regime in bargaining relations.

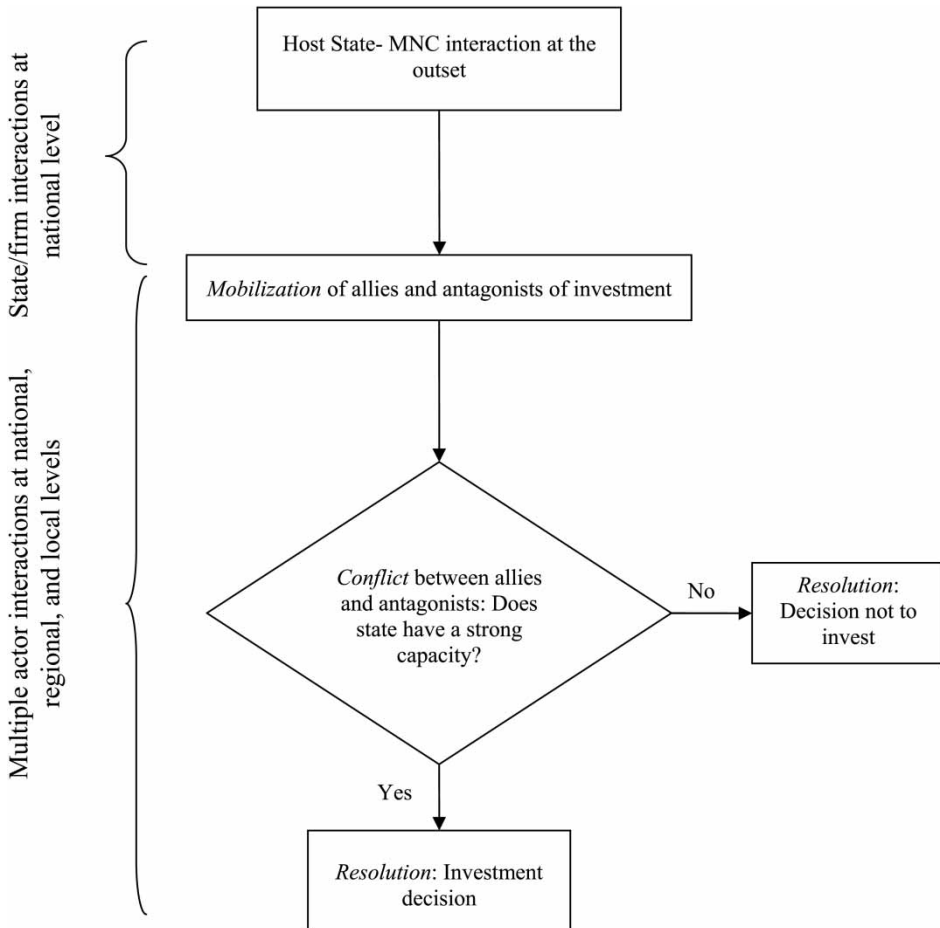


FIGURE 1. The state-centric bargaining model

### State-centric model of entry bargaining

Kane (1981: 355) used the concept of ‘regulatory dialectic’ to explain financial regulation as a dynamic process of conflict and resolution between opposing political and economic forces. He argued that ‘introducing political power into economic affairs initiates a dialectical process of adjustments and counter adjustments’ (1977: 55). According to Kane, ‘the dialectical *conflict* can *resolve* itself’ in this process (1977: 56, emphasis added; see also Reinicke 1995; Bakir 2011).

Informed by Kane’s (1977, 1981) views on a dynamic process of conflict and resolution, this article generates insight into how the bargaining process develops. It integrates state capacity concept to this process-based view to develop the state-centric model of bargaining (Figure 1). The bargaining process is composed of mobilisation, conflict and resolution phases which involve multiple actors interacting at various levels. Specifically, the bargaining process includes proponents and opponents of MNC investments who *mobilise* at national, regional and local levels to pressure HSs to adopt positions that would accommodate their respective vested political, economic and/or bureaucratic interests. As such, the *conflicting demands* of the investments’ allies and antagonists influence bargaining outcomes during the dynamic bargaining process. Thus, the resolution of the bargaining with an investment outcome will be vulnerable to these adverse influences during the bargaining process. This is where the HSs’ capacity (incapacity) to *resolve* these conflicts and steer the process towards an investment deal can be a key to completion (incompletion) of the investment deals.

