

MULTINATIONAL CORPORATIONS AND THE STATE IN CONFLICT

MULTINATIONAL CORPORATIONS AND THE
STATE IN CONFLICT: STRUCTURAL POWER
AND DOMESTIC STRUCTURES AS
DETERMINANTS OF OUTCOME

By

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ABSTRACT

Multinational corporations have been the source of contention and debate for several decades, among academics and politicians alike. Much of the discourse over multinationals has focussed on their perceived impacts on state sovereignty or deciphering whether they are harmful or beneficial to states. However, contending approaches provide us with little understanding of the sources of their power. This thesis approaches conflicts between multinational corporations and states with this as its central query. The three cases - Union Carbide in Bhopal, India; Toshiba Corporation and the United States; and pharmaceutical multinationals in Canada - are examined, collectively and individually, so as to evaluate the various prevailing approaches and assumptions regarding the power of multinational corporations. Although it is recognized that these approaches have their merits, the case studies strongly affirm the value and necessity of incorporating other factors into an analysis of the power of a multinational corporation during a conflict with a state. As such, the case studies establish that, in instances of contention with a state, structural power and domestic structures are more cogent determinants of outcomes, or power, of a multinational corporation than are traditional methods of evaluating power.

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**Introduction: Going Beyond the Conventional
Assessments of the Relative Power of States
and Multinational Corporations**

*Cosmopolitan globalism weakens national boundaries and the power
of national and subnational communities, while strengthening
the relative power of transnational corporations.*

*Herman E. Daly, in a farewell
lecture to the World Bank,
January 1994*

The Politics of States and Multinational Corporations Revisited

Nation states are dinosaurs waiting to die.¹

Kenichi Ohmae, a world-renowned business management expert, is certainly not alone in his bold assertion. In fact, in recent years, a proliferation of literature has emerged which denounces the nation-state as a dying institution.² Hence, it is not surprising that much debate, among academics and politicians alike, is centred on the relevance and effectiveness of the nation-state in both its domestic and international activities. The state system, as developed from the Peace of Westphalia in 1648, appears to be in a period of radical transformation, if not erosion. The absolutes of the Westphalian state - territorially fixed states where everything of value lies within some state's borders; a single, secular authority governing each territory and representing it outside its borders; and no authority above states - appear to be in a process of dissolution.³ Even Boutros Boutros-Ghali, the former Secretary-General of the United Nations, submits that "the

¹ Kenichi Ohmae, *The End of the Nation State: The Rise of Regional Economies*. (New York, et al. : The Free Press, 1995), book jacket.

² See Jean-Marie Guehenno, *The End of the Nation-State*. (Minneapolis: University of Minnesota, 1995) ; David Korten, *When Corporations Rule the World*. (Connecticut: Kumarian Press, 1995) and Joseph A. Camilleri and Jim Falk, *The End of Sovereignty? The Politics of a Shrinking and Fragmenting World*. (London, England: Edward Elgar Press, 1992) for a few examples of literature that are critical of the role of nation-states in both the domestic and international realms.

³ Jessica T. Mathews, "Power Shift," in *Foreign Affairs* 76, no. 1 (January/February 1997), p. 50.

time of absolute and exclusive sovereignty has passed” and that “its theory was never matched by reality.”⁴ But national governments are not simply losing autonomy, they are also sharing powers. Powers, such as those relating to political, economic, social and security issues, once only thought to be in the authority of the state, can now be seen as manifested in various other actors in addition to, or exclusion of, the state. International business enterprises, known more widely as multinational corporations, are but one example of these ‘non-state’ actors, but it is their existence and relationship with the state that has been a source of contention and debate since the 1970s.

Although the origins of transnational production by corporations can be traced back to the late decades of the nineteenth century, if not earlier in some cases, it was the 1960s and early 1970s that witnessed not only their proliferation but also the rise of these enterprises as important players in the global economy. Whereas the term ‘multinational corporation’ has been subjected to a variety of subtle definitional refinements by scholars⁵, a simple working definition of the term is a business firm that engages in foreign direct investment (FDI) and that owns and manages economic units or value-adding activities in two or more countries⁶. John Dunning, one of the foremost

⁴ In Jesse Helms, “Saving the United Nations: A Challenge for the next Secretary General,” in *Foreign Affairs*, September/October 1996, p. 3.

⁵ Multinational corporations have also been referred to as transnational corporations, multinational business enterprises, and transnational business enterprises. Although it is recognized that there are differences (some very obscure) between the terminology used, for all practical purposes, I will use the term multinational corporation as primary and consider the others to be synonymous with this or be used interchangeably.

⁶ See John H. Dunning, *Multinational Enterprises and the Global Economy* (England: Addison-Wesley Publishing, 1993), p. 3; and Robert Gilpin, *The Political Economy of International Relations* (Princeton, N.J.: Princeton University Press, 1987), p. 231.

authorities on multinational business enterprises, extends this definition:

A global multinational enterprise is an orchestrator of production and transactions within a cluster, or network, of cross-border internal and external relationships, which may or may not involve equity investment, but which are intended to serve its global interest.⁷

Not surprisingly, these multinational corporations, with their wealth and transnational mobility, became the target of much fear, awe, controversy, and debate. Because these global corporations were the prime actors in the economic transformation occurring at the time, they inspired flights of hyperbole from many different quarters. Some

considered these powerful corporations to be a blessing to mankind: diffusing technology, providing economic growth, and interlocking national economies into an expanding and beneficial interdependence. However, others believed that such firms, fuelled by their abilities to exploit economies of scale and scope, would grow faster and bigger than whole countries and would soon dominate the world economy with their unbeatable efficiency.⁸ To these scholars and politicians, multinational corporations were huge, ruthless, stateless and an obvious threat to the sovereignty of states, not only internationally but domestically. These firms would exploit the poor, manipulate governments and defy public opinion. Others attacked these multinationals as being agents of Western imperialism; they were tools used by the governments of the wealthy industrialized West to keep Third World countries, or developing countries, dependent

⁷ In Lorraine Eden, "Bringing the firm back in: Multinationals In International Political Economy," in Eden and E. Potter, eds. *Multinationals in the Global Political Economy* (New York: St Martin's Press, 1993), p. 36.

⁸ "Everybody's Favourite Monsters: A Survey of Multinationals," *The Economist*, 27 March 1993, p. 5.

on these 'core' nations. Indeed, these negative opinions and understandings of the multinational corporations even became so extreme as to suggest that they would eventually supersede the nation-state and would virtually control the world economy.

Needless to say, the obituary of the nation-state was premature, for not only has the multinational corporation not superseded the nation-state, but both entities have proven themselves to be remarkably resourceful and versatile in dealing with each other.

The size and number of multinationals in the world has continued to increase since the 1970s. In 1970, according to the now-defunct United Nations Centre on Transnational Corporations, there were 7,000 multinational corporations in the world, and more than half were based in the United States and Britain.⁹ By the early 1990s, there were 35,000 multinationals, and the countries of the U.S., Japan, Germany, France, Britain, and Switzerland combined account for 70% of all foreign investment by MNCs and about half of their total number. The combined sales of the world's largest 350 MNCs total nearly one-third of the combined Gross National Product (GNP) of all industrialized countries and exceeds the individual GNPs of all Third World countries.¹⁰ The most recent figures show that foreign direct investment (FDI) by multinational

⁹ In Richard Barnett and John Cavanaugh, *Global Dreams: Imperial Corporations and the New World Order* (New York: Simon and Schuster, 1994), p. 423.

¹⁰ UN Centre on Transnational Corporations, *World Investment Report*, 1992.

corporations has risen 40% from 1995 to 1996, which is \$315 billion dollars (U.S.) with \$270 billion dollars coming from MNCs based in the industrialized countries.¹¹ It can be postulated that the growth and increased transactions of transnational business has increased due to a number of factors: falling regulatory barriers to investment; advances in technology and telecommunication and the decreased costs of those and transportation; and the increasing liberalization of markets, both in trade and capital. However, aside from the reasons for this growth, it is quite obvious that multinational corporations have continued to increase their wealth and role in the global economy. These figures alone would suggest that the allegations against multinationals in the prior decades would have continued and increased, given the fact that there appears to be tangibility in their original arguments. But although skepticism toward multinationals did not disappear, the unexpected did happen: attitudes softened toward multinational corporations.

‘Everybody’s favourite monsters,’ as the Economist coined multinational corporations, effectively epitomizes this modified attitude. It can be hypothesized that this ‘warming’ could have occurred from what did not occur. That is, even though they have increased in size, scope, and profitability, multinational corporations have not taken over the world. In addition, no longer is the MNC considered synonymous, or the

¹¹ UN Conference on Trade and Development, *World Investment Report : Investment, Trade and International Policy Arrangements*, 1996.

primary villain attributed to the loss of sovereignty of the nation-state. Susan Strange remarks that the change that has occurred does not mean that multinational corporations threaten to supersede the state:

[The change] does not mean that sovereignty is at bay in the sense that [MNCs] are displacing the state--the sort of implication of those simplistic comparisons that were made in the 1970s between the GNP of middle-sized states and the turnover of GM or IBM.¹²

Obviously, remarks that the nation-state was just about finished were gross exaggerations, for Strange suggests that "no one seriously expects states to disappear, at least not in the foreseeable future."¹³

In addition, despite the amount of concern expressed over their potential for politically intervening in the countries in which they operate, it also became recognized that MNCs are interested in profits rather than politics, except insofar as the latter affects the former. As well, it is now realized that the multinational corporation is merely a part of a much wider force, 'globalization', that has eroded sovereignty while integrating the world economy. Thus, gradually, almost imperceptibly, governments:

are becoming reconciled to a modified concept of sovereignty in the economic field...In short, as governments respond to the functional problems that crop up in an increasingly crowded universe, they redefine the scope of the autonomy that sovereignty demands.¹⁴

Therefore, it appears that governments are recognizing their limitations and realizing that

¹² Susan Strange, "Politics and Production," in Strange, ed. *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996), p.46.

¹³ Ibid, p. 46.

¹⁴ Raymond Vernon, "Sovereignty at Bay: Twenty Years after," In Lorraine Eden and Evan Potter, eds. *Multinationals in the Global Political Economy* (New York: St. Martin's Press, 1993), p. 22.

multinational corporations have not taken over their role, nor that they have any real desire to do so. Although states still view multinationals with skepticism, or rather their attitudes towards multinationals have not completely reversed, multinationals have gained acceptance as the “embodiment of modernity and the prospect of wealth: full of technology, rich in capital, replete with skilled jobs.”¹⁵ Thus, governments in all countries, especially developing ones, are “queuing up” to attract multinational corporations in the hopes of extracting from them all the benefits that they have to offer.

States want the economic, social, and political benefits from the MNCs, but significant tensions can be and are still generated from this interactive relationship. Conflicts still exist between the goal of states and the profit-seeking goals of multinationals, but it can be stated that the relationship is not just one of conflict, but also of cooperation. In fact, it could be asserted that, over the past decade and a half, the interaction between governments and MNCs has changed from one primarily of conflict, arising from the perceived differences in the objectives of the two parties, to being one of cooperation, so as to achieve mutually acceptable goals.¹⁶ Thus, to the extent that a corporation’s operations sustain or create jobs, exports, generate profits and pay taxes, and follow a nation’s laws, then that corporation’s strategy is in relative

¹⁵ *The Economist*, 27 March 1993, p. 5.

¹⁶ John Dunning, “Governments and Multinational Enterprises: From Confrontation to Cooperation,” in Lorraine Eden and Evan Potter, eds. *Multinationals in the Global Political Economy* (New York: St. Martin’s Press, 1993), p. 64.

harmony with the nation's interests. In sum, the state-MNC relationship can be depicted as:

Two systems, each legitimized by popular consent, each potentially useful to the other, yet containing features antagonistic to each other... Yet it would be folly on the part of MNCs or governments to assume that the endemic tensions associated with their relationship will go away.¹⁷

Hence, although states are increasingly viewing multinationals as the means by which they can achieve their social goals and advance their economic competitiveness in relation to other states, MNCs can still be 'thorns in the sides' of states, albeit necessary ones.

