Discretionary Economic Nationalism?: Business policy preferences towards open markets for corporate control

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This paper develops a conceptualisation of the demand for, and supply of, restrictive policy towards foreign direct investments of particular forms. It hypothesises that some commonly observed regulatory approaches to FDI reflect nuanced political responses to the complexity, namely temporal and transaction specificity, of domestic corporate preferences for foreign investment policy. It also examines political entrepreneurship tapping popular economic nationalist sentiment as a constraining variable on policy outcomes. The paper consequently discusses the political economy logic of how non-transparent and discretionary FDI regulation can deliver generally liberal policy outcomes in practice, with occasional significant exceptions. In doing so it draws upon the theory of political markets, a detailed historical study of the Australian case, as well as recent developments in Japan and beyond.

I. Introduction

Many nations have liberalised substantially their policy regimes towards inbound foreign direct investment during the last two decades. Proactive state efforts to attract FDI, of certain kinds at least, often overshadow continuing restrictions and investment screening mechanisms. Yet ever more open policy is not inevitable. The restrictive policy regimes of many countries in the 1960s and 1970s, for instance, had frequently been preceded by more liberal policy settings. Moreover, the extent of policy openness has varied significantly not just inter-temporally but also across sectors. Binding international agreements on foreign investment regulation and other state action impacting on corporate presence abroad are still at an embryonic stage; in contrast to the international governance of trade policies. Within the multilateral GATT-WTO framework, binding commitments on foreign investment are limited to the narrow subset of issues related to the TRIMS agreement on trade-related investment measures, and limited commitments on commercial presence in services under GATS (WTO, 1998, 1999). The 1998 failure of negotiations amongst OECD member states over a multilateral agreement on investment starkly demonstrated the continuing domestic sensitivities towards relinquishing national control over foreign investment, even in nations that are significant sources of global FDI flows (Graham, 2000). Recent national security concerns, in the United States and elsewhere, over foreign control of privately-owned critical infrastructure, have compounded this reticence to cede regulatory control. Regional and bilateral economic agreements increasingly involve commitments to the free flow of capital as well as goods. Yet many governments – including in the EU recently – have shown considerable determination to retain discretionary means for constraining foreign participation in domestic markets for corporate control in particular. Economic nationalism – as ideational and political phenomena – remains significant although the policy instruments chosen by governments in response to it are becoming more discretionary.

Surprisingly, there are still few academic studies specifically of the domestic demand for, and supply of, foreign investment regulation; despite the historical and contemporary importance of FDI to many economies. A number of valuable surveys of the state of foreign investment policy regimes exist, such as Safarian (1993), Brewer & Young (1998), and regular UNCTAD reports, but these tend to be rather static accounts of policy settings at a particular juncture. Within the international business literature there is a long established concern, from managerial perspectives, with political risk and bargaining between multinational enterprises and host governments (Gomes-Casseres, 1990; Kobrin, 1982, 1987; Vachani, 1995). Murtha (1991, 1993), Jacbosen, Lenway and Ring (1993), Kobrin (1993), Rugman and Verbeke (1998) and others have provided tentative explorations of the determinants of government policy preferences but such analysis generally lies beyond the disciplinary concerns of international business scholars. At the same time, political scientists generally have been concerned with the implications of large multinational enterprises for national sovereignty and state policy latitude rather than with the analysis of domestic constituencies for policy towards FDI (eg. Strange, 1997; Boyer & Drache, 1996). There are some valuable historical case studies of the role of foreign enterprises in particular national economies, most commonly focusing on the resources sector, although some works are burdened by now rather outmoded theoretical underpinnings (such as dependency theory). There remains little in the way of a general literature on the domestic determinants of FDI policy preferences. By contrast, there is a large literature on the domestic sources of national trade policy preferences. There is a need to extend the analytical concerns and approaches within this literature to FDI policy, given its significance in evolving bilateral, regional and multilateral agreements and potential economic impacts. Yet the political economy of FDI policy is ultimately more complex that in the case of trade policy, as is explored subsequently.

The rest of the paper is structured in the following way. Section II briefly outlines the analytical framework adopted, namely a political markets approach, whilst section III explores domestic demand for inward FDI regulation at some length. Section IV then considers the supply of that regulation, and how the particular forms FDI policy often takes may represent attempts by state actors to optimise politically across complex patterns of public and private interest demands in relation to FDI. Finally, section V draws several conclusions about the interface of economic nationalism and domestic private interests and the implications for FDI policymaking.