### Method

This study adopts an explanatory case study method. This is because it poses ‘how’ and ‘why’ questions; the researcher has no control over events, as well as dependent and independent variables; the focus is a contemporary phenomenon within its real-life context; and multiple sources of evidence are used (see Yin 1994: 13). Its aim is not only to explore and describe the outcome of entry bargaining but also to explain causal relationships and to develop the state-centric model of entry bargaining.

Why does this paper choose to study the HMC case in Turkey? Previous research on the entry bargaining between the Czech state and HMC showed how strong state capacity contributed to investment outcome (Bakir 2011). Strong administrative capacity in the Czech Republic included bureaucratic consolidation, effective investment promotion agency in formulating policies,<sup>1</sup> the state’s control over its financial resources<sup>2</sup> and the state’s relational power over the opponents of the investment.<sup>3</sup> Strong institutional arrangements included a competitive FDI regime guided by state industry vision that contributed to the investment decision.<sup>4</sup> However, without examining the HMC case in Turkey, we will not know if the variation seen in the bargaining outcome was due to the state capacity. In this context, this case offers two valuable theoretical and methodological opportunities. First, the mobilisation, conflict and resolution phases of the entry bargaining process (that is, patterns and processes) examined are comparable with HMC’s experience in the Czech Republic. Second, bargaining

outcome (that is, the dependent variable) varies across cases allowing us to know if the variation is due to the variations in state capacity (that is, explanatory variable) or to other differences between the cases that might be related to bargaining outcome. In so doing, it will be possible to determine whether previous theoretical prediction (that is, investment outcome is more likely when the state has capacity to steer the entry bargaining process towards an investment deal) is idiosyncratic to the Czech experience or not.

The article applied the qualitative method of data collection, which comprised a combination of interviews and written sources. There were seven 60-minute semi-structured interviews with open-ended questions conducted in Ankara and Istanbul between July 2009 and April 2013. At the end of the first round of interviews in 2009 and 2010, the interviews increased in focus and depth because of the iterative and cumulative nature of this research. Interviewees included a former Minister of Industry and Trade, three senior bureaucrats and three General Managers in the automotive sector who had a thorough knowledge of the 2005 bargaining process. They provided critical and valuable information concerning the entry bargaining process in Turkey.

Primary written sources such as an official letter and its annex enabled an analysis of what the HMC promised to deliver and requested from the government. The Emerging Markets Electronic Database enabled a search of secondary sources, such as news and company reports published in English and Turkish between 2004 and 2008. The search selected Turkey as a country and used the broad keyword 'Hyundai'. This paper also covered the written material not covered by the database and scholarly papers for additional information. Other textual sources included reports and press releases of the supranational, public and private agencies.

This paper used these data to generate a chronology of events (Miles and Huberman, 1994). The multiple data sources helped the paper accomplish 'triangulation' (Jick 1979). An extensive review of the secondary written sources augmented the interview data. In data analysis, this study kept iterating between the data and emerging theoretical arguments to reach theoretical saturation. Interview transcripts analysis applied NVivo software to code, identify themes of and analyse the data.