It is, perhaps, not an exaggeration to state that MNCs have probably never been more powerful than they are today, and have spread their tentacles into a great majority of states in the world. As was described previously, these multinationals are believed to bring capital, technology, know-how, and skills with them. Thus, the countries in which they invest can potentially reap benefits, such as jobs and training, technology transfer, and taxation income. Multinationals can, indeed, bring these assets with them, and governments attempt to solidify these benefits in their negotiations. However, governments are aware that there can also be a downside to embracing these multinationals. Although there may be positive effects, there may also be negative ones. Multinationals can also transfer their profits abroad, keep access to the best technology at home, and keep the best jobs at home. They may also put undue pressure on

¹⁷Vernon, p. 19.

governments to lower their taxes at the expense of education or health spending, adopt anti-labour policies, or weaken environmental protection, just by threatening to leave.¹⁸ However, in all fairness, multinational corporations are not social institutions, they are profit-seeking entities. And, as touched on earlier, this is the fundamental element of antagonism between the MNCs and the governments of states. However, conventional approaches to this relationship appear to be too simplistic, as much of the debate has centred around whether the MNC is 'good' or 'bad', or on the power resources of states and multinationals. These are not adequate approaches to understanding this relationship, nor the 'influence' that a multinational may have in it. Hence, given the potential for great friction between the two, a more sophisticated approach to an analysis of this interactive relationship between the MNC and governments is necessary, one that takes into account structural power and a state's domestic structures. Nonetheless, an understanding of the conventional approaches, and their failures, is warranted.

Prevailing Approaches to the Multinational Corporation

Having come thus far, the purpose of this paper is to analyze the state-MNC relationship, albeit from a different angle than research previously done. It is quite obvious from the brief synopsis of the role, relations, and issues of and about multinational corporations since the 1970s that they have been a topic rich in research

¹⁸ David Crane, "Multinationals must be held accountable," in *The Toronto Star*, 26 September 1996.

and analytical possibilities. Part of the ongoing debate and research has been normative-- that is, establishing whether MNCs are beneficial or harmful to states, particularly developing ones. Within this debate in International Political Economy are three basic positions on this relationship: the liberal, the nationalist (or neo-mercantilist), and the Marxist perspective (and its offshoot, the dependency approach). The liberal approach views the multinational corporation as an integrating force in the world economy. They are viewed as a force of progress, a tool for increasing wealth, and an important actor in lessening the income inequalities between developed and developing countries. The other two approaches view the multinational corporation in a much less favourable light. The nationalist perspective perceives multinational corporations as potential threats to the power of the state. Conflict between the two is inevitable, as both have different motives and pursue different goals. Within this perspective, the central issue is that of control-- control of the multinationals, that is. This perspective postulates that multinational corporations need to be regulated, both nationally and internationally, so that state autonomy and sovereignty remain intact. The third main perspective stems from Marxist thought. This approach views MNCs as "oligopolistic transnational capitalists emanating from the 'core' that systematically exploit and promote underdevelopment in the 'periphery' and 'semi-periphery'".¹⁹ It is believed that these MNCs are under the command of their masters, the rich industrialized countries, for the purpose of enhancing their wealth and keeping developing countries 'under their thumb'.

¹⁹ Eden, p. 27.

The familiarity of these perspectives can be explained by the fact that they were, and continue to be, the main approaches in studying, or questioning the MNC's impact on the interests of states. In fact, strands of these perspectives can be found in variety of other models and approaches that have been formulated to understand the impacts of MNCs and the tensions associated with the relationship. Examples of these are three approaches by Raymond Vernon: the product life cycle model, obsolescing bargaining model, and the sovereignty at bay model; and two others stemming from Marxist and dependency thought: Stephen Hymer's law of uneven development and another approach that examines the impact of multinationals on the state due to the changing international division of labour.²⁰ However, analyzing whether the MNC is 'good' or 'bad' is but one of the debates and research surrounding the study of multinational corporations in the field of political science, albeit an ongoing and important one.

Other research pertaining to multinational corporations has been done in business disciplines, specifically International Business Studies (IBS). Much of the IBS research has focussed on the resources, structures, and operations of the firm so as to derive some explanation of the 'roots' of the competitiveness of a multinational corporation vis-à-vis other multinationals. Perhaps one the most popular approaches that has emerged in IBS to the multinational corporation is the 'eclectic' paradigm, or OLI. The ownership, locational, and internalization advantages of multinational corporations explain their

²⁰ For a more detailed explanation of these approaches, see Eden, pp. 28-32; and Gilpin, pp. 241-2.

competitiveness, growth and success in international markets. Multinational corporations form and grow because they possess these three sets of advantages relative to other firms. These advantages can also be used to analyze MNC decisions about locating, expanding, and divesting abroad.²¹ Aside from the locational advantages, the country-specific factors that help determine which countries are host to MNE production, there is little mention of the role of the state, or its relations with governments. This appears to be an omission throughout IBS literature on multinational corporations.

Although some of the research conducted within this field pays lip service to the role of the state in explaining the activities of multinational corporations, quite simply, the state is almost an ignored aspect in this discipline. Aside from explaining the economic benefits of the MNC to the state, or the state as a factor in explaining locational choice or other strategies relating to the firm's competitiveness, states are relegated to a very secondary, if not minuscule, role in their research parameters. In all fairness, this is a business discipline and it is not surprising that the firm is held to be the primary focus, but in terms of the relationship between MNCs and the state, the explanatory power of the various IBS approaches is limited, to say the least.

²¹ See John Dunning, *Multinational Enterprises in the Global Economy* (England: Addison-Wesley Publishing, 1993) for a complete examination of his OLI paradigm and a very thorough examination of issues surrounding multinational corporations from a liberal economic viewpoint.

The Failures of Various Approaches

The model of obsolescing bargaining was introduced earlier as being an offshoot of IPE approaches to explaining the power resources and the relationship between multinational corporations and the state. This model, also called the bargaining power model, was developed by Raymond Vernon and has been the most widely accepted paradigm of 'host' country²²- MNC relations in International Political Economy. It explains the development of 'host' country-MNC relations over time as a function of the goals, resources, and constraints of each. The model assumes that: each party possesses assets valuable to the other; each party has the ability to withhold these assets, thus giving it potential bargaining power with respect to the other; each party is constrained in its exercise of power; the party with larger actual bargaining power gains a larger share of the benefits; and that the game is positive sum so that both parties can win absolutely, although only one can win in relative terms.²³ It is also recognized by this model that the bargaining power of one is not static, or rather, that the elements that make up the bargaining power change, and so do the dynamics of MNC-state relations. For example, prior to the entry of the MNC and because of the options available to the MNC globally, the host country is assumed to be in a weak bargaining position, and will,

²² 'Host' country can be defined as the nation that is not the nation of origin of the MNC that it has chosen to invest in or locate operations. However, this terminology is becoming obsolete, as it has become difficult in recent times to decipher exactly what nationality a MNC is, as they have truly become 'global' in nature.

²³ The explanation of the bargaining power model is taken from Eden, pp. 30-31.

more than likely, have to make some agreed-upon concessions in order to attract the MNC's entry and investment. However, once the investment is made, more immobile resources are committed by the MNC, and as the host becomes less dependent on the MNC for capital, technology, and access to markets, then it is believed that bargaining power shifts to the state, which will be more likely to insist on a renegotiation. Thus, it is concluded that the MNC must then keep the country dependent on it for new technology, capital, products, or access to export markets, or give in to new state demands, or exit.²⁴ Ergo, this example illustrates the usefulness of the model in explaining shifts in bargaining power between the MNC and state.

Although the model has been applied to and seems appropriate for many extractive industries, it lacks the same explanatory power towards those MNCs involved in manufacturing. Manufacturing industries are not subject to the structurally-based obsolescence of depletable resource industries. In fact, where the MNC is part of a globalized industry or where technology is changing rapidly, then the bargain may not obsolesce.²⁵ In addition, other factors have not been included that could affect the relative bargaining power of the 'host' and MNCs. For instance, competition among various MNCs for entry into the potential host country's market can strengthen the position of the state. As well, other actors could also strengthen the bargaining power of

²⁴ Ibid.

²⁵ See Kobrin's critique of the obsolescing bargaining model in Eden, p. 31.

the MNCs, such as the political nudging or influence of its 'home' state on the 'host' state. Thus, although the model does have its merits, in that it can be a useful tool in explaining changes in the bargaining relationship between MNCs and the state in extractive industries, it does not explain fully the reasons as to why certain multinational corporations are more successful than others in extracting benefits from, or influencing, the state.

Alongside the obsolescing bargaining approach, other approaches have examined power in this interactive relationship and have also come up short in explanations. For example, neo-classical economists have examined the bargaining power of multinational corporations, and the determinants and policy consequences of short term capital flows, but have neglected the institutional and ideological aspects of power.²⁶ These are needed to be examined for a better understanding of how multinational corporations have power over states, internationally and domestically. Realists, too, have not fared well. The traditional view of the state, found in realist and also neo-realist thought, emphasizes the state's comprehensive control, through coercive and administrative means, over its territory and population and also of its capacity to operate as a unitary, autonomous actor. Although realism can still be considered significant in understanding this relationship, in that it assumes the state to be dominant (and thus, always the winner), it

²⁶ Stephen Gill and David Law, "Global Hegemony and the Structural Power of Capital," in Gill, ed. *Gramsci, Historical Materialism, and International Relations* (Cambridge: Cambridge University Press, 1993), p. 102.

does not explain the instances, and there are many, of multinational corporations successfully outmanoeuvring the state. As well, International Business Studies' approaches that postulate the success of the multinational based on its own degree of institutionalization do not take into account the very obvious constraints that the state poses to its success, including domestic institutions. Lastly, that the sole economic clout of the multinational corporation is enough to explain their power is, too, flawed. The sole possession of resources that could give potential power is not enough in determining the multinational corporation's impact on the domestic policies of the state. Quite simply, possessing resources of power is not enough in explaining the successful exercise of that power. Obviously, a more thorough look at the determinants of success or failure of the multinational corporation in its attempts in influencing states is needed; one which takes into account the structural shift in power that has occurred, and also includes domestic politics and structures, which provide the framework in which multinationals operate.

Developing an Alternative Approach

My objective is not to repeat the debate over the threat of multinational corporations to the sovereignty of the state, nor is it to decipher whether MNCs are 'good' or 'bad' to the states in which they operate, nor to reiterate the elements of the competitiveness of the multinational firm. Rather, I will examine why multinational

corporations are able to successfully achieve their objectives when in confrontation, or conflict, with the state, and possible reasons as to why MNC impact varies. Hence, an examination of where or how the multinational corporation derives its power is essential to this approach. An illustration of the power of the MNC vis-a-vis the nation-state and an analysis of how the factors relating to this power enable some multinationals to have a greater influence, or impact, on the goals and policies of the nation-state is the primary purpose of this paper. As was shown, a variety of models and approaches have been designed to study this interactive relationship and the origins of the 'power' of the multinational corporation in its dealings with the state. However, many of these approaches appear to have limited explanatory power or do not incorporate important elements into their analysis. Hence, in terms of understanding and explaining the roots of this 'power', or influence, of multinational corporations in confrontations with states in their domestic sphere, I postulate that the ability of multinational corporations to successfully achieve their objectives can be attributed to structural changes in the global economy, the domestic institutional structure of states, and through their application of direct power towards the state so as to achieve their goals. Although other approaches, such as the obsolescing bargaining model, have their merits in explaining this success, it is these factors that will be my focal point.

My approach will incorporate the international structural shift and the domestic conditions under which multinational actors are able to influence states. Explanations of

the structural changes will be useful in illustrating how power has shifted to multinational corporations relative to states (“having” power) and explanations of domestic structures will be useful in explaining how that power translates into influence (“exercising power”), or the successful outcome of a goal or objective. It is my aim to illustrate that structural shifts have allowed great power to pass into the hands of multinational corporations, and that states are acting more cooperatively with multinationals, as they now realize that they are essential in pursuing their own goals. However, this alone cannot explain the impact that multinational corporations have on the state. Thus, domestic structures must also be taken into account. Domestic structures do determine both the accessibility of multinational corporations to the state and their ultimate policy impact. Within this approach, it follows that the impact of the MNC also depends upon the compatibility of their goals with that of state policies and goals. In addition, success may also hinge upon how MNCs interact with other domestic actors, such as building coalitions, or how they have been able to become ensconced in the domestic institutional structure. Thus, this approach may be compatible with realism, as it supposes that a multinational must shape itself to the domestic structure of the state in order to have greater influence. But as one would assume by realist thought, the state may not always come out the winner. Hence, my purpose is not to degrade the other approaches, for they do have merit, but rather to suggest that structural changes and domestic institutions provide greater explanatory power, or are more important determinants of the ‘power’ that the multinational corporation will have in its relations with the nation-

states in their domestic realm. Therefore, along with an explanation of structural power and domestic structures, an understanding of power is necessary.