II. Analytical approach

There is a very substantial literature on how domestic structures of economic interests may shape national trade policy preferences; with the latter in turn reinforcing and sometimes altering the former (for instance, Destler & Odell, 1987; Milner, 1988; Rogowski, 1989; Simmons, 1994). National political leaderships therefore find themselves engaged in a policy (and inevitably political) calculus across what Putnam (1988) termed 'two level games'. As shall be seen in section IV of this paper, the supply of foreign investment regulation is further complicated by the role of both sub-national governments, and quasi independent market institutions such as stock markets. The key analytical concern, nonetheless, is with the domestic sources of demand for particular FDI policy outcomes, and the means by which national governments might seek to reconcile contending domestic imperatives through the design of particular FDI regulatory practices.

Much of the literature on the domestic determinants of trade policy, and tariff protection in particular, adopts – explicitly or otherwise – a political markets approach. This broad and essentially rational choice theoretical approach shares with the wider economics of regulation literature an assumption that governments, in democracies at least, produce a package of private and public goods in response to demands from voters, influential enterprises and organised interest groups. Those seeking to gain and retain political office will act entrepreneurially in seeking to devise an optimal policy mix in the face of political competition. Political markets approaches prioritize the insight that economic actors may cost-effectively secure protection from market forces by investing in political action. Both as a cause and a consequence of this, regulatory favours to rent-seekers rather than public interest goods may predominate in the policy mix that governments adopt (Mueller, 1989). The likelihood of this is compounded by information shortage and collective action problems; in particular, the benefits of market interventions are typically concentrated whilst the costs are often widely diffused. This is acutely so in the case of tariff protection and market distortions. Economic regulation is therefore supplied in response to political demands which, in the more austere versions of the political markets approach, are assumed to be driven overwhelmingly by firms' and individuals' own immediate economic interests.

The political markets approach has been criticised at times for its excessively narrow account of political motivations, and, in its public choice variant, for excessive pessimism about the prospects for economic reform (eg. Radnitzky & Bernholz, 1987). Whilst valid critiques in some respects, with certain modifications the political markets concept remains a useful means of conceptualising both the demand and supply side dimensions of economic regulation. For a political markets model to have explanatory clout, especially in relation to foreign investment policy, sufficient analytical weight must be given to the ideational dimensions of policy. That is, ideas and ideology should be accorded a degree of independent explanatory significance in political markets characterised by inevitable information limitations. Noted economic historian Douglas North has made the important point that those who would downplay the role of ideas in economic affairs need to account for the enormous financial and other resources devoted by societies to the dissemination of them. North (1981: 49) concluded that 'ideology is an economizing device by which individuals come to terms with their environment and are provided with a 'world view' so that the decision-making process is simplified'. This is certainly not limited to voters, although the greater the economic stake an actor has in certain policy settings the greater incentive they have to invest time and resources in understanding their workings. North's (2005) latest work elevates ideas and cognition to central analytical significance, along with institutions, in explaining systematic patterns in national economic structures and performance. This recognition of the interdependent explanatory roles of interests, ideas and institutions accords with the recent work of Roe (2003) and Gourevitch and Shinn (2005) on the political determinants of differences in national systems of corporate governance.

III. Demand for inward FDI regulation

The political economy of FDI policy centres on the fact that, in general, FDI will lift the returns to factors of production it utilises in the host economy while entailing complex distributional aspects (Caves 1996; Gorg & Greenaway, 2004; Girma, Greenaway & Wakelin, 2001). Complex private interest dynamics hence can arise, but prior to exploring those consideration needs to be given to some potential 'public interest' demands for restrictions upon FDI.

Public interest determinants

National *security* imperatives in sensitive sectors, such as defence-related industries and some critical infrastructure, can be readily envisaged. Indeed, these concerns have recently become more politically salient in the United States, for instance, in relation to port security. In late July 2007 President George W. Bush signed a bill which has the effect of tightening security reviews of foreign investments in defence-related areas, as well as extending the review process to include critical infrastructure and energy-related enterprises (Associated Press, 28 July 2007). Most acquisitions by foreign state-owned enterprises will also be vetted. At the same time the Japanese government is considering similar measures (*Yomiuri Shimbun*, 3/5/07). Whether these recent policy developments are sufficiently measured and warranted may become clear in time. Although the evidence is still anecdotal, it does seem that the imperative for the policy lies in the cognitively 'arresting events' – to use Posner's (2004: 122, 169) terminology – of September 11 and subsequently, and their domestic political manifestations, rather than in private rent-seeking.