### **The HMC case**

The automotive sector plays a significant role in the Turkish economy. This sector was

the 18th largest in the world with an export value of \$17.6 billion in 2007. Its export share grew by 1.37 per cent from 1997 to 2007, with Turkey becoming the 16th largest automotive manufacturer in the world by 2010. (Abylkassymova *et al.* 2011: 21)

Thus, the Turkish state had a strong incentive to host the world's 90th largest MNC ranked by foreign assets in 2006 (UNCTAD 2006: 222). In a similar vein, HMC was not an outsider in Turkey: Hyundai Assan started its operations as HMC's Turkish distributor in 1990 and became HMC's local subsidiary in

1997. HMC had largely overcome the liability of foreignness and had achieved organisational legitimacy by being a partner of a local company. The new local investment could help HMC maximise its long-term after-tax global returns, making Turkey a more attractive location. Thus, each side had high stakes in the bargaining relation.

Unsurprisingly, the Minister of Industry and Trade (hereafter Minister) and the Chief Executive Officer (CEO) of the Turkish partner of the local subsidiary mobilised to convince the Turkish government to provide HMC with appropriate land and attractive investment incentives to bring the investment to Turkish soil. The Minister was the strongest political supporter of the investment. He noted an intense direct competition with other states for the investment:

We were in competition with the governments of Czech Republic and Slovakia which offered very attractive incentives. Based on our initial meetings with Hyundai seniors, it became clear that if we could provide [the] same incentives, the investment would be materialised in our country ... We talked and investigated the project. We found it *very attractive*.<sup>5</sup>

HMC proposed a USD1384 billion investment to create 2793 new jobs and 305,000 units per year with a targeted export valued at USD7.573 billion by 2010. In return, it demanded investment discounts, full corporate tax relief and a free transfer of 47 hectares (116 acres) of land adjacent to a sea port with a fully completed infrastructure.<sup>6</sup>

#### *Administrative capacity*

Despite the collaborative interactions between the Turkish state and HMC at the outset, there were several major weaknesses in the Turkish state's administrative capacity. In the words of a very senior government bureaucrat, there was 'bureaucratic fragmentation ... a lack of coordination, cooperation and conflict resolution mechanisms' to generate coherence and consistency in policy responses.<sup>7</sup> In regards to fragmentation, there were five ministries, three bureaucratic agencies and a municipality that had authority over the processing of HMC's requests.<sup>8</sup> Accordingly, the administrative decision-making structure and process pointed to a bargaining process dispersed across various public-sector actors (that is, diffused decision-making).

The General Directorate for Foreign Investment (GDFI) was the government department in charge of FDI in Turkey. The GDFI was one of the eight operational general directorates of the Treasury under the Ministry of State in Charge of Treasury. It was under-resourced, uncompetitive and invisible in the FDI entry bargaining process. In the words of the Minister, GDFI 'did not have a one-stop-shop approach' in a 'fragmented bureaucratic environment':

Industrialists are in contact with the Minister of Industry and Trade [not the Treasury] as they know that we understand their [investment related] problems. With the Treasury's perspective, it was

impossible to develop an international investment framework [attracting and embedding inward FDI]. . . . When [owners of] foreign capital came to Turkey, they could not get [an] appointment from [GDFI]. . . . I insisted on having [inward FDI related issues] managed under [the] Ministry of Industry and Trade. In so doing, [the] ministry's staff, undersecretary and deputy undersecretaries, general managers, and specialists could steer [the bargaining process] easily.<sup>9</sup>

In this environment, the GDFI could not play an effective policy advocacy role in advising the government whether the direct cost of incentives would exceed the benefits derived from the investment for the national economy. There was no autonomous bureaucratic agency (for example, investment promotion agency) with strong internal resources including its mission, mandate, human capital and budget to initiate and administer an FDI incentive regime and/or facilitate a coordinated FDI response.

Intra-bureaucratic conflict was the first face of entry bargaining. In the words of the Minister, the Treasury started saying: 'it is our job because it involves investment incentives'. The Finance Minister began saying: 'there are tax incentives involved that's our job'.<sup>10</sup> As a senior bureaucrat noted, there was 'no active investment promotion and FDI-related capacity building' through policy advocacy to the government.<sup>11</sup> Unsurprisingly, the CEO of a local subsidiary emphasised Turkey's need for investment promotion agency: 'many countries had set-up investment [promotion] agencies [which] facilitated investment agreements. The government has not dealt with this issue in an organised manner' (cited in Vatan 2005).