Power, the State, and the Multinational Corporation

In international relations, power has been defined as the ability to create or disrupt order in the system.²⁷ Thus, it has followed that because it is most often states that disrupt this order, then the prime concern in analysis has been with relations between states. But power is not only the ability to create or destroy order, but also wealth. Multinational corporations have this ability, and this is why multinational corporations have become an important facet in international relations and in domestic politics. Therefore, an explanation and analysis of power with regards to the state and the multinational corporation is necessary in understanding this interactive relationship and in understanding the outcomes of struggles between the two.

It is assumed that power is the function of the demand of each party for resources that the other possesses. Thus, power can be measured by influence over outcomes rather than mere possession of capabilities or control over institutions.²⁸

²⁷ This definition can be credited to Kenneth Waltz and Hedley Bull, in Susan Strange, "Big Business and the State," in Lorraine Eden and Evan Potter, eds. *Multinationals in the Global Political Economy* (New York: St. Martin's Press, 1993), p. 102.

²⁸ As defined by Susan Strange, "Politics and Production," in Strange, ed. *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996), p. 53.

Therein lies the distinction between potential power and actual power. Actual power can be defined as the ability and willingness to exercise the potential power that possession of 'power' resources gives, for the purpose of extracting more favourable terms from the other party.²⁹

One of the most important assets, or power resources, that a state possesses is the monopoly over violence and coercion, primarily used for the maintenance of peace and security. Although the possession of this resource of power is an important attribute of the state, it is rather an unimportant asset in its relations with multinational corporations. The state could use its force against a multinational corporation to compel it to act, or produce, in a certain manner. However, it is not surprising that this blatant power is not used often, if at all. It is not of much benefit to the state to deploy this power because of the ability of the multinational to 'exit' the territory, not to mention the self-defeating character of physically attacking a firm. Therefore, even though the state's monopoly over the use of violence and coercion is an important resource of power, the possession of these are not important assets in its relations with the multinational corporation. Rather, other assets, or resources, should be considered.

In their economic relationships with the multinationals, states appear to have the critical advantage, in as much as they control access to their respective territories. That

²⁹ See Shah Tarzi, "Third World governments and multinational corporations: Dynamics of host's bargaining power," in J. Frieden and D. Lake, eds. *International Political Economy: Perspectives on Global Power and Wealth* (New York: St. Martin's Press, 1995), p. 156.

access includes internal markets, the local labour and capital supplies, investment opportunities, sources of raw materials, and other 'immobile' resources that multinationals need or desire.³⁰ Thus, the basis of a particular state's comparative advantage, with other states or multinational corporations, are these resources that are immobile across borders, and the power to allow or deny access to these. These can be used by the state in a bargaining situation with a multinational corporation, but the immobile resources that it possesses must be imperative to the operation of the multinational and must not be found elsewhere. This, of course, includes such state-specific possessions as its legal structure and regulatory policies and institutions. Thus, it is evident that this 'power' is applicable in cases where extractive resources are at stake, but it may not hold explanatory power in other industries. In addition to immobile resources and the ability to regulate access, according to bargaining power assessments, the state's source of strength could also be derived from other factors, such as the extent of industry heterogeneity, the attractiveness of their markets and production factors, and from inducements to invest.³¹ Therefore, it can be argued that the state has the legitimate authority to use whatever powers it has to shape the entry of MNCs, and regulate and restrict the activities of multinationals within its territorial borders. However, it is obvious that there are constraints to the exercise of this 'power'.

³⁰ Ibid, p. 154.

³¹ Anne Gregory, "Political Risk Management," in Allan Rugman, ed. *International Business in Canada: Strategies for Management* (Scarborough: Prentice Hall, 1989), p. 322.

As Susan Strange explains:

the only trouble is that, though legitimated, these are all negative powers. The gate can be barred, but when open, it is up to the [MNCs], not the state, to decide whether they should enter. Therein lies the rub; if there is too much restriction, too rigid regulation of the way they operate once they are inside the gate, then the [MNC] will stay away, or leave, or enter only in such a way as to minimize the risk.³²

Thus, states are territorially-fixed, whereas multinational corporations are not and are therefore able to assess locational and operational choices on global, transboundary basis. Thus, it can be hypothesized that, faced with this understanding, governments have become more accommodating to the multinational corporations as they vie for their attention in competition with other states. Although the powers of restricting entry and regulating in their territory lies with the state, exercising these 'powers' in a manner that counters the goals of the multinational corporation may not be beneficial for the state, as a multinational corporation may choose not to enter, or to leave, and thus exclude the possible economic advantages and benefits associated with it.

Henceforth, in practical terms, it can be stated that the apparent bargaining advantage, or power, on the part of the state is, in most instances, surpassed by the superior advantages of the multinational corporations. The power of the multinational corporation relative to the state can depend on the situation and on its own characteristics. Some of the assumed ingredients of their power are: the size of the firm, its financial base, access to capital, its human resources, expertise, its ability to generate

³² Susan Strange, "Big Business and the State," p. 103.

exports, leadership quality, prestige, communication and persuasion skills, access to the media, its cohesiveness, prior experience in waging conflict, intensity of commitment, the degree of trust and legitimacy, and its risk-taking ability.³³ Just by their very large size and financial assets, some have assumed that multinationals would have the 'upper hand', or extreme influence in shaping the policies of the state to their liking. But how can we measure the political impact of such immense concentrations of wealth and centres of control of economic resources? Perhaps then it is not their resources we should be examining, but rather their activities.

By allocating factors of production and controlling investment flows, there is no doubt that the activities of the multinational corporation can seriously influence the character of economic development. The payments of royalties and taxes, the establishment or closing down of facilities, decisions on where to locate plants, advertising decisions, and the like are decisions made by the multinational corporation that can crucially affect a country's economic structures, tax revenues, level of employment, and consumption patterns. In addition, multinationals possess the required capital, technology, managerial skills, access to world markets, and other like resources that governments of states need or wish to obtain for the purposes of economic development. Ergo, these can be considered to be sources of a multinational's power, or

³³ See Thomas Gladwin and Ingo Walter, "How Multinationals can manage social conflict," in Walter Goldberg, ed. *Governments and Multinationals: The policy of control versus autonomy* (Cambridge, Mass.: Oelgeschlager, Gunn, and Haim, 1983), p. 84; and Gregory, p. 351.

leverage, with the state. But again, these can be considered strong bargaining chips only if the state 'needs' these elements. In this sense, the MNC may be able to convince the state that it has superior knowledge or abilities that are necessary to the state.

Therefore, the MNC can hold out the promise of benefits, such as investment or job creation, whereby it is clear that the reward of these depends on the conflict outcome that is favourable to the multinational. In addition, it can threaten a pull-out of its operations from the territory of the state if the conflict outcome is not favourable. In sum, it can be stated that multinationals often obtain their power through a degree of indispensability; that is, by possessing something needed by the state or something unique to offer or withhold when a conflict arises. Therefore, this calls into question the validity of using analyses solely based upon the economic strength of a multinational, as the relationship between states and multinationals requires a more complex approach. That is, clearly the economic clout, or monetary resources of a multinational are not enough to explain the differentials of power of a multinational, as its capabilities and the need for these by states must also be taken into account.

Hence, it appears that a structural and institutional analysis is necessary.

Structural power is an important determinant of the influence that a multinational will have on the state, for it takes into account the capabilities of the multinational and the needs of the state. Thus, structural power, an important factor in determining the influence that a multinational will have on influencing a state's policy, will be examined

in much closer detail. However, when analyzing the influence of a MNC on a state, structural power alone is not enough to explain the differing degrees of this influence. That is, domestic structures of a state in question must also be considered, for they, too, play an important role in shaping the degree of influence that a multinational will have. The impact of domestic institutions on the multinational, in terms of shaping their impact on the state, is also an important determinant, and perhaps has greater explanatory power than the others (such as analyses based on 'resources') in demonstrating the variance in MNC influence on the state. Although this will be covered more in detail later, one of the factors that could determine the success or failure that a multinational will have is the alliances that it has made with other domestic actors. This can be called 'coalition-building', in which a multinational considers it important or useful to join forces with other domestic actors with complementary objectives, so as to increase its probability of a successful outcome. Other ways that the multinational could increase its effectiveness in achieving its goals with the state could also be found in the way that the multinational structures itself in that particular state. These factors, structural power and domestic structures, could, perhaps, provide more insight as to how the 'power' of the multinational translates into success.

Thus, it would appear that the multinational corporation possesses and is able to exercise more power than the state in situations of conflicting goals and agendas. But this does not mean that multinational corporations are positioning themselves to displace

the state in its functions. But rather, they seek to ensure that state functions and policies do not contradict or inhibit the firm's profit-making capacity. Moreover, there are roles that only the state can play: such as imposing order; the power to tax; and in protecting health, safety, and the environment. In addition, multinational corporations, in order to function, do need states that are secure, or stable. Severely weakened states will encourage internal conflict, and this would discourage investment by the multinational, or potentially cause unnecessary economic losses. Therefore, it is important to note that the power that the multinational possesses or exercises is not meant to be used in overthrowing the political structure of the state³⁴, but rather to promote its own goals within that structure. However, as noted earlier, this increasing power of the multinational corporation relative to the state is still a concern. Although the factors of structural power outlined above are useful in providing a framework for an understanding of this 'power', much more is needed in order to understand why multinationals have gained this 'strength' relative to the state, and how this strength is translated into influence on the state. Therefore, an examination of structural power and the effect of domestic institutions and politics may provide us with a more comprehensive framework in which to understand this.

³⁴ Although overthrows of governments have occurred, such as in the case of United Fruit Company in Guatemala in 1954, and in the case of ITT in Chile in 1973, it should be noted that these are not the norm, but, in fact, a rarity. It should also be noted that, in these cases, the MNCs would not have succeeded had they not have had the backing of their 'home' government, the United States, which perceived this as an opportunity to achieve their political goals.

Structural changes and power shifts

As outlined earlier, the latter part of the 1980s witnessed a general warming of attitudes of states towards multinational corporations. There are, of course, a number of explanations for this change: a better appreciation of the nature and advantages of MNCs; the successful experiences of industrialization with the inclusion of FDI; the growing capacity of many developing countries to negotiate with MNCs; and the speeding up of the process of technological change, with a resulting need of most countries to gain speedy access to modern technologies, services and information networks.³⁵ These factors, just to name a few, combined with the realization that multinational corporations have not displaced the state, have contributed to the decline in the extreme criticisms that have surrounded the role of the MNCs in the 1970s.

Although the issues of sovereignty seem to have been relegated to the background, and even though concerns about the MNC have not been forgotten entirely, a shift has occurred, one that has ultimately benefitted multinational corporations. Joined with a strong affirmation of the merits of the capitalist market economy³⁶, this shift has been coined 'globalization'. Globalization can be best defined as a:

³⁵Sanjaya Lall, "Multinationals and Developing Countries: Some Issues for Research," in Lorraine Eden, ed, *Multinationals in the Global Political Economy* (New York: St Martin's Press, 1993), p. 122.

³⁶ There has been a shift in ideology--that is, a widespread move to a greater belief in market efficiency. This has come to mean a belief in freer flows in trade and capital, with no unnecessary governmental interventions.

long-term trend linked to [information and communication] technological innovation, business practices, and moves toward the freer flow of trade and money.³⁷

Lorraine Eden explains 'globalization' further by noting that it is a multifaceted phenomenon with at least three components: convergence, which refers to the trend within the 'Triad' countries for the underlying production, financial and technological structures to approach a common standard; synchronization, which refers to states using similar macroeconomic and structural policies; and interpenetration, which relates to the growing importance of trade, and inward and outward investment and technological flows within each domestic economy.³⁸ Thus, the 'globalization' of the world economy can be illustrated by the tremendous growth of all forms of international transactions, and the integrated strategies pursued by corporations towards their domestic and foreign production and market activities.³⁹ According to Lorraine Eden:

multinationals now function in a global political economy : global because borders are disappearing between markets, political because national politics and policies still matter.⁴⁰

In essence, the multinational and international production reflect a world in which technology and capital have become increasingly mobile, while states have remained, and

³⁷ Richard Falk, "Appraising the UN at 50: The Looming Challenge," in *Journal of International Affairs*, vol 48, no 2 (1995), p. 634.