Historically, *'second best'* arguments were often made for regulating foreign direct investment. If domestic policy settings give rise to substantial private rents and/or moral hazard problems at the expense of the community, and there is little scope for policy reform, then a public interest argument for a restrictive FDI policy may arise. If foreign firms are able to secure a share of consumer surplus owing to market-distorting regulations, and then repatriate it abroad, then there will be a welfare loss to the host economy (Corden 1974: 221). The positive externalities that FDI can entail may be large enough to more than offset this loss, making a liberal FDI regime still desirable. If the rents lost are larger than the spillovers, and they cannot be clawed back through taxation, then restrictions on FDI, or at least profit repatriation, would become attractive. It must be stressed that this would only be a second best solution and that domestic reform would be the first best. The most common scenario is of foreign firms earning large profits by 'tariff-hopping' into very protected and oligopolistic markets, at least until the high rates of profitability attract more firms into the market (Corden 1974: 330–50). This scenario accords with critiques of the profitability of Australian subsidiaries of American firms such as General Motors, manufacturing locally behind high tariff barriers, in the early and mid-1960s (Johns, 1967).

Another 'second best' public interest argument for restrictive FDI policy may arise in relation to national resource rent regimes, especially in the context of weak or federalist political systems. When citizens see themselves as residual claimants to the nation's resources, and when there is a question mark over whether governments are adequately managing the process of selling property rights to public resources, such as in minerals, forestry, fishing or even the right to pollute, foreign investment policy is likely to become even more contentious. Recent rather heavy-handed interventions by the Russian state in natural resource projects involving foreign investors have been justified by President Putin's supporters as righting wrongs during the rushed privatisations following the end of the Soviet era.

In Australia throughout the 1960s there was a growing chorus of criticism, popular and sometimes academic, of supposedly excessively generous state-level concessions to mining consortiums (Fitzpatrick, B & E. L. Wheelwright, 1965). Foreign investors were significant stakeholders in these large projects; which had in common their orientation towards serving rapidly growing Japanese demand for coal and minerals. Queensland, in particular, was singled out for criticism (see Fitzgerald, 1984: 305-87; Galligan, 1982). There was an element of regional political economy to this as the new open cut coal mines of central Queensland were significantly lower cost than the underground operations of New South Wales and the unequal distribution of resources across the states raised issues about Australia's federal structure (Drysdale & Shibata, 1985). Foreign investment and the Japan energy resources trade became contentious within the labour movement, culminating in the economic nationalist policy adventurism of the Whitlam Labor government between 1973 and 1975 (Fitzgerald, 1974). This ultimately included a rash plan to have the Federal government buy back stakes in resources projects with borrowings raised abroad (and indeed through rather dubious channels). Yet the conservative Fraser Coalition government that followed retained its predecessor's policy of 50% local equity requirements for natural resources projects and introduced a resource rent tax (Flint, 1977). Popular concerns about whether Australia was earning a 'fair return' on its resources trade lingered well into the 1980s (Harris & Ikuta, 1982; McQueen, 1982; Crough and Wheelwright, 1982). In the late 1980s the focus of such fears then shifted to Japanese investment in real estate and agricultural industries; compounded by much populist media and political entrepreneurship on the issue (see Pokarier, 2004; David & Wheelwright, 1989). In hindsight such controversy is unsurprising given Japan's historical status as the only nation to have attacked Australian territory militarily, in addition to the particular sensitivities that arise in relation to land and resources.

Central to national identities is a common territory that citizens share and which bestows resources upon them. Smith (1991: 9–10) summarises the popular nationalist conception where

> The homeland becomes a repository of historic memories and associations... The land's resources also become exclusive to the people; they are not for 'alien' use and exploitation. The national territory must become self-sufficient.

Whether or not Smith is right in his subsequent assertion that "autarchy is as much defence of sacred homelands as of economic interests" is beyond the scope of this paper. Suffice it to note that the ideational potency of territory, and the land and resources it delineates, makes it more likely that foreign investment in real estate or extractive industries will be more contentious politically. Breton (1964: 377), in an early, influential and rather rare work on economic nationalism, suggested that the territorial fixation of economic nationalists was evidenced by the fact that that they seldom consider capital owned abroad by nationals as part of the national capital.

Foreign investments entailing controlling stakes in *culturally sensitive* sectors such the broadcasting media are still prohibited by otherwise rather liberal contemporary economies, such as the USA, Japan and, until recently, Australia. Whether such restrictions are well-founded or not can certainly be contested, although there can be little doubt (based on a range of opinion poll data) that substantial majorities of citizens in many countries hold concerns about such foreign investments (see Pokarier, 2003).