Given the salience of the investment for the Turkish economy and competition for the investment, the Minister sought the intervention of the Prime Minister. He aimed for a coordination of policy response:

I took the issue to the Prime Minister. I was also responsible for the evaluation of economic problems as a coordinating minister at the time. I gathered all relevant parties of this issue together. We discussed there and identified issues including incentives to be given within the context of World Bank and IMF stand-by agreements, and what we can accept within the context of European Union relations. [Then], I made a presentation to the Prime Minister who [later] gave full authority to me in the Council of Ministers [to conduct negotiations with HMC].<sup>12</sup>

The Minister formed and led an ad hoc, inter-ministerial and inter-bureaucratic coordinating committee. This committee included senior members of key bureaucracies and ministries that were legally integral to the decision-making process. In so doing, the government aimed to improve its policy capacity and to strengthen the steering role of the Minister in the entry bargaining. In the words of the Minister:



I formed a committee composed of the General Director of the General Directorate for Foreign Investment from the Treasury who is related to investment discounts, general director from Ministry of Finance who was responsible for the allocation of a Treasury land for investment, and a general director from State Planning Organization. *My aim was to prevent conflicts that might arise in the future. . . .* We prepared all documents relating to our proposal offering free land close to a sea port, tax and investment incentives, and building infrastructure. We went to South Korea. *I went there to represent the State.* I took bureaucrats with me who would have their signature on this job. [The CEO of HMC's local subsidiary] also accompanied us. We held top level and long meetings with [the] Hyundai president, chairman and their technical advisors.<sup>13</sup>

The appropriate choice of organisational response for negotiations was a mix of coordination and delegation of decision-making.

The Turkish state 'promised a 40 per cent investment discount, an imposition of only two per cent corporate tax for 10 years for investments over 500 euros, [and] provision of the free land requested' when the Turkish negotiators visited HMC headquarters in South Korea on 18 November 2005 (cited in Muderrisoglu 2005). HMC's senior officials 'agreed to visit Turkey on the basis of our proposal. They asked us to identify potential investment sites in the Organised Industry Regions close to a seaport', said the Minister.<sup>14</sup> HMC's senior executives reciprocated this visit:

When we returned [to Turkey], we prepared potential sites and informed HMC officials. They inspected 13 sites we suggested and accepted to have their investment in Corlu that was one of our offers'.<sup>15</sup>

As such, the bargaining interactions between the Turkish state and HMC were cooperative at the outset.

### *Institutional capacity*

There were still institutional arrangements reinforcing reliance on rules that were in conflict with these customised incentives. There had been three regional classifications for the government's investment incentives: 'Priority Regions for Development', 'Normal Regions' and 'Developed Regions'. The Turkish formal investment regime, which regulated the government's special financial and fiscal incentives, included direct subsidies, free land offers and tax incentives aimed at channelling investments to underdeveloped regions. These incentives were applied to both domestic and foreign investors. Interviews revealed that the Turkish state was 'constrained by this legislation'.<sup>16</sup> Specifically, to qualify for the support mechanisms, the government offered HMC some unattractive

land in the ‘Priority Regions for Development’ which then included 49 provinces. In the words of the Minister:

Ministry of Finance said that ‘if we offer the land requested they should pay rent for several years . . . ‘If [HMC] want free land, it should choose a site from within 49 provinces in underdeveloped regions as stipulated in the Incentive Law number 5084’. We could not solve the problem . . . <sup>17</sup>

Indeed, the Finance Minister noted his preference for non-selective policy response:

We value both national and foreign investors. We appreciate their investments and do our best [to attract and embed FDI]. However, we have to comply with our current legislation and be neutral to everyone . . . I am not in favour of supplying privileges [to HMC]. (cited in Referans 2005)