³⁸ Eden, p. 47.

³⁹ Dunning, p. 69.

⁴⁰ Lorraine Eden, "Thinking globally, acting locally: Multinationals in the Global political Economy," In Eden and Evan Potter, eds. *Multinationals in the Global Political Economy* (New York: St Martin's Press, 1993), p. 2.

will remain, territorially fixed. These changes have increased the competitiveness of firms on a global scale as they contend for shares in the world market, and have, consequently, forced nation-states to reconsider their policies vis-a-vis multinational corporations. Hence, cooperation between the two entities has become more evident in recent years.

These changes have certainly benefitted multinationals in their relations with states. That is, due to 'globalization' and all its related factors, multinational corporations are now able to, indirectly, influence the decisions of states. This influence can be referred to as structural power.

Structural power is the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises, and other actors have to operate.⁴¹ In essence, structural power confers the power to decide how things shall be done; the power to shape frameworks within which states relate to each other or to other actors, least of not economic enterprises.

Susan Strange argues that structural power can be found in four separate distinguishable but related structures, none of which can be considered dominant.⁴² That is, structural power lies with those in a position to exercise control (ie. to threaten or

⁴¹ Susan Strange, *States and Markets* (London: Pinter Publishers, 1988), p. 24.

⁴² *Ibid*, pp. 26-7.

preserve) over security, production, finance, or knowledge.⁴³ What is common to all four kinds of structural power is that the possessor is able to change the range of choices open to others, without apparently putting pressure directly on them to take one decision or to make one choice rather than the others.

Structural power is less visible, as it is indirect, but, as will be illustrated in the case studies, no less potent. The range of options open to the others would be extended by giving them opportunities they would not otherwise have had. Just the same, the range may be restricted by imposing costs or risks upon them larger than they would otherwise have faced.⁴⁴ Thus, structural power makes it harder to make some choices while making it easier to make others. Through a brief understanding of the four types, it will be evident that structural power is an important feature of multinational corporations, especially in the eyes of states.

The first is the structural power that relates to control over security. Quite simply, structural power lies with those in a position to control a state's, or people's, security, especially from violence. This power, albeit to a lessened degree, is still considered to be held by states. However, the latter three in Strange's typology, control

⁴³ Ibid. See also Robert Cox, "'Take Six Eggs': Theory, finance, and the real economy in the work of Susan Strange (1992)," pp. 174-188, in Cox, ed. *Approaches to World Order* (Cambridge: Cambridge University Press, 1996) for a critique of Strange's assessment.

⁴⁴ Strange, p. 31.

over production, finance, and knowledge, have shifted immense power into the hands of multinationals.

With regards to production, structural power lies with those able to decide or control the manner or mode of production of goods and services. That is, who decides what shall be produced, by whom, by what means and with what combination of land, labour, capital and technology holds structural power.⁴⁵ The internationalization of production, stemming from increased ease of mobility, has shifted power into the hands of transnationally mobile firms, which are able to make these decisions on a global scale. These production-locational decisions are, of course, important to states, especially given the priority placed on economic growth and competitiveness. Thus, if a state wishes these operations on its soil, it will consider the 'business climate' it has, or must shape, in order to entice these multinationals there. Therefore, control over production, held by many transnational firms, is a structural power.

The structural power associated with finance, particularly the control over credit, is the facet which has perhaps risen in importance in the last few decades more rapidly than any other. It has come to be of decisive importance in international economic relations and in the competition of corporate entities.⁴⁶ Its power to determine outcomes - in security, in production, in research - is enormous, as much growth and projects

⁴⁵ Strange, p. 39.

⁴⁶ Ibid, p. 30.

could only have been financed through the creation of credit or the infusion of capital. As governments, especially those in advanced economies, have been reluctant to run large deficits (borrow to finance spending shortfalls), consequently more reliance has been placed upon the economic growth that can occur with private financing. For this 'investment' to occur, this places great pressure on the shoulders of governments to maintain stable and attractive investment climates within their states.⁴⁷ If the business climate deteriorates, a reduced willingness to invest by these private entities, including multinational corporations, will most likely occur. Thus, the supply of finance to governments through the purchase of government bonds and bills may decline, which may result in the government being unable to finance its current activity.⁴⁸ However, the same is true for governments that are using credit, as they must maintain the confidence of the lenders. This, too, would require governments to maintain a climate which the lenders feel is favourable, otherwise credit-ratings could be harmed and economic distress could occur. Thus, those who are able to infuse capital and control credit, multinational corporations and financiers, hold the power to indirectly discipline the state.

Lastly, those who have control over knowledge are also believed to hold structural power. Knowledge is power, and this power is held by whoever is able to

⁴⁷ It can be asserted that 'markets' (especially financial ones) can take power away from governments that do the 'wrong' things: borrow recklessly, run inflationary policies or try to defend unsustainable exchange rates. They thereby encourage governments to adopt policies that will benefit their economies, and their 'business climates'. See "Survey: The World Economy," in *The Economist*, 7 October 1995.

⁴⁸ Gill, pp. 100-101.

develop or acquire and to deny the access to others a kind of knowledge respected and sought by others.⁴⁹ That is, this power often lies in the negative capacity to deny knowledge, or to exclude others, rather than in the power to convey knowledge. It has been suggested that knowledge, particularly in the form of technology, has become more important in the competition between states than either crude manpower or crude gunpower.⁵⁰ That is, competition between states has evolved to include competition for leadership in the knowledge structure, so as to be at the 'leading edge of technology'. Because many multinational corporations engage in research and development for innovative products and technologies, this has given them great power in their relations with states, as states seek to entice these multinationals into locating on their territory or transferring their knowledge (technology) into the state. Hence, knowledge has certainly awarded structural power to those multinationals that can control access to it.

In sum, Strange's typology of structural power certainly enlightens one as to its importance in the relations between the state and a multinational, as a multinational corporation can hold structural power which, in turn, enables it to indirectly influence a state's decisions. However, one cannot dismiss the normative dimension of structural power. Although Strange does not incorporate ideology in her categories of structural power, ideology has been recognized as an important dimension of structural power.⁵¹

⁴⁹ Strange, p. 30.

⁵⁰ Ibid, p. 130.

⁵¹ Refer to Gill and Law (1993).

It, too, can be stated that ideology, like Strange's four elements, is a separate and distinguishable structure, but also interconnected with the others. However, for all practical purposes, it will be treated as a fifth dimension of structural power.

These structural powers have been accompanied by changes in the basic belief systems, or ideology, that support the political and economic arrangements acceptable to society.⁵² The strength of normative structures can be illustrated by how, in modern economies, consistently higher priority is given to economic growth relative to other goals, such as security and environmental concerns.⁵³ The processes of economic integration and elimination of controls on international trade and capital are certainly good examples of how most states are now convinced that economic liberalization is the surest path to growth.⁵⁴ As well, the assumptions and claims made about the conditions for the achievement of growth by states is also another illustration of the importance of these belief structures⁵⁵. There is widespread acceptance of the view that economic growth is fundamentally dependent on investment and innovation by private enterprise, which means that governments have to be concerned with the maintenance, or cultivation, of an appropriate business climate. Otherwise, investment may not occur, or

⁵² Strange, p. 123.

⁵³ Gill, p. 100.

⁵⁴ G. Pascal Zachary, "Super-capitalism: The Third Golden Wave," in *The Globe and Mail*, 29 March 1997.

⁵⁵ Gill, p. 100.

be rescinded, and negative economic consequences will follow, which would harm not only the economic welfare of a state, but also harm a state's competitiveness and deter investment. Indeed, it is not surprising that states pay a great deal of attention to providing a 'favourable' business climate, in the hopes of attracting private enterprises, especially multinationals, to bring their production, capital, and knowledge into their state, and not another.

Thus, not surprisingly, most states have moved from conflict to cooperation with multinational corporations. They have gone from regulating to encouraging entry, from taxing to subsidizing operations, and from opposition to partnership.

Multinational corporations and the nation-state are now seen as partners in the race to engineer competitive advantage and move up the value chain to higher value-added and more technically sophisticated products.⁵⁶

Thus, MNC-state relations have appeared to have shifted from being primarily conflictual, as states sought to influence anti-competitive behaviour by states, to cooperative, as states now see MNCs as the means by which national competitive advantage can be generated and sustained. Therefore, it can be argued that the shift away from states regulating to cooperating with MNCs is the result of the new competitiveness agenda adopted by nation-states,⁵⁷ which is the result of changes in the belief systems of states, especially with regards to economic growth.

⁵⁶ Edcn, p. 2.

⁵⁷ See Dunning, "Governments and Multinational Enterprises: From Confrontation to Cooperation?" for a more thorough explanation of this shift in relations.

States have been put into a position of either adapting to these changes or experiencing economic decline, or potentially even economic collapse. In essence, it appears that there has been a shift of power, one that is a consequence of changes in world production and financial structures that has stemmed from the increasing mobility of these because of technological changes. Because multinational corporations can exploit these changes, this has not only given them increased bargaining power relative to the nation-state, but has also brought more cooperative relations between the two entities, as states see FDI as complementary to domestic investment and as necessary for engineering long-run competitive advantage in the world economy.⁵⁸ As a result, state policies are creating a more symbiotic relationship between its governments, markets, and the primary actor in that market, the multinational corporation. Thus, since these firms combine their mobile firm-specific advantages with immobile country-specific advantages, and since globalization has made MNC production more mobile, it can be concluded that the balance of power has shifted from the nation-state to the multinational corporation.⁵⁹ Balance of power has shifted away from governments as the flexibility of firms increases relative to nation-states. States are less free to impose restrictions on MNCs and are more likely to engage in competition to attract FDI. At the least, the increased mobility of capital and the increasingly arbitrary nature of a state's comparative

⁵⁸ See Eden, p. 16; and Dunning, op cit.

⁵⁹ See Magnus Blomstrom and Robert Lipsey, "The Competitiveness of Countries and their Multinational Firms," pp. 129-141, in Lorraine Eden and Evan Potter, eds. *Multinationals in the Global Political Economy* (New York: St Martin's Press, 1993).

and bargaining advantage have given rise to intensified international inter-state competition for investment, as governments attempt to attract corporate investments and influence the international location of economic activities.⁶⁰ In this age of increased transnational mobility, states that fail to create the right climate will find their domestic living standards and economic well-being affected, but those that can extract the benefits and advantages that MNCs have to offer will emerge as winners. Hence, it can be concluded that globalization, as a consequence of technological and ideological changes, has caused the underlying production, financial, and knowledge structures to shift permanently in a way that favours the MNC and requires more cooperative responses from nation-states.⁶¹

It is obvious that multinational corporations have come to play a significant role in determining 'who-gets-what' in the international system of states. This can be illustrated by the fact that states, collectively, are retreating from their former participation in the ownership and control over industry, service and trade, and even from the direction of research and innovation in technology. 'Privatization' has become the ruling cliché among many industrialized nations, and has even infiltrated many Latin American nations. This can also be further exemplified by the fact that multinationals have done more than states and international aid organizations in the last decade to

⁶⁰ Gilpin, p. 262.

⁶¹ Susan Strange, "Big Business and the State," in Eden and Potter, eds., p. 16.

create favourable economic conditions in both developing and developed countries, and in redistributing wealth, just by relocating manufacturing operations because of this increased mobility.⁶² Thus, multinationals are the main actors that, through their trade and foreign production strategies, have been able to take advantage of a relatively more open world economy, more international mobility, and the retreat of states from areas no longer considered to be financially feasible.

Part of this structural shift of power that is occurring to the benefit of the MNCs is due to the fact that they are non-territorial in nature, whereas states are fixed geographically. States cannot relocate (at least, not without a war), and thus rely on the transnational character of multinational corporations and hope that operations will locate within its boundaries, and not elsewhere. This is not surprising, given the control that multinationals have over a variety of tools--command of technology, ready access to global sources of capital, ready access to major markets--that are all necessary for a state's competitiveness in the world market.⁶³ Thus, the modern multinational, in addition to its economic resources, possesses that structural freedom of action which accrues to economic enterprises in a capitalist world economy characterized by fragmented political jurisdictions. Advances in transportation and communication

⁶² Susan Strange, "Politics and Production," p. 54.