This suggests *historical proximity* may be a factor in the openness or otherwise of a foreign investment regime to investors of particular national origins. Vachani (1995:164–65), in seeking the determinants of MNC-host government bargaining outcomes, found evidence to support his hypothesis that: 'multinationals with positive historical or cultural ties with the host country will enjoy a higher proportion of foreign ownership retained than those without such ties.' That is, firms face less pressure from host governments and societies to 'indigenize' the firm through involving local equity partners. The concomitant of this is an anticipated correlation between the proportion of total inward FDI being from culturally proximate countries and the openness of the FDI policy regime. This certainly accords with the historical openness of Australia to 'overseas capital' (officially, in contrast to the later terminology of 'foreign capital') when it was predominately British; that is, up until the late 1950s. Yet it does not fit with the significant liberalisation of FDI policy by the Hawke and Keating governments in the mid and late 1980s; a time when Japanese investment was domestically contentious[1]. Although anecdotal, it is striking too that many Japanese moves

[1] Yet Vachani's hypothesis and findings are, a priori, logical and suggest in fact both the magnitude of the economic governance imperative faced by the Labor government owing to

even today to prevent particular foreign takeover bids have involved American firms, despite the centrality of the US-Japan relationship in the security and broader fields.

The cultural dimensions of FDI policy suggests a further 'public interest' (contentious) possibility; namely, *economic nationalism as good in itself*. A recent academic literature, although not entirely convincing to this author, seeks to reclaim the terminology of economic nationalism from its pejorative associations amongst liberal economists and to see it as a natural manifestation of nation-building and developing national identities (eg. Helleiner, 2002; Levi-Faur, 1997; Pickel, 2003; and, in a slightly different vein, Harlen, 1999). Richard Caves, has provided a tentative model, compatible with a rational choice-based political markets approach, for giving serious analytical attention to the possible preferences of citizens for national economic self-determination, or a simple xenophobic preference for minimising dealings with foreigners (Caves, 1996:250–51). In Caves' conception, voter support for control of FDI on nationalist grounds would be '…subject to the condition that real-income costs of the restriction do not outweigh the utility of the gain in perceived independence.' Both substantial opinion poll data and secondary academic sources attest to the historical influence of economic nationalist ideas in Australia (Goot, 1990). Either increasing promise of high-yielding FDI and/or declining domestic economic performance, may change perceptions of the opportunity costs of FDI regulation.

All the possible 'public interest' based rationales for restrictive policies towards FDI are significant, independently of their analytical importance when manifested directly as political demands, because their logic/sentiment may be appropriated instrumentally by those who stand to gain economically from such policy measures. Breton (1964: 379), for instance, saw economic nationalist ideas as primarily serving the interests of protectionist constituencies; making restrictive policy that was not in the interests of the society as a whole (and the working class in particular) more palatable politically. It is to these substantive economic constituencies for and against an open FDI policy regime that we now turn our attention to.

Private interest determinants

As noted above, in general FDI will increase returns to the factors of production that it utilises in the host economy but in doing so will impose costs on other corporate entities.

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the balance-of-payments problem Australia faced, and the significance of its defence of the benefits of Japanese FDI to a sceptical public constituency.

The dimension of control that is fundamental to FDI also entails additional potential distributional impacts. So too does FDI that is market-seeking instead, or in addition to, that which is location-advantage seeking. Gourevitch and Shinn (2005), in their work on the political economy of corporate governance systems, identified labour, management, and shareholders as three broad interest groups with a number of potential alliance combinations and outcomes that, in turn, systematically patterns corporate governance institutions and practices. Foreign direct investment entails even more fragmented constituencies and potentially shifting coalitions as interests are often transaction (control-event) specific. Core constituencies are labour, other suppliers of business inputs, domestic entrepreneurs and investors (not necessarily with uniform interests), domestic competitors for inputs or markets, and domestic managements. Their potential interests in relation to FDI policy are hence explored briefly.

Labour

Foreign direct investment will generally increase the financial return to labour and/or the overall employment level. Within the international business literature the presence of high levels of unemployment has been identified as a political driver of liberal FDI policy (Kotabe 1993; Globerman 1988). Historically in open frontier economies rising returns to labour from capital inflow would attract migrants, resulting in the possibility of real wages being constrained below the level they would otherwise reach. However, a larger labour force would be supported (Arndt, 1957; Parry 1978:194–97). Consequently, political representatives of labouring interests historically had strong incentives to support higher levels of foreign capital inflow while opposing any policy settings that might result in labour inflow. This was clearly evidenced in the Australian case.