Similarly, the State Minister responsible from the Treasury underlined the Turkish state’s rule-based approach to bargaining: ‘*Principles are important. Turkey should not be in the position of a country that offers incentives through negotiations.* How can we explain this to those who invested in the 49 provinces?’ (cited in Sabah 2005, my emphasis). A General Manager of a car-manufacturing firm noted in an interview that this was an ‘archaic’ FDI regime ‘implemented very strictly’ by the government.<sup>18</sup> Collaborative interaction among the parties turned to a conflictual one that defined the ‘two faces of bargaining’. On the one hand, there was a conflict within the state apparatus on investment site and offered incentives. On the other hand, HMC insisted on a site in a developed region along with fiscal and financial incentives. There was no effective state-steering to resolve these conflicts towards the investment deal.

State tradition inherited from the Ottoman period has been a public philosophy influencing formal FDI and incentive regimes and the normative underpinning of state capacity in this instance. The then Deputy Director of the GDFI revealed this informal structure that apparently guided the Turkish investment incentive regime and state behaviour in bargaining with HMC:

We have the same investment incentives for foreign and domestic investors. This is the state’s proposal package [to investors]. *I show certain regions and propose which incentives to offer . . . It is up to the investor to accept or reject this proposal. . . [incentives are not negotiable].* Turkey has 600 years of state tradition. We have certain practices. They are gained via experiences. This is [our] culture and does not change.<sup>19</sup>

This view is an exemplar of state tradition inherited from the Ottoman Empire to the Early Turkish Republic, during which time the state bureaucracy enjoyed a superior position in its relations with society and markets. As Ozbudun (2000:

128) notes: ‘The state is valued in its own right, is relatively autonomous from society, and plays a paternalistic role’ (see also Heper 1992, 2001). The state welcomed FDI but specified clear rules and non-selective policies with respect to foreign and domestic investors.

Interview material suggests that the Turkish state was also constrained by the lack of an economic growth strategy reflecting the collective objectives and goals of macroeconomic and industrial policies to direct the entry bargaining process towards the investment deal.<sup>20</sup> As the Minister notes:

We should have adopted a research and development-led, technology-led industrialisation model during those days. . . . the Turkish economy was managed via monetary policy [i.e. exclusive focus on price stability] over the years. Monetary policy should have been supported by fiscal policy which had to be linked with production [i.e. industrial] policies.<sup>21</sup>

Unsurprisingly, the Turkish state’s behaviour was not guided by strong FDI-related policies and ideas during the entry bargaining. In this environment, the state’s administrative capacity was further constrained by the limited fiscal capacity where the public debt burden was about 75 per cent of gross domestic product at end-2004. As the Economist Intelligence Unit (2005: 9) noted: ‘Under a new IMF-backed programme the government will have to agree to maintain ambitious fiscal targets, particularly the public-sector primary surplus (i.e. the public-sector balance less interest payments on government debt)’. As such, the state had limited fiscal capacity and policy autonomy. The key state actors which implemented the IMF agreement were the Treasury and Ministry of Finance. Specifically, the Treasury opposed the incentives requested by HMC, whilst the Ministry of Finance resisted the provision of land due to Turkey’s dependence on IMF support and their bureaucratic commitments to the IMF. In the words of the Minister, the Treasury said that:

when we declared those 49 provinces in Law no. 5084, we reached a very difficult agreement with the IMF and World Bank. Thus, we could not declare the desired land as an incentive region and we could not offer investment discounts. I was embarrassed . . .<sup>22</sup>

On 20 December 2005, the State Minister responsible from the Treasury made a public statement that: ‘[w]e gave promises to the IMF, and we cannot proceed against them. At the moment we cannot provide special investment incentives to Hyundai’ (cited in Baysal 2005).