⁶³ Susan Strange, "States, Firms, and Diplomacy," in Jeffrey Frieden and David Lake, eds. *International Political Economy: Perspectives on Global Power and Wealth* (New York: St. Martin's Press, 1995), p. 65.

technologies, in information-processing techniques, and the increased mobility of capital have provided the conditions for these firms to attain dominant positions.⁶⁴ These changes have led more firms to plan their activities on a global basis, and thus the increase in the number of multinational corporations in recent years can be understood. However, more importantly, the net result of these structural changes is that there is now intensified competition among states for world market shares. This competition is forcing states to bargain with foreign firms to locate their operations within the territory of the state, and with national firms not to leave home (or at least not entirely).⁶⁵

The shifting of power from states to the market does not, however, posit the demise of states.

Markets do normally require some form of political organization and protection, and this is usually provided by the state. [However] by the same token, governmental institutions require finance.⁶⁶

From this, it can be derived that both states and markets need each other. Thus, it follows that because the MNCs are the primary actors in the market, they are needed by the state just as they need the state. Obviously a symbiotic relationship exists, which will characterize their interactions.

⁶⁴ See Iain Wallace, *The Global Economic System* (London: Unwin Hyman, 1990), p. 133; and Strange, op. cit., p. 61.

⁶⁵ Strange, op. cit., p. 65.

⁶⁶ Gill, p. 98.

In conclusion, although evidence suggests that the MNCs do not take over from the government of states, what is apparent is that they have, because of structural changes, increased their power and have somewhat encroached upon, or are sharing, some of the powers traditionally only in the domain of the state, not only internationally but also domestically. Thus, this 'shift' has made political players of the multinational corporations, and has certainly enabled them to have greater influence in their relationships with the state.

The Impact of Domestic Structures

As outlined, the structural shift in power that has occurred can certainly provide an explanation of the increased success of the multinational corporation in its relations with the state. In fact, it does provide a good explanation as to how multinationals are able to carve for themselves a good deal from the state, especially in their entry to their territory. However, this alone would suggest that all multinationals, provided that 'something' they possess or have the ability to do is wanted by the state, would have the same impact, or influence, on all states. This is, obviously, not the case and thus, a close examination of how domestic structures shape the impact of the multinational corporation on the state should be used in conjunction with the structural approach.

Domestic structures, among other elements 'domestic' in nature, could provide a

greater explanation of the variances of MNC impact on the state. Domestic structures encompass the organizational apparatus of the political and societal institutions, their routines, the decision-making rules and procedures incorporated in law and custom, as well as the values and norms embedded in the political culture.⁶⁷ This has great potential to provide an explanation as to how actors, such as MNCs, alter their behaviour to fit in and gain influence inside the state. That is, it will be demonstrated that the interaction of domestic politics and MNC activities may account for the outcome in a conflict between the two entities. In fact, competitive pressures encourage MNCs to organize themselves in ways that allow them to interact effectively with states. In addition, success may also hinge upon how multinationals interact with other domestic actors, such as in building 'winning coalitions', or perhaps the degree of establishment in the domestic institutional structure also has some bearing. Therefore, I will illustrate that domestic structures provide an excellent framework from which to understand the variances in the success or failure of a MNC in its attempts to influence the governments of states.

Stephen Krasner suggests that:

the institutional structure of [MNCs] must reflect the institutional environment in which they function. The most important component of that environment is the sovereign state. State structures influence not only the avenues through which transnational actors must operate, but the very nature of these actors themselves.⁶⁸

⁶⁷ Thomas Risse-Kappen, "Bringing Transnational Relations Back In: Introduction," in Risse-Kappen, ed. *Bringing Transnational Relations Back In: Non-state actors, domestic structures, and international institutions* (Cambridge: Cambridge University Press, 1995), p. 20.

⁶⁸ Stephen Krasner, "Power politics, institutions, and transnational relations," in Risse-Kappen, ed. *Binging the State Back In: Non-state actors, Domestic structures, and International institutions* (Cambridge: Cambridge University Press, 1995), p. 260.

Thus, the framework of domestic politics provides the structure in which MNCs gain access, operate within, and can also shape the very nature, or structure, of the multinational itself. It is, then, the political setting, or domestic structures, that determine corporate strategy in that state's territory. Therefore, although multinationals have gained a great degree of structural power, or rather that there has been a shift of power away from states, it can be hypothesized that states still possess a great deal of power.

The state, in its interaction with the multinational corporation, is the 'stronger' actor in the sense that the MNCs must conform to its structure. In addition, the state is still considered to be powerful in the sense that most multinational corporations must have the approval of the state in order to secure territorial access. Although this appears to be gradually diminishing, states may still be prone to restrict or provide limited access in some sectors, such as those that are strategically important to the state.

Multinationals also need the state, in that it is the legitimate authority in providing and maintaining property rights, and other laws crucial to the operations of the MNC.⁶⁹ As stated previously, in order to be effective and influential actors, MNCs must organize themselves within the domestic framework of the state in question. Thus it follows that because all states are different, the operations, activities, and even the structure of the multinational will vary within different states, as it must accommodate itself to unique

⁶⁹ Krasner, p. 263.

state structures. That is, multinationals may “arrange themselves as bribe-givers in one state, lobbyists in another, and diplomatic emissaries in another,”⁷⁰ depending on the state in question. In addition, MNCs must also adapt to the rules, regulations, and laws of the nation in which it operates. Thus, how they arrange themselves will differ depending on the state and its structures (which determine the ‘points of access’), and may even include adjusting to, or adopting, established state norms. It can, therefore, be concluded that domestic structures are likely to determine both the availability of channels for MNCs into the political system, the requirements for their ‘institutionalization’, and thus create incentives for the MNC to shape its structure, operations, relations, and political behaviour so as to have the greatest potential for the outcome of their goals in that state.⁷¹

Domestic structures are likely to determine the availability of access points into the political system of the state. As recognized earlier, access to a state’s territory can be considered to be primarily a function of the state structure. States, or rather national governments, ultimately determine whether these MNCs are allowed to enter the country and to pursue their goals in conjunction with national actors. Thus, governments have considerable leeway to enable or constrain entry and activities in that they distribute

⁷⁰ Ibid, p. 261.

⁷¹ See Risse-Kappen, p. 6.; and Peter Katzenstein and Yutaka Tsujinaka, “Bullying, Buying, and Binding: US-Japanese Transnational Relations and Domestic structures,” In Risse-Kappen, ed., op. cit., p. 109; Although Risse-Kappen refers to all Transnational actors rather than specifically MNCs, it is recognized that MNCs are transnational actors.

visas, guarantee property rights, issue export licenses, and the like.⁷² However, as was noted in the explanation of structural changes, because governments of states find themselves 'needing' multinational corporations for economic development and to maintain their competitiveness internationally, granting access to a MNC to operate within its territory may be done more readily than it was in prior decades.

Although access is crucial, it, itself, does not guarantee a MNC's impact or influence. This, however, depends, to a large degree, on the ability of the MNC to adjust to the domestic structure of the particular state. Clever MNCs will adapt to the distinct institutional structure of the state within which they operate to achieve their goals.⁷³

What is evident is that the institutionalization of MNCs in their environment, the state, is imperative for not only their potential influence, but also for their survival. It has been argued that there are a number of linkages which, if formed and strengthened, will greater institutionalize multinationals in their environment.⁷⁴ These linkages can be referred to as: enabling, functional, diffused, and normative.

Enabling linkages provide the authority to operate (or entry into the state) and also allow legal access to resources. Thus, in this sense, the multinational must be

⁷² This is a reiteration of a point made by Krasner, in Risse-Kappen, p. 25.

⁷³ Risse-Kappen, p. 26.

⁷⁴ See A.H. Meleka, "The Changing Role of Multinational Corporations," in *Management International Review*, Vol 25, No 4 (1985), pp. 40-44 for a more thorough explanation of these linkages.

legitimized by the state. The second is the functional linkage. These are connections or associations to other competitive, complementary, or cooperative entities, such as other domestic firms, financial organizations, suppliers, and the like. Building relationships with other domestic actors, or organizations, further integrates the MNC into the state and creates 'interdependencies'. These interdependencies could prove to be vital to the operation and survival of the multinational corporation in that state (as in the case of Toshiba in the United States). The MNC's ability to form 'winning coalitions' with these groups, especially other like-minded businesses, will have a great impact on the success or failure of the MNC in its interaction with the state.⁷⁵ Such business organizations, or groups, are likely to be the best organized and best financed groups, with a number of important political connections ('access points') and with a persistent interest in the outcome of policy. Becoming a member, or becoming associated with these groups could strengthen the potential influence of the multinational. As well, lobbying efforts undertaken by these groups could also prove to increase the chances of success, or the preferred outcome. Therefore, functional linkages of a MNC in the domestic state structure can be quite lucrative for the MNC, especially in terms of influence.

Thirdly, diffused linkages are those relationships that are not connected with any 'formal' organizations, per se, but are able to influence the institution-building process of the system. Therefore, a multinational's diffused linkages are strengthened because of

⁷⁵ See Risse-Kappen, p. 26; and Tarzi, p. 163.

their integration into the state political and professional milieux, by virtue of forging and fortifying relationships with political factions and intellectual elites. It should be noted, though, that the promise of money, perhaps in terms of campaign funds or in the financing of research, is an effective tool in building these relationships.

Lastly, normative linkages emerge from religious, educational, and social institutions which have a value-based supportive or hostile interest towards the multinational corporation in question. This could also be extended to include important state norms, such as norms of appropriate behaviour.⁷⁶ The Japanese decision-making norm of 'reciprocal consent' and the US notion of 'liberal pluralism' are examples. Although these are not explicitly-written regulations, they do constitute powerful political and cultural norms which define appropriateness with regards to the way decisions should be made in the political system.⁷⁷ Thus, it can be hypothesized that the strengthening of these linkages institutionalizes MNCs in their environment, and could, consequentially, establish the MNC as an effective institution in that environment. Thus, as multinational corporations establish their importance and influence in their environment, the state, they can posit and predict changes so as to adapt their strategies to ensure their profit-making capacities and survival.

⁷⁶ Risse-Kappen, p. 21.

⁷⁷ Ibid, p. 21.

In addition, it should be noted that the MNC may be able to exert influence by virtue of its own efforts, such as directly lobbying the government of the state or by 'buying' officials. This can be referred to as direct power and is, most certainly, an example of when the economic clout of a multinational is an important factor, for, generally speaking, lobbying requires large sums of money. Although individual MNC lobbying can be successful, MNCs recognize that an increased chance of the success of these efforts would come through 'coalition-type' lobbying, or indirect lobbying. As the old cliché goes, there's strength in numbers. As well, there are also some unofficial lines of persuasion and propaganda. For instance, the MNC may directly work on governments and publics, through propaganda campaigns, to try and create a 'better climate' for investments and operations, or as a means of 'damage control'.⁷⁸ Because of their access to the media, MNCs waging these campaigns can be quite successful in spreading their message across a particular territory. Examples of this behaviour are the 'print' campaigns of Toshiba in the United States in 1987, and of Merck-Frosst in Canada in 1993 and 1997. Although these lobbying efforts and propaganda campaigns can be successful, and although great amounts of money are needed for these campaigns, it is not the 'resources' (money) that determine their effectiveness, but rather the degree of institutionalization in the domestic structures, as these would give them heightened credibility.

⁷⁸ K.J. Holsti, *International Politics: A Framework for Analysis*, 6th ed. (New Jersey: Prentice Hall, 1992), p. 159.

Although the institutionalization of the MNC in its environment may strengthen its influence and determine its impact on the state, as well as its survival in the territory, this may not be the case if the goals of the state dramatically differ from those of the multinational. Enterprises, too, have to learn diplomacy.

Bull-headed disregard for the political constraints upon governments or for the social concerns which are often the main source of political legitimacy will do a company no good in negotiations with a government.⁷⁹

Thus, complete disregard for a state's position or goals could potentially have a negative impact on the outcome for the multinational corporation.