And yet resistance by organised labour to some forms of foreign direct investment, especially takeovers, has been often seen. As FDI entails issues of control by foreign managers it raises distinct issues that other forms of capital inflow do not. Foreign firms might bring certain human resource management practices that conflict with established local practice but which are an important part of the firm's ownership advantages. This was clearly evidenced with Japanese investment abroad in industries such as automobile manufacturing. Consequently there might be resistance to foreign takeovers of existing enterprises by unionised workers in the target firm if they believe that job levels and entitlements can be roughly maintained in the absence of new foreign ownership (Rugman and Verbeke 1998:126). Trade unions also tend to favour the interests of existing employees rather than the creation of greater employment overall. On the other hand, unions may also perceive that they can extract greater rents from a profitable MNE than a domestic firm (Caves 1996:123). However, foreign firms might make more credible threats during wages negotiations to relocate business operations to another country. This has been in evidence historically in the Australian case. Executives of foreign firms, very often Australians, communicated to both unions and the Australian public-at-large that they have alternative location options. In turn domestic firms increasingly came to make similar threats but, anecdotally, seem to have had less credibility in doing so.

Other suppliers

That a liberal FDI policy will be in the interests of labour as a whole suggests other domestic suppliers of business inputs should also have such a strong preference for it. Whether oriented towards the domestic or export markets, a wide array of suppliers of physical inputs and ancillary business service providers, such as lawyers, merchant bankers and accountants, will be utilised by foreign firms. They will not only favour a liberal policy but also stability in other policy settings so as not to jeopardise such contracting with foreign firms. In the Australian case, for instance, since the 1960s providers of professional business services have been most prominent in Japan-related organisations and have often been articulate public defenders of the contribution that Japanese businesses – as customers, investors, and suppliers – made to Australian national welfare. This was strikingly evident during controversy over Japanese investment in the late 1980s.

Domestic entrepreneurs and investors

The interests of domestic entrepreneurs and investors in relation to FDI policy fragment. Any local business facing liquidity constraints, or wishing to share risk, will welcome the opportunity to enter into joint ventures with foreign firms. This was essentially the experience of Australian resources pioneers in the early 1960s. They sought both Japanese and American capital and expertise, as well as access to Japanese markets and long term contracts in order to exploit the opportunities presented by large resource endowments they won claim to (Anderson, 1983; Fitzgerald, 1984: 324). This leads to the broader but important observation that sellers of assets have an interest in an open investment regime because it can increase the pool of bidders.

The clear corollary of this is that local buyers of assets, in relatively fixed supply, would have an interest in a restrictive investment policy. In the absence of foreign buyers, local bidders might pay less for an asset, especially in a context of rather inefficient financial markets. Such logic extends to local equity requirements, one of the popular objects of foreign investment policy adopted by many governments. These can provide local firms with involvement in enterprises at below free market prices and therefore may create political constituencies for the establishment and perpetuation of such a regulatory requirement. It is notable that during the late 1960s and 1970s Australian domestic business representatives were frequent supporters of local equity requirements; policy preferences realised through the years of the Fraser Coalition government with its policy of equal partnerships between foreign and local equity in the key resources and manufacturing sectors (Arndt, 1977). Some domestic business constituencies, such as the firm CSR, benefited from its local status under such a policy and lobbied for its maintenance. The Fraser Coalition government's maintenance of historically strict local equity requirements for the resources sector in particular is striking; especially in light of subsequent liberalisation in the next decade by the Hawke and Keating Labor governments. It may have been that the latter's lack of links to such domestic business constituencies actually made liberalisation of local equity requirements politically much easier than for a Coalition government. However, the Labor government was also confronted by the policy challenge of a rapidly worsening external balance-of-payments in a way that the Fraser Government was not.

Domestic competitors for inputs or markets

When a foreign firm directly invests to secure market share in a host economy, taking advantage of its competitive advantages, local competitors (perhaps of foreign origin) will have the same incentives to lobby for protection, through barriers to investment, that they would have if faced with competition from the rival firm's imported product (Parry 1978: 178–191). Indeed, the decision of the rival to invest directly in productive capacity might be a strategic response to the local firms' successful lobbying for protective barriers against its goods: 'tariff-hopping' FDI as noted above.

It is often stated in the international business literature that export-oriented foreign investment is likely to beget far less opposition and empirical studies of MNC-host government bargaining do offer some evidence to support this (Poynter 1986:57). Nonetheless, there will be domestic constituencies opposed to the entry of export-oriented firms. While export orientation implies there is not an immediate threat to the customer base of local domestically oriented firms, the latter may still fear product might be later directed to the domestic market. Solely export-oriented FDI also might still be in competition for the established export markets of local firms in the host country.