The IMF agreement contributed to a weak relational foundation that exacerbated the state-led steering of the entry bargaining process towards an investment deal. In the words of the Minister:

We were constrained by the current legislation and obstacles put forward by bureaucrats who acted in-line with the IMF and World Bank agreements. They argue that government subsidies

in investment regions contribute to our budget deficits [such as] 50 per cent discount in energy, free land, tax holiday for three to five years, and exemption from corporate tax, etc. We could not overcome this bureaucratic obstacle. To do so, you should be [financially] strong. Today, we could have overcome a similar bureaucratic resistance. Why? We paid our debt in full to the IMF [and run a primary surplus]. We no longer depend [on the IMF].<sup>23</sup>

In summary, elected Turkish politicians were helpless in tailoring firm-specific investment incentives for domestic and foreign industrialists due to the pressure of unelected IMF officers (for an anecdotal evidence, see also Munyar 2006). In January 2006, it became public that HMC had sent a letter to the Minister indicating that the Czech Republic was a preferred location for the investment. Apparently, when state officials bargain under the IMF conditionality, they may face a greater incentive to adopt uncompromising bargaining position with MNCs that may result in bargaining breakdowns.

## **Conclusions**

The primary focus of this article was to examine the entry bargaining process and its outcome. Drawing on evidence from the HMC case study and by integrating relevant perspectives from the IB, IPE, CPP and economic geography literatures, this study argues that the outcome of this governance process is a function of state capacity that has interrelated administrative and institutional dimensions.

This article contributes to the IB, IPE, CPP and economic geography literatures on both bargaining interactions and the role of state capacity in domestic policy-making. Very little attention has been paid to date to the role that state capacity plays in entry bargaining processes and how decisions not to invest are explained. The focus instead has been on how the relative bargaining powers of the parties can influence the terms of investment agreements, and how bilateral or multilateral agreements offer protection and bargaining leverage to mobile MNCs vis-à-vis immobile HSs in a globalising world economy. Thus, the governance of entry bargaining processes by state has been overlooked in the past. However, this article highlights the need to devote greater analytical attention to links between state capacity and bargaining outcomes. In doing so, this article contributes to previous research on bargaining models and state-centric governance models. Unlike previous research on bargaining models, which has been static, investment outcome-oriented and MNC-centric, this article offers a dynamic, process-based and state-centric bargaining model. In doing so, it complements recent empirical research on state capacity in bargaining interactions (Bakir 2011) on two grounds. First, it shows causal mechanisms that operate in the mobilisation, conflict and resolution phases of the entry bargaining process in Turkey. Second, it shows that previous theoretical prediction that investment outcome is a function of state capacity is not idiosyncratic to the Czech state and HMC bargaining. Thus, it offers an alternative explanation that moves beyond conventional explanations of MNC investment decisions in IB literature that focuses on country-specific locational advantages such as infrastructure, industry clusters

and proximity to target markets (see for example, Akcaoglu and Erol 2011). Further, the HMC case contributes to previous research on bargaining relations inside HSs, and between HSs and MNCs (Encarnation and Wells 1985). It demonstrates that the portfolio of organisational responses available to states and their successful implementation is a function of state capacity. Specifically, the Turkish state initially departed from its general approach (that is, reliance on rules) and adopted a special bargaining arrangement for HMC investment: it formed an ad hoc coordinating committee led by the Minister. The aim was to resolve anticipated conflicts in internal bargaining amongst public-sector actors arising from a fragmented administrative structure. This committee proposed customised incentives and desired-land-for-free that would overcome the constraints originating from formal and informal institutions of the investment regime. However, the Ministry of Finance and the State Ministry responsible for the Treasury acted inconsistently with the initial proposal, made by the coordinating committee to HMC. They strongly resisted this proposal due to Turkey's dependence on the IMF financial support and their bureaucratic mandate to implement the IMF agreement. The state had weak capacity to resolve these conflicts inside the state apparatus. The result was HMC's withdrawal from the bargaining.