As well, it should also be understood that if a multinational is unable to infiltrate the state through its structural power or if access or influence cannot be met through domestic structures, then another option could be available. As was stated, these two 'conditions' may have the greatest potential for predicting the influence of a MNC and the outcomes, but they are not perfect. There is, however, a factor, if used, that could seriously affect the influence that a MNC has on a particular state, even if these other conditions favour the state. That is, in instances that the MNC feels that its 'institutionalization' into the domestic structure, or that its resources and capabilities are not enough to influence the state, then the MNC may bring another actor into the MNC-state conflict. That is, the MNC may strategically use another state, usually a more powerful one than the state with which the conflict is occurring, to help further their goals. In the 1970s, the fear among lesser developed countries was that the 'stronger'

⁷⁹ Strange, "Big Business and the State," p. 106.

states were using 'their' MNCs as their tools to help further their goals in that country, or keep that country 'under their thumb'. This role, however, appears to have reversed, such that MNCs can now seek assistance from their 'home' state⁸⁰, or from another state that it operates in. Therefore, the extent to which the MNC can mobilize the support of its home government, and providing that the home government is more powerful (or influential) than the state of conflict, can prove itself to be an important determinant of the success of the MNC in its confrontation with the state in question. But again, the support of the home government will also depend on a number of factors, notwithstanding the ability of a multinational to use that state's structures to gain support for its endeavour. That is, the MNC may also have to prove the importance of the intervention, especially in terms of the home state's interests. For instance, the home government may support MNCs for a variety of national security reasons, to maintain access to cheap sources of labour, or to improve its balance of payments position.⁸¹

There is, however, no systemic relationship between the home government interests and MNC interests that might automatically trigger their support for the MNC in the state in question. As well, although the MNC may turn to its home government for support, this will not stop them, at the same time, turning for help and support to other governments

⁸⁰ It should be noted that I use the term 'home state' loosely. It is widely acknowledged that multinationals have become more global, even in its ownership. Thus, it is very difficult, in many cases, to decipher exactly which nationality a multinational is, for even the multinational may not consider itself to be of any nationality, but just a firm that transcends borders and loyalties. In addition, because of unidentifiable ownerships, a multinational could become a chameleon, in that it may call itself a "Swiss" company in Switzerland and an "American" company in the United States. Thus, the "home country" of a multinational may not be where its loyalty lies (for there is probably no loyalty to a particular state--MNCs are not 'citizens') but rather where the MNC decides to seek assistance when needed.

⁸¹ Tarzi, p. 163.

acting as hosts to their offshore operations.⁸² Therefore, what this confirms is that states are still the dominant actors, both domestically and internationally, for the multinational corporation, by using this as a strategy, realizes its limitations as an actor and that another state may influence the outcome in its favour in the state conflict in question. This can occur, especially in the cases where a MNC is unable to successfully penetrate, or integrate itself into the domestic structure of the state.⁸³ However, this alters the conflict, in that it is now longer a MNC-state conflict, but rather an inter-state conflict, in which the determinants of influence would have to be explained by virtue of a different analysis, perhaps one that incorporates the relational power of the states involved.

In conclusion, domestic structures, through shaping the multinational activities and even its structure, can likely determine the degree of influence and determine the impact of the multinational on the governments of the state. Again, this approach in studying the 'power' of the multinationals is not comprehensive enough to be used alone to predict outcomes. Thus, it is my position that domestic structures and international structural changes will provide us with a very good 'paradigm' for determining and understanding the influence, or power of the multinational corporations on the governments of states in their domestic realm. Hence, although it may not be perfect, it

⁸² Strange, "Politics and Production", p.57.

⁸³ A prime example of this is the American government 'bullying' on behalf of its MNCs in Japan, because the domestic structure of Japan was too difficult for them to penetrate successfully. For a more detailed explanation of this, see the Katzenstein and Tsujinaka article.

can certainly be used as an effective tool of analyzing the MNC-state relationship and as a predictor of the outcomes of possible conflicts.

Conclusions

As one would recall, much of the earlier debate was focussed on the impact of multinationals on state policies or whether states or multinational corporations win in direct confrontations between the two. Some argued that the state control over outcomes was a losing proposition given the proliferation of MNCs, transnational relations, and complex interdependence, while others maintained that national governments could easily prevail if they chose to do so.⁸⁴ Perhaps neither of these views is correct. Although it has been illustrated that multinational corporations have certainly grown in power over the past years, and that states have still retained a great deal of power with their interactions with MNCs, it cannot be so simply stated that either the state or the MNC will always win. The outcomes will differ and will depend upon the balance of interests and capabilities. However, in this perspective, the state is still the dominant actor, in that MNCs will have to interact with them to achieve their goals in their territory. But again, this does not mean that the state will always win, just that the MNC must adapt itself to the state (and its structures) so as to increase its chances of success in the outcome. Thus, we must examine the determinants of the power of the

⁸⁴ Risse-Kappen, p. 293.

MNC in order to assess the possible outcomes and to provide explanation of the variances.

It can be successfully argued that domestic structures and international structural changes are the most important determinants of the power, or influence, that the MNC will have in its relations with a particular state. Successful outcomes for the MNC will greatly depend on these. However, as stated earlier, these may not provide 'perfect' predictions. That is, there may be other factors, or variables, that could also account for differences in MNC impact.

It has been noted that the specific nature of an issue-area can be important in deciphering both the entry and the impact that a multinational corporation might have. For instance, it was mentioned earlier that variations in influence might be explained by the degree of importance of the issue-area to the state in question. For example, a MNC may have more difficulty gaining access to areas of 'high' politics, such as areas defined to be important to national security. As well, the MNC may gain access but may not be influential, for it may be denied access to certain information because of the questionability of its loyalty to that state. However, others have argued that, once admitted, MNCs operating in areas of high politics may prove themselves to be highly influential, especially if there are relatively few actors. Thus, it is extremely difficult to accurately assess the degree of influence, or success, that a multinational corporation will have by solely examining issue-areas. One should not expect the same MNC impact on

state policies across issue-areas in a given country. Again, it is nearly impossible to generalize about MNC influence just by examining the specific context of the issue-area and by ignoring other more potentially explicative conditions, such as the domestic structures in which the MNCs operate and the international structural changes that have occurred.⁸⁵ Thus, to illustrate this hypothesis, an examination of structural power and domestic structures will be incorporated into an analysis of three specific cases of conflict between a MNC and a state.

Choosing Case Studies

A number of cases where the multinational corporation has come into direct conflict with the government of a state have been chosen to illustrate these assumptions. However, there are methodological difficulties. There is a plethora of cases of MNC-state conflict from which to choose, and it is impossible to determine whether the cases chosen constitute a reasonably representative sample. However, for all practical purposes, the cases are differentiated in a number of areas and were not chosen for the sole purpose of adding substance to my arguments. In addition, the cases were also chosen for their comparative value, in that their selection was made to introduce variation in the distribution of the various resources of the state relative to the multinational and also to have variation in the issue area. Thus, the cases of Union

⁸⁵ Risse-Kappen, p. 307.

Carbide in Bhopal, Toshiba in the United States, and pharmaceutical multinationals in Canada are, for analytical purposes, an acceptable sample.

The first case, the Union Carbide toxic gas leak in Bhopal, India in 1984, was chosen for a number of reasons: firstly, to analyse the argument that “weaker” states are not as able to defend themselves against the wishes of multinationals; secondly, the multinational in this case is a large, well-established, and wealthy American MNC in the chemical industry, and to question whether this had any bearing on the outcome; and lastly, to question whether structural change and domestic institutions have greater explanatory power in understanding their success, or whether other factors play a greater role in explanation.

The second case, the Toshiba incident in the United States in 1987, was also chosen so as to try and hypothesize whether the “strong” state, the United States, would be in a greater ‘power’ position to ward off the influences of the multinational corporation. In addition, this case was selected so as to analyse the hypothesis that variance in issue areas could potentially explain the success or failure of the multinational. That is, because the incident was in a ‘high politics’ area, sensitive military technology, one would assume that the state would be in a greater ‘power’ position and that the state would ‘win’ in a confrontation. However, this was not the case, and thus, other factors must be examined, such as the domestic institutions, and the ‘direct’ application of power of the multinational in the domestic realm.

Lastly, in the case of multinational pharmaceutical corporations in Canada in the late 1980s and early 1990s, the issue at hand, again, is to decipher whether Canada's 'strength' in the international system could have any bearing on the outcome.⁸⁶ Or perhaps that domestic structures and the exercise of direct power were more functional in their success? Or perhaps the 'origin' of the multinational corporations may have a bearing on the outcome?

To a certain degree, all three cases illustrate the success of the multinational corporation in achieving its goal with the state, although in different time periods, industries, and states of operation. However, the purpose of this approach is to compare these cases in which multinational corporations sought to influence policies, namely state behaviour, and to decipher whether structural changes and domestic institutions provide a greater understanding of where the multinational derives its 'power', how it is exercised in its confrontations with the state, and, thus, to explain the outcomes.

Having come thus far, the basic hypothesis that I will assess through the case studies of Union Carbide in India, Toshiba in the United States, and multinational pharmaceutical corporations in Canada is that the structural changes that have occurred and that the domestic structures of the state of operation are the most important

⁸⁶ In defining states as 'weak', 'strong', or 'middle power', I am attempting to illustrate the weaknesses in approaching the variance of multinational corporation's influence by the use of the state's position in the international system. This, I believe, is inadequate in explaining the variances in success or failure of the MNC in conflicts with the state in its domestic realm.

determinants of the influence, or power, that a multinational corporation will have on the policies of that state. Therefore, in order to assess this hypothesis, an explanation of the incidents is required, as is an analysis of the factors that contributed to their successes.

**Union Carbide Corporation and the Bhopal Incident:
Structures as Strategy**

*It is not proper for an international corporation to put the welfare
of any country in which it does business above that of any other.*

Union Carbide spokesperson

Introduction

In the late evening of December 2, 1984, over 40,000 tonnes of methyl isocyanate gas were accidentally released from a pesticide factory in Bhopal, India. Tens of thousands have died and hundreds of thousands were injured in what has been coined the world's worst industrial disaster. Unfortunately, over a decade later, the surviving victims continue to suffer, both physically and economically, while the perpetrator, Union Carbide Corporation, maintains a stable, profitable operation. Union Carbide escaped, virtually unscathed, at the expense of the victims.

Workers and local communities regularly suffer death, injury, and ill health due to the actions or inactions of corporations. Often these actions or inactions are the consequence of economic calculations on the part of corporate executives. The Bhopal accident is, perhaps, the best illustration of what happens when a powerful corporation sets up in a developing country with a weak regulatory structure and little political motivation to control the activities of these multinationals. Hence, Union Carbide's performance in dealing with the world's worst industrial disaster is well worth examining in terms of the capacity of large multinational corporations to evade serious accountability for their actions, especially when those actions are harmful to others.

This chapter, through an examination of the Bhopal accident and the ensuing litigation, scrutinizes the behaviour of the perpetrator of the accident. It also seeks to look beyond the tragic accident and to understand how Union Carbide, an American-based multinational corporation, was able to successfully shape the outcome to its preference: that is, how Union Carbide was able to escape relatively unscathed warrants closer consideration. Thus, in this case study, the tragic events that occurred in Bhopal will be utilized so as to pose certain theoretical questions relating to the source of this 'power'. From this, it will be evident that structural power, in the form of the Indian government's ideological stance on economic development, and the effective use of differing domestic structures (the Indian and American legal institutions) allowed Union Carbide a critical role in determining the outcome. However, in order to illustrate such, a review of Union Carbide's operations in Bhopal and the legal battle transpiring from the accident are necessary.

The World's Worst Industrial Accident: A Chronicle

Genesis

The company's history in India can be traced back to 1905¹, when it began marketing its products there. It was one of the very few U.S. companies active in India prior to independence because India, as a colonial possession, was considered to be the

¹ David Weir, *The Bhopal Syndrome* (San Francisco: Sierra Club Books, 1987), p. 39.

protected preserve of British companies.² In 1924, an assembly plant for batteries was opened in Calcutta and, by the 1960s, the Eveready battery had become a well-known household name in India.³

The late 1960s were also a time for Union Carbide to consider expanding its operations in India in the lucrative field of pesticide manufacturing. Thus, in 1969, Union Carbide India, Limited (UCIL) and Union Carbide Corporation (UCC) agreed with the government of India to build a pesticide manufacturing plant in Bhopal.⁴ By 1984, expansion strategies appeared to have worked, for there were now fourteen plants in India, which manufactured such items as batteries, chemicals, and pesticides.⁵ By all accounts, it certainly appeared that Union Carbide's operations in India were doing quite well.

Union Carbide's operations in India were conducted through a subsidiary, Union Carbide India Limited (UCIL). Managerial control of UCIL was exercised by Union Carbide through its Eastern Division, headquartered in Hong Kong, but it was widely recognized that centralized decision-making existed, and thus, the 'true' authority lay

² Ward Morehouse, "The Ethics of Industrial Disasters in a Transnational World: The Elusive Quest for Justice and Accountability in Bhopal," in *Alternatives: Social Transformation and Humane Governance*, Vol. 18 No 4, Fall 1993, p. 477.