Less obvious but equally significant is the threat to a domestic firm's cost structure and supply chains that the arrival of an export-oriented foreign enterprise might represent. The corollary of the local suppliers of business inputs being, prima facie, supporters of a liberal FDI policy regime is that local end users of those inputs would prefer new competitors were not able to enter the economy (unless the additional demand generated scale economies that benefited all users). FDI may be driven by recognition of the clear locational advantages the host country's firms have in a competition with the investor in international markets. This was the case with the direct investments by Japanese beef processors in Australia in the late 1980s and early 1990s as they confronted the prospect of direct competition from Australia after the liberalisation of the domestic Japanese market (Morison & Officer, 1992). Similarly, Japanese travel and tourism enterprises responded strategically to the growing popularity of international travel in the 1980s – at the expense of domestic travel – by investing in hotel and other travel businesses in Australia and other popular destinations.

The ultimate FDI policy preference of the local firms having to compete with direct investors for inputs will depend upon their calculus of the costs associated with that competition, versus the other benefits FDI might bring them. Foreign direct investment, like other forms of capital inflow, can help raise the limits on economic growth and so raises the possibility for any business to also grow at a faster rate. A larger economy may allow firms to capture more economies of scale and scope (Caves 1996:251). As FDI also entails spillover effects, such as a raising of the skills base of an economy, other businesses standing to benefit from such positive externalities, and not bearing counter-veiling direct costs from its presence, should favour a liberal policy (Caves 1996:251; Drysdale, 1993).

Management

Managerial insiders may act contrary to the interests of shareholders/owners, foreign or local and the latter, in turn, will seek to guard their interests. Within the increasingly rich literature on corporate governance systems, and in the so-called 'comparative capitalisms' area in particular, close attention is given to the potential divergence of interests of shareholders and managers. This key issue of agency slack, and how particular national institutional and political contexts might compound and systematize it (although not without shareholder resistance) is now well explored. Gourevitch and Shinn (1995: 23) ably schematize the potential varieties of coalitions between labour, management, and shareholders, and the predicted outcomes for patterns of shareholding and corporate governance under particular conditions. They, and other scholars in the comparative corporate governance literature, do not given much consideration however to the mutual impacts of corporate control practices and foreign investment regimes. In so far as the cultural variables discussed above have force, local managers may be more likely to form coalitions with local employees, at the expense of foreign owners, than if the latter were locals.

More straightforward are the diverging interests of management and shareholders during corporate control events. A degree of agency slack in corporate governance might see managements of firms supporting restrictions on foreign takeovers. As potential sellers, company shareholders have an interest in the pool of buyers being as large as possible. Management, on the other hand, will fear a change of owners because they may lose their positions. Management may then be tempted to utilise some of the firm's resources, including reputation, to lobby for a restrictive FDI policy that will be contrary to the interests of the owners of the firm. Such logic also leads to the hypothesis that managements facing the possibility of a hostile foreign takeover bid will endeavour to empower government with discretionary authority over takeovers to block bids.

Australian historical experience in regard to this is striking. During the late 1960s foreign manufacturing enterprises drawn to Australia's growing domestic (owing to substantial immigration) but protected market increasingly sought to enter through acquisition of existing enterprises. Support with the domestic manufacturing community for a foreign takeovers review mechanism grew. One of the last acts of the conservative McMahon Coalition government in 1972, which had previously adhered to a longstanding 'open door' policy towards foreign investment, was to establish such a takeover vetting apparatus. The resurgent Labor Opposition was gaining political mileage through advocating an FDI vetting regime, albeit one focused on the resources sector. The Coalition response was a desperate act of political pragmatism; yet one attractive to certain members of its managerial support base.

Similar issues of managerial self-defence arise in Japan today. Following several high profile hostile takeover bids for Japanese firms by an American private equity fund, and growing awareness of the prevalence of cross-border M&A activity, well over three hundred Japanese publicly listed firms have adopted poison pill-style takeover defences in the last two years. Although the actual level of foreign takeover activity, friendly as well as hostile, in Japan statistically is actually very low, events such as Steel Partners' bid for control of firms such as Bulldog Sauce Co and influence over Sapporo Breweries have been potent 'arresting events' for Japanese management (*Nikkei*, 22/6/07; PWC HK, *Asia Pacific M& A Bulletin*, Year End 2006: 14). Strikingly, in the former case and several others, Japanese managements have been able to win shareholder support for defensive measures against the American fund, despite the – at least short-term – negative impact on shareholder value entailed. Strong media and even governmental support for such managerial action suggests the explanatory significance of ideational factors, namely nationalism and/or beliefs in the efficacy of a distinctly Japanese model of corporate governance – despite little evidence in the contentious cases observed (Kyodo/*Daily Yomiuri*, 15/6/07).