This article yields several implications for research and theory. It suggests that investment outcomes are least likely when developing country states have weak capacities to set strategic directions to allocate administrative and institutional resources, and to steer various public- and private-sector actors to deliver investment decisions. Thus it challenges those analyses that suggest minor formal bargaining interactions and residual roles for states in developing countries to host inward FDI. It also provides new insights into the centrality of states in entry bargaining and investment promotion strategies. Further, it refines administrative and institutional capacity concepts as the key interrelated dimensions of state capacity. In doing so, it shows their utility in the governance of entry bargaining.

Although the IB, IPE, CPP and economic geography literatures have made significant advances in recent years in state and business relations, little has been done to integrate these growing streams of literature in the context of the governance of entry bargaining. The study of state capacity in entry bargaining suggests the need for scholars to be open to the study of state capacity and entry bargaining processes. In so doing, IB, IPE and economic geography scholars can learn from scholars of CPP who have focused much of their analyses on governance as a theory of state capacity (Pierre and Peters 2000; Peters and Pierre 2006; Goetz 2008; Bakir 2009; Bell and Hindmoor 2009), while CPP scholars can learn from scholars of IB and IPE who have devoted much of their attention on entry bargaining (Boddewyn 1988; Behrman and Grosse 1990; Grosse 2005), and bilateral or multi-lateral negotiations in trade, finance and investment (Putnam 1988; Odell 2000; Heron 2011), respectively.

Politicians and bureaucrats can also draw insight from this study. They should align the state capacity with the evolving state-business relations in a globalising world economy. They should avoid adopting several negotiating approaches simultaneously during entry bargaining. Instead, it would be better for them to carefully consider enhancing the state capacity to *form* and *implement* the most appropriate organisational arrangements and procedures for various investors.

## Notes

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1. Czech Invest offered customised incentives to HMC (Bakir 2011: 353–5).
2. The Czech state benefited significantly from the EU's regional support programmes with special incentives for investment and job creation which corresponded to 15 per cent of the total HMC investment (Bakir 2011: 355).
3. The farming cooperative and six landowners had no interest in selling land requested by HMC. The Czech state's threat of land expropriation over these opponents resolved the conflict and contributed significantly to investment outcome (Bakir 2011: 356–8).
4. State industry vision informed the Czech FDI regime and guided the state behaviour (Bakir 2011: 351–53).
5. Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013 (my emphasis).
6. Figures and information on what HMC officially offered to and requested from the Turkish government are based on an official letter and its annex which were supplied to the author on the condition of anonymity.
7. Interview, the Head of Investment Promotion Agency in Turkey, Istanbul, 29 May 2010.
8. Ministries included Ministries of Finance, Industry and Trade, Transportation, Forests, Energy and Natural Resources. The three bureaucratic agencies were Undersecretariats of Treasury, Foreign Trade and Privatization Board.
9. Interview, the Head of Investment Promotion Agency in Turkey, Istanbul, 29 May 2010.
10. Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013.
11. Interview, the Head of Investment Promotion Agency in Turkey, Istanbul, 29 May 2010.
12. Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013.
13. Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013. Emphases added.
14. Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013.
15. Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013.
16. Interview, a General Manager of auto-manufacturing firm, Istanbul, 14 July 2009; Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013.
17. Interview, Deputy Director of Incentive Implementation and Foreign Capital General Directorate at Ministry of Economy, Ankara, 5 April 2013. My emphasis.
18. Interview, a General Manager of auto manufacturing firm, Istanbul, 15 July 2009.
19. Interview, Deputy Director of Incentive Implementation and Foreign Capital General Directorate at Ministry of Economy, Ankara, 5 April 2013. My emphasis.
20. Interview, a General Manager of auto manufacturing firm, Istanbul, 15 July 2009.
21. Interview, Former Minister of Industry and Trade, Ankara, 11 April 2013.
22. Interview, Deputy Director of Incentive Implementation and Foreign Capital General Directorate at Ministry of Economy, Ankara, 5 April 2013. My emphasis.
23. Interview, Deputy Director of Incentive Implementation and Foreign Capital General Directorate at Ministry of Economy, Ankara, 5 April 2013. My emphasis.

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