³ Weir, p. 29.

⁴ R. Clayton Trotter, Susan Day, Amy Love, "Bhopal, India and Union Carbide: The Second Tragedy," in *Journal of Business Ethics*, Vol 8, 8 June 1989, p. 440.

⁵ Morehouse, p. 477.

with its American top management.⁶ In addition to 'centralized' control, the parent US company⁷ also held the majority of UCIL stock, with 50.9% while the Indian government held 22%, and the remainder by individual Indian stockholders.⁸ This, in itself, could be considered to be an important measure of the influence of UCC in India. Despite Indian law limiting foreign ownership of corporations to 40%, the US parent company was allowed to retain majority ownership of UCIL.⁹ The Indian government waived this requirement in the case of Union Carbide because of the sophistication of its technology and the company's presumed potential for exports. Thus, the Indian government hoped that industries, such as Union Carbide, would be the key to the economic development of India.

In any event, it was partly in response to government incentives that Union Carbide launched its operations in Bhopal in 1969. A small plant was to be built with the intention of formulating a range of pesticides and herbicides derived from a carbaryl base.¹⁰ The impetus for this initiative was provided by the Indian government because of the need for pesticides in India and because of the government's embrace of the Green

⁶ Frank Pearce and Steve Tombs, "Bhopal: Union Carbide and the Hubris of Capitalist Technocracy," in *Social Justice*, Vol 16 No 2, 1989, p. 121.

⁷ It should be noted that Union Carbide Corporation is incorporated under the laws of the State of New York, USA, but is headquartered in Danbury, Connecticut.

⁸ Lincoln Keyte, "Trussed in Red Tape," in *Far Eastern Economic Review*, 26 February 1987, p. 63.

⁹ From "The Trade Union Report on Bhopal," International Federation of Chemical, Energy and General Workers' Unions, Geneva, Switzerland, 1985, p. 6. Cited in Weir, *Bhopal Syndrome*, p. 31.

¹⁰ Morehouse, p. 477.

Revolution agricultural strategy.¹¹ Thus, in addition to waiving its ownership requirements, the Indian government provided further incentives for UC to launch its operation in Bhopal. Because Bhopal was in one of the most economically-depressed states of India, schemes to attract industry there had been put into place. It was reported that UC was allowed to build the plant on five acres of government land at an annual rent of about 40 dollars (US) an acre, including taxes.¹² Therefore, it is quite evident that the government of India hoped, through its concessions and incentives, that UC operations in Bhopal would be beneficial to its development.

The Bhopal plant was designed to combine and package intermediate chemicals, thereby producing the end pesticide, *Sevin*. The ingredients of *Sevin*, alpha-naphthol and methyl isocyanate (MIC), were to be combined, diluted with non-toxic powder, and packaged at the Bhopal plant.¹³ Hoping to take advantage of a growing market in India for carbamates like *Sevin*, Union Carbide expanded the plant several times during the 1970s. However, to maintain its operating license in India, UC was forced to begin building a second plant in Bhopal.¹⁴ That facility was designed to manufacture MIC for the production of *Sevin*, which occurred in the original plant. The plant was located in

¹¹ Ibid, p. 477. This strategy was characterized by chemical and energy intensity, and the high use of manufactured inputs.

¹² Weir, p. 31.

¹³ Trotter et al, p. 440.

¹⁴ Ibid, p. 440.

the existing plant to the north of the city, close to a railway line, and adjacent to a residential neighbourhood.¹⁵

Before the construction was finalized in 1979, substantial problems appeared, resulting in construction modifications during 1978.¹⁶ By 1980, the plant was considered operational. By 1984, the plant was a 25 million-dollar manufacturing facility sprawled over eighty acres of Bhopal. However, not only was the plant not operating at capacity, but, throughout the years, numerous safety deficiencies were discovered.¹⁷ It would be these deficiencies that would prove to be the recipe for disaster.

The Accident

From the time of their discovery (1982) to 1984, the deficiencies caused various stages of shutdown and partial operation of the MIC facility. The two deficiencies that remained were that the refrigeration unit continued to malfunction and that the pressure gauge which measured the level of toxic gases was missing.¹⁸ However, in June of 1984, a memo from UCC was issued that assured that the problems had been rectified. At that same time, it became public that Warren Anderson, the Chairman, and top management

¹⁵ Morehouse, p. 478.

¹⁶ Trotter et al, p. 440.

¹⁷ Ibid, p. 440.

¹⁸ Trotter et al, p. 441.

of UCC endorsed a plan to sell the plant due to its under-utilization.¹⁹ However, before this could occur, tragedy struck.

On the evening of December 2, 1984, the MIC plant was operating far below capacity and was partially shutdown for maintenance. An operator noticed that the pressure in one of the MIC storage tanks read four times higher than usual, but was unconcerned because he assumed that the tank had been pressurized with nitrogen by personnel from the prior shift.²⁰ Although many workers began to complain of 'watering and stinging' eyes, there was little concern as minor leaks at the plant were common. Hence, it was unknown to the workers that the so-called 'minor problem' would turn out to be, what has been coined, the "world's worst industrial accident".

Water had somehow entered the storage tank, which led to a build-up of pressure more than the MIC tank's rupture limit. The pressure forced a relief valve open, and gases burst out, past the gas scrubber, and into the atmosphere.²¹ Gas could be seen escaping one hundred and twenty feet into the air! The escape of this gas would result in a tragedy of horrific proportions.

Because the accident occurred after dusk and during winter, and because the

¹⁹ Ibid, p. 440.

²⁰ Ibid, p. 440.

²¹ Trotter et al, p. 440.

chemical components of MIC were heavier than air, the gas drifted down to the neighbouring villages.²² Gas leaked for forty minutes from an underground tank and covered a twenty-five square mile area.²³ Exact estimates of the number of deaths or injuries resulting from the emission of deadly gases cannot be made, but it has been approximated that there were between 2,000 and 3,000 immediate fatalities. In addition, at least 300,000 were exposed, with 60,000 of those seriously affected and with 20,000 permanently injured.²⁴ In addition, doctors predicted that much of the population would experience adverse health problems in the short-run, while the potential for birth defects and other long-term effects was yet to be known.²⁵ Thus, although exact figures are impossible to calculate, what is evident from these estimates is the magnitude of death and injury from this unfortunate, and avoidable, accident.

The Immediate Aftermath

Immediately following the accident, the chief executive of UCIL indicated that his company was willing to pay compensation, which, at that time, was estimated to be in the millions of dollars.²⁶ UCC, the parent company and majority shareholder, upon seeing the value of its shares drop, claimed that its insurance would cover it, if its liability

²² Pearce and Tombs, p. 117.

²³ From D. Cotton, "India poison toll tops 460," USA Today, 4 December 1984, p. 1. Cited in Trotter et al, p. 441.

²⁴ The figures from the various sources researched vary, and exact figures are not available. Thus, the figures used are the range of figures from the sources cited.

²⁵ Trotter et al, p. 441.

²⁶ Pearce and Tombs, p. 117.

was proven, for the costs of compensation to the victims and for the costs of relief and clean-up operations.²⁷ At the same time, however, UCC began to take precautions to prevent any liability, and thus, presented itself as an innocent party to the accident. UCC asserted that:

[it] did not locate the methyl isocyanate plant at Bhopal for reasons of economy or to avoid safety standards, and that, although the plant was managed by Indian nationals, it was the same as the one in Institute, West Virginia, which [is] very safe.²⁸

Thus, with UCC's assertion of non-negligence, the battle for accountability for the Bhopal accident had begun.

Although announcements were made that UCC would provide a relief fund and other humanitarian efforts²⁹, it was later revealed that these were never intended to occur, but were, rather, used as propaganda to re-establish a positive reputation in the eyes of its shareholders and the customers of its products.³⁰ What soon became apparent was the elaborate campaign being undertaken to distance UCC from its 'offending' subsidiary, UCIL. Again, public testimony was made that stressed that UCC had specified the same standards throughout all its operations, both those in America and

²⁷ Ibid, p. 117.

²⁸ Pearce and Tombs, p. 117; see also "Union Carbide is off the hook in Institute, West Virginia," *Multinational Monitor*, March 1986, p. 19.

²⁹ Aside from a \$5 million contribution to the International Red Cross for humanitarian relief, UCC did not aid, monetarily or otherwise, the victims of Bhopal.

³⁰ On December 9, 1984, Warren Anderson announced that a \$1 million relief fund and an orphanage in Bhopal would be set up for the victims of the disaster. However, what was not explicitly expressed was that this would be established only if it were shown that UCC was liable for the incident, which it worked to maintain that it was not. See Pearce and Tombs, p. 117-119; and Trotter et al, pp. 441-442 for further detail.

abroad,³¹ and was regarded as having one of the best safety records of the major U.S. corporations. These statements, and other statements of ‘innocence’ and ‘non-liability’ would become routine in the year(s) following the disaster and would prove to be a tremendous stumbling block to attain justice for the victims of the accident.

Causes: Sources of Contention

In the years following the Bhopal accident, UCC took almost every opportunity to develop a case as to the details of the accident and to deny its own responsibility for the series of events that lead to the gas leak. UCC made five basic contentions:

- 1) UCC had an excellent safety record and the design of the plant’s Standard Operating Procedures (SOPs), UCC’s responsibility, was basically sound. Moreover, in fundamentals, the plant was the same as that at Institute, West Virginia;
- 2) The production of MIC in India, the setting of the plant and the quality of the materials used were all the responsibility of the Indian state;
- 3) UCIL was an independent company, responsible for its own efforts [hence, autonomous decision-making];
- 4) India’s cultural backwardness was responsible for the poor maintenance and management, poor planning procedures, and the inadequate enforcement of safety regulations; and
- 5) There was a national proclivity to engage in sabotage, for political or personal reasons, and this demonstrated national immaturity.³²

Thus, UCC took a variety of measures to attempt ‘damage control’ and to assert its

³¹ Warren Anderson testified this to a Congressional sub-committee on December 14, 1984. See Pearce and Tombs, p. 118.

³² These basic contentions are formulated from the *UCC 1984 Annual Report*, “*The Bhopal Methyl Isocyanate Incident Report*,” UCC’s *Memorandum of Law*, and from a series of statements made in a number of public forums. This listing is a direct citation from Pearce and Tombs, p. 118. As well, it should also be noted that its fifth claim, that of sabotage, was one that was carried through the investigative process. Carbide asserted that a disgruntled employee was responsible for the leak, and even went so far as to produce a videotape re-creating the actions of the ‘saboteur’. For a more detailed explanation of the sabotage theory, see “Union Carbide in Bhopal,” in *Multinational Monitor*, June 1988; Pearce and Tombs, p. 118; and Robert Manning, “Deadlock over Bhopal,” in *Far Eastern Economic Review*, 11 July 1985, p. 19.

innocence, and hence, non-liability for the accident. Given the possible outcome, this strategy was not surprising. If the cases against UCIL and UCC were to ever go to trial, either in the US or India, the evidence indicating reckless operation of the Bhopal plant could mean a verdict that would quickly deplete the assets of UCIL, which were estimated at 100 million dollars. Although as half-owner of UCIL, the loss of the Bhopal plant's assets were of concern to UCC, of greater concern was the threat of losing its own assets, which were estimated to be close to 10 billion dollars.³³ Thus, if a judge made a legal determination that UCC exercised control over its Indian subsidiary, then UCC's entire net worth would be open to the claims of the victims. Hence, not surprisingly, UCC found this unpalatable, and attempted to dismiss this by all means possible. In addition, it was obvious that a legal battle was seen as being costly to UCC, and it attempted to avoid this at all costs. A proven charge of sabotage would have prevented both from occurring, for this would have presented UCC as the 'victim', and not the culprit (or 'victimizer'). Alas, as evidence of the accident slowly presented itself, its sabotage theory was easily dismissed. As well, despite UCC's emphasis on the negligence of UCIL and the Indian government, UCC would not escape accountability so easily. Its 'supposed' innocence and quest to disclaim any liability would prove to be the basis for the ensuing process of determining liability and rectificationary measures.

The Indian government proclaimed itself the sole actor on behalf of the victims of Bhopal. However, as the situation progressed, the Indian government relinquished its

³³ "Corporate Crime and Violence," in *Multinational Monitor*, April 1987, p. 6.

sole control over the investigative and judicial procedures and allowed victims the choice to attain representation from American lawyers. However, once the case was dismissed from US jurisdiction, the Indian government again became the sole representative of the victims (plaintiffs). For all practical purposes, however, the various legal representatives acted in concert for the demand for compensation to be immediately awarded to the victims, so as not to unnecessarily prolong their suffering. However, in order for this to occur, UCC's involvement, or negligence, had to be proven.

According to UCC's official statements and position, it had done nothing wrong. The negligence had been on the part of its subsidiary, UCIL, which UCC stated had autonomy, and the Indian government, for the most part because of its lack of regulatory capacity. However, it appears that UCC misrepresented its involvement in the tragedy.

As outlined in the position of the government of India, contrary to UCC's statements, the parent company did have control over its Indian subsidiary. It held the majority of stock, its top management were on the board of UCIL, the continued existence of the plant was its decision, and it dictated how and which chemicals were to be produced and stored.³⁴ What was clear was that the top management of UCC had represented itself to its shareholders as effectively controlling the different sub-sections of its organization and had received the commensurate rewards and privileges associated

³⁴ For example, UCC insisted that large amounts of chemicals be stored in Bhopal, against UCIL management's wishes. This, in itself, questions the 'supposed' autonomy that UCC states that UCIL held. See Pearce and Tomb, p. 119-123, for a more detailed examination of this misrepresentation on the part of UCC.

with such controls. Thus, they were responsible for, if not in fact totally in control of the organization's actions. Therefore, UCC's statements to the contrary were proved factually incorrect, and thus exposed the parent company to its proper liability, which it tried, in vain, to discharge.

There is no doubt that badly maintained equipment, lack of spare parts, inadequate Standard Operating Procedures, and untrained staff all contributed to the accident. However, what needed to be determined was the extent to which Union Carbide Corporation played a role in these contributing elements. The investigative process brought this to light, and consequently gave the Indian government a stronger case against UCIL and UCC.

Firstly, badly maintained equipment could be considered to be the foremost reason for the occurrence of the accident. At the time of the accident, the refrigeration unit was not working. With this unit not in operation, it was crucial that instruments designed to measure the temperature and pressure of the gas in the storage tank be in good operating order. But these, too, were faulty.³⁵

The plant also had an emergency scrubber system to neutralize gas in the event of a leak. But the scrubber system had been out of use for six weeks.³⁶ The flare tower,

³⁵ "Corporate Crime and Violence," in *Multinational Monitor*, April 1987, p. 6.

³⁶ *Multinational Monitor*, April 1987, p. 7.

designed as the final line of defense to burn off excess MIC, was also closed down. Due to the neglected maintenance, the line to the flare tower had corroded.³⁷

Obviously badly maintained equipment contributed to the accident. However, equally important were the ad hoc modifications of the plant's design.³⁸ Aside from these modifications, there were also serious questions about the plant design itself. Plant instrumentation was inadequate to monitor normal plant processes and leaks were detected by smell, which was only possible at levels of twenty times higher than the Threshold Limit Value (TLV).³⁹ In addition, the storage tanks at Bhopal were a type unsuited to Indian climatic conditions, which led many to believe that they had originally been used at the Institute, West Virginia plant and transported for use at Bhopal.⁴⁰ However, what is perhaps the most interesting of all of UCC's assertions was that the Bhopal plant was designed to be identical to the one at Institute, which was regarded as safe.

With regards to plant design, the Institute plant was far superior to that of Bhopal. In all of the above factors, Institute had superior technology. Firstly, it had larger dump tanks and an additional dedicated overflow system, even though both plants

³⁷ Ibid, p. 7.

³⁸ For instance, an unmarked (and not included in the design draft) jumper line may well have been the means by which water entered the MIC tank. See Pearce and Tombs, p. 119.

³⁹ Pearce and Tombs, p. 119.

⁴⁰ Ibid, p. 120.

stored comparable amounts of MIC.⁴¹ Moreover, the Institute plant had an additional and more powerful emergency back-up system. Lastly, the Institute plant's safety systems were automated with a state-of-the-art computer system, as opposed to the manually-operated controls at Bhopal.⁴² Therefore, contrary to the statements issued by UCC, the plant in Bhopal was far inferior to that of its sister operation in West Virginia in the United States.

These deficiencies and design inadequacies raise some important questions about the operations and intentions of Union Carbide. According to a report on December 27, 1984 published in the *Times of India* by a chemical engineer, Praful Bidwai, Union Carbide designed the Bhopal plant and was responsible for approving and inspecting all major equipment installed in the factory. The Bhopal plant was "grossly under-designed," according to Bidwai⁴³, and especially considering the structure and management of its other plant in West Virginia. This raised charges that Union Carbide employed a "double standard", in that UCC took advantage of a less-regulated atmosphere in India so as to construct and manage a plant that was not up to the standards of its other operations in the United States. Thus, Union Carbide was criticized for setting a higher value of life for those in the United States than in India by allowing 'shoddy' design and operating standards to be employed at the Bhopal plant.

⁴¹ Pearce and Tombs, p. 119.

⁴² Weir, p. 33.

⁴³ *Multinational Monitor*, April 1987, p. 7.

Thus, criticisms that Union Carbide was negligent in both the design and operation of the plant appeared to be justified.

What was also of interest was the hypothesis that these deficiencies may have arisen from a strategic management decision to sell the plant. As the plant never operated at capacity, management of UCC announced in the summer of 1984 that measures were being undertaken to put the Bhopal MIC plant on the market. Hence, it was suspected that, in order to decrease expenses, UCC management allowed the plant and equipment to deteriorate, allowing attrition among qualified employees and lowered entrance standards resulting in a lack of qualified applicants.⁴⁴ Thus, the extensive cost-cutting efforts that were implemented by UCC management appear to have led to a greater potential for accidents at the Bhopal plant. And an accident, if not an outright tragedy, did occur.

In addition, far fewer people would have died if the plant had not been sited near shantytowns and if there had been adequate risk assessments, modelling and monitoring of discharges, and emergency planning and management procedures in place.⁴⁵ As well, UCC and UCIL officials did not adequately convey the inherently dangerous nature of the MIC gas to the Indian officials or the public.

⁴⁴ Trotter et al, p. 442.

⁴⁵ Ibid, p. 443.

Despite the number of prior accidents at the UCIL plant⁴⁶, few Bhopal residents knew that pesticides were being produced at the factory, and nor did they know of MIC's danger. Even after the leak, Carbide took two hours to warn Bhopal residents, many of whom lived in shantytowns surrounding the plant. The accident had occurred at about 12:30 a.m., but the first alarm failed to alert most Bhopal residents until between 2:00 and 2:30 a.m. By then, the damage had been done.⁴⁷

In fact, it was denied, time and time again, by the officials of UCC that the MIC gas was hazardous. Despite scientific evidence and an Institute operating manual that illustrated the incorrectness of these public statements, UCC officials continued to maintain that the gas was nothing more than "merely an eye and throat irritant".⁴⁸ Thus, if the plant personnel, local medical services, and the state and national governments had known more about the nature and effects of these gaseous emissions, then it is quite possible that most of the disaster and many of the senseless deaths and injuries may have been lessened.

However, although the culpability of UCC in the disaster was evident, the Indian government, while not negligent in a legal sense, cannot be considered entirely blameless. Although the design of the Bhopal plant was specified by UCC, the actual construction was done by UCIL, which used local equipment and material. In addition, industry publications state that the Indian government also required manual controls wherever

⁴⁶ See Morehouse, p. 481 for a brief listing of the prior accidents that occurred at the Bhopal plant.

⁴⁷ *Multinational Monitor*, April 1987, p. 8.

⁴⁸ *Multinational Monitor*, April 1987, p. 8.

possible.⁴⁹ Another way in which the Indian government may have shown poor foresight was in requiring Indian labour. That is, there was a definite lack of qualified personnel operating the plant and equipment because American trained personnel and technicians were required “to leave the country as soon as they were no longer needed”.⁵⁰ For example, the last American technician left in 1982, after his contract as Plant Manager of the Bhopal factory had ended. Regardless of whether another Indian employee was adequately trained to run the operation, the contracts were never renewed.⁵¹

From the renewal of its license in 1982 through to the date the plant was closed (December 6, 1984), the Indian government allowed no American technicians or engineers to work within the plant.⁵² Prior to 1982, American engineers were licensed by the Indian government for short periods of time. However, while working in India, it was required that the Americans would train Indian nationals as replacements.⁵³ Unfortunately, the period of the contract proved, in many instances, not to be enough time to adequately train Indian employees, and thus, poorly-trained personnel were managing and operating a factory that was already dangerous in design and in the nature of its operations.

⁴⁹ In J.C. Forman, “Bhopal in Perspective,” *Chemical Engineering Process*, May 1985. Cited in Weir, p. 33.

⁵⁰ Trotter et al, p. 443.

⁵¹ Trotter et al, p. 443.

⁵² Ibid, p. 443.

⁵³ Ibid, p. 443.

As well, even though Union Carbide was forced to agree to strict licensing arrangements prior to obtaining an operating license in India⁵⁴, environmental control agencies in India were small, underfinanced, and with meagre representation by citizens. However, even more damaging was the reluctance of local officials to enforce the existing laws. Political will and enforcement measures would certainly have forced UCC (and thus, UCIL) to 'clean-up' its operations in Bhopal. Ergo, regardless of the disincentives to do so, the ultimate responsibility to ensure that 'safe' operations were being maintained rested with Union Carbide. Given this self-proclaimed reputation for safety concerns, this lack of regulatory enforcement should not have affected UCC's decision to pursue and maintain a safe operating environment at Bhopal. Thus, the inability and lack of political will of the Indian government to enforce safety and environmental standards, although important, should not have provided a disincentive for UCC (and UCIL) to do so. The ultimate responsibility and accountability for this was with UCIL, and its superior, UCC.

Moreover, it can be argued that the stipulated requirements of the Indian government in these other areas did not pose any damage that UCC (and UCIL) should not have been able to accommodate. That is, the cause of the accident can be regarded as the failure of UCC and UCIL to maintain safe equipment and promote safe operating and emergency procedures. However, the requirements of the Indian government could

⁵⁴ Union Carbide of India, Ltd., *Strategic Management: Strategy Formulation and Implementation*, 1988, p. 772. Cited in Trotter et al, p. 443.

be construed as, inadvertently, playing a role in the disaster.

The kinds of requirements by the Indian government for local input into projects and for a degree of local control over foreign companies on its soil were seen to be necessary strategies for developing countries hoping to share the economic benefits of foreign investment. In addition, a labour-intensive approach appears to be the only logical way to industrialize in countries with many residents lacking jobs. This was especially the case in Bhopal, a severely economically-depressed area. In hindsight, these very 'requirements' may have, inadvertently, contributed to the MIC accident.

Given the easily-proven control that UCC had over the design and daily operations of the Bhopal plant, and the obvious consequences of its poor management, it was not surprising that UCC would become the target of litigation on the behalf of the accident's victims. The quest for justice for the victims, through settlement and litigation processes, would prove to be a lengthy and uphill battle for their representatives, the government of India. It would be this process that would bring to the forefront some interesting questions and analytical possibilities regarding the operations of multinational corporations in foreign states, and of the conflicts that arise with them. Needless to say, the litigation arising from the accident became a complicated process and served to outline the influence that a multinational corporation would have in shaping an outcome to its liking.

The Tangled Web of Litigation

It soon became quite evident that the Indian government expected the parent company, Union Carbide Corporation, to shoulder the full burden of compensation. Although the Indian government was willing to negotiate a settlement for the economic and physical losses, it also took the initiative and filed suits in American courts almost immediately following the disaster. At the same time, UCC strongly wanted to settle this matter out-of-court quickly, on the right terms and away from publicity that could do further damage to its already-soiled reputation. However, negotiating a settlement would prove to be difficult.

The first major round of legal skirmishing over claims resulting from the Bhopal disaster ended in late June of 1985, with a large gap between the out-of-court settlement offers made by UCC and the demands of the Indian government. Indian officials had spoken of an acceptable settlement in the range of one to five billion dollars (US), and thus, not surprisingly, rejected UCC's offer of two hundred and thirty million dollars.⁵⁵ In fact, the Indian Minister of Law and Justice, Asoke Sen, stated that the offer was "unrealistic, too small, and actually less than the \$230 million because it was to be paid out over twenty years." He further stated that