IV. Supply of inward FDI regulation

This author's working hypothesis, supported by considerable evidence of unilateral FDI policy liberalisations, is that governments are inclined to promote FDI and other foreign capital inflow in the absence of counter-veiling pressures for restrictive policies given the boost to their electoral fortunes that robust economic growth may provide. Yet, as seen, governments almost inevitably are subjected to demands on both ostensibly public interest grounds – for some nationalism is a virtue in itself – and for, often frequently shifting, private interest reasons. Reconciling these contending imperatives is a political challenge. Recent broad comparative research affirms the evidence from case studies, such as of Australia, that the presence of multiple state actors may privilege liberal policy. Jensen's (2003, 2006) recent work, involving a large sample of nations, reveals that countries with federal systems are systematically more likely to attract foreign direct investment. Jensen's posited rationale for such a pattern is that states are more likely to provide additional 'veto points' against the adoption of policies unfriendly to foreign firms wishing to make substantial direct investments. Jensen finds sub-national governments to be generally welcoming of foreign direct investment because of the stimulus it can provide to local economies. This accords with earlier scholarly work on the American experience; which highlights that addressing unemployment and/or boosting state revenues are significant motivations for states becoming proactive in attracting foreign investment (Eisenger 1988; Ventriss 1994, Bacchetta and Espinosa 1995; Kotabe 1993:135–38).

Discretion is the better part of valor

Governments caught between recognition of the contribution to FDI can make to economic growth (or at least sub-national governments that articulate that view) and popular economic nationalist sensitivities in the electorate at large, may be attracted to a discretionary investment review mechanism as a means for managing these tensions. The thirty year history of Australia's Foreign Investment Review Board certainly seems to accord with this. Moreover, contending interests and demands from within domestic business constituencies, as seen above, may also make such a foreign investment regime the preferred regulatory mechanism for both governments and the domestic business community at large.

Domestic firms might welcome a discretionary FDI policy rather than blanket restrictions because this would provide them with the opportunity to lobby for the specific restrictions they desire; while remaining passive when foreign investments are seen as benign. Such diffused benefits of FDI, and concentrated costs, would tend to drive policy in a restrictive direction if it were not for the countervailing constituencies of input providers and domestic businesses facing liquidity and/or know how constraints. Unlike tariff politics, governments can resort to a highly discretionary regulatory regime that allows it to weight the significance of each constituency on an individual investment basis. As seen above, that process may pit the interests of domestic shareholders, who stand from a sale to a foreign acquirer, against those of domestic managers, who fear their displacement with a change of ownership.

As just seen, domestic divisions of interest on FDI policy tend to cut across those of other major issues. The FDI policy interests of firms may change fairly rapidly; depending upon whether they are currently a buyer or seller of assets, considering expansion but face capital or technological constraints, or fending off new competitors. The inflow of FDI is also much 'lumpier' than traded goods so there are likely to be times of intense debates and other times when FDI policy is not a political issue at all. All these considerations make the development of FDI policy-specific interest groups rather unlikely. This means the private interest politics of FDI will be complicated by the institutionalised pattern of interest groups. In such circumstances, direct lobbying of governments by particular firm managements and entrepreneurs is posited to be more likely than in many other areas of business regulation. Although business associations as a whole may agree that national economic welfare, and hence their own, is generally enhanced by liberal FDI policy, firms may cheat on any 'rent-seeking moratorium' by seeking specific regulatory interventions that would entail significant benefits to the particular firm.

Yet if domestic firms increasingly have stakes in directly-run operations abroad that subject them to the foreign investment regimes of other nations, a domestic constituency for reciprocally liberal policy will be in the making. Coupled with the increasing sophistication of multinational enterprises' location decisions, and the extensive consulting and appraisal services that serve them, host governments face a heavily constrained calculus across the 'two level games' of FDI policy-making. An implication of this is that FDI policy 'at the gate' may look more open, whilst more discrete means are pursued in the attempt to reconcile contending domestic political and economic imperatives.

Japan's formal FDI policy regime is now very open, submits few investment proposals to screening (although, as noted above, new national security-related measures are on the way), and Japan identifies FDI policy liberalisation abroad as a key objective in bilateral, regional, and multilateral negotiations[2]. Yet a renewed climate of economic nationalism prevails amongst business and policy elites, made salient by professed concerns about the risk of loss of technological advantages abroad through foreign takeovers. Discretionary measures to attenuate this supposed risk have been facilitated by the state through revision of the Japanese corporate code that has made notorious Delaware-style defences, such as poison pills and golden shares, readily available to Japanese managements. The Vice Minister of Japan's Ministry of Economy, Trade and Industry went so far as to call a press conference in June 2007 to stress the legality of such measures after the head of US investment Steel Partners criticised them for damaging Japan's reputation in the international investment community (*Kyodo*, 15/6/07). While not exactly discrete in itself, the broader direction of Japanese policy is devolution of defences against foreign takeovers to the likely corporate targets themselves. Initial resistance from the Tokyo Stock Exchange, which initially sought through listing rules to prevent such measures as golden shares, was overcome through intense suasion brought to bear upon its executives by national government officials. Elsewhere historically, such as in Australia during the

[2] Mason (1992) provides an excellent study of an earlier period of more restrictive Japanese FDI policy and the means by which domestic industry interests were incorporated into investment screening procedures.

odd MLC affair of the late 1960s, governments have sought to use control over incorporation and stock market listing rules to head off contentious corporate control events involving firms in the absence of a general FDI screening regime. It is anticipated that as national governments face greater scrutiny abroad, especially after entering binding commitments on the permitting of cross-border capital mobility such as in the European Union, that there will be more discrete resort to manipulation of the basic architecture of the market for corporate control.

V. Conclusions

The broader implication of this analysis is that non-transparent and discretionary foreign investment screening mechanisms, for all the concerns they invoke amongst the executives of foreign enterprises and their domestic allies, conceivably can be a a potent mechanism for retaining a relatively liberal foreign investment policy regime *in practice*. This seems to have been the case in Australia. Since 1976 the mechanism of the Foreign Investment Review Board helped successive national governments to manage popular economic nationalist sentiment, often cultivated by entrepreneurial opposition politicians and commercial media outlets, whilst maintaining relatively liberal FDI policy by the standards of the times. In the Australian case at least, more transparent regulation of FDI may have been less liberal, especially during the 1970s and early 1980s when political contention over returns from the resources trade, and then over Japanese investment in the beef industry and real estate in the late 1980s, were at their height.

The Australian case showed that, ultimately, good information on the real extent of FDI can diminish the impact of economic nationalistic political entrepreneurship – of either the zealotry or cynical, private-interest serving, variety (DFAT, 1999) This was the ironic consequence of the creation of a register of foreign ownership of land in the state of Queensland in the late 1980s; a move that had been long resisted by the state's pro-development conservative government on the grounds that it was knee-jerk reaction to anti-Japanese sentiment in particular. The register, once established, revealed a much lower percentage of the state's landholdings under foreign ownership and control than had been popularly anticipated. Better information, as well as liberal commentary from the business media, also helped to blunt criticisms of foreign investment mounted by established domestic interests resistant to change in several industries. This was particularly notable amongst Queensland beef producers fearing an industry shake-up with major American and Japanese investments in the late 1980s and early 1990s (AMLIPC, 1989). It can never be assumed though that countervailing political pressures will arise to offset the combined political pressures of popular nationalist sentiment and private rent-seeking. It remains to be seen whether recent data on the small scale of foreign M&A activity in Japan ultimately attenuates popular managerial concerns about massing flocks of foreign financial vultures.

Caves (1996:250), theorising the political market for FDI policy, suggested that 'because foreigners do not vote in national elections, pure redistributions away from foreign equity holders cause no negative equity votes and thus should proceed further than redistributions adverse to the interests of enfranchised minorities.' However, the domestic partners, suppliers and employees of foreign firms can constitute a domestic political constituency against the imposition of excessive rent-extracting regulations. It remains an open empirical question as to how effective, in particular times and places, foreign firms are in mobilising the support of such actual and potential constituencies in the face of regulatory threats. More too could be done to test the efficacy of representations on a firm's behalf by home governments and their official agencies, which is one of the few conceivable advantages of foreign-ness (Krasner 1985:170–76) – the other being more readily credible commitment to exit. Finally, more thought needs to be given to the evolving constituencies for corporate control events involving foreign investors in the context of aging populations and pressing issues of sustainable retirement incomes. Gourevitch and Shinn (2005: 25) identified a possible coalition of interests between domestic owners and labour against managers; the latter having interests in resisting control events. This logic extends powerfully to the role of foreign investors in domestic markets for corporate control. Owner-shareholders gain directly from the presence of foreign bidders for corporations, and the general shareholder wealth maximisation norms that can be reinforced. Labour benefits collectively through higher returns to retirement funds that are increasingly tied directly to share market performance. Japan's Pension Fund Association, for instance has criticised the recent rush by managements to implement poison pill takeover defences (*Daily Yomiuri*, 18/6/07). Yet, in the minds of many people the issues of retirement incomes – an impending crisis in Japan as in some other mature economies – and foreign participation in markets for corporate control, are rarely seen as related. Patriots in peaceful times often don't know the price they pay.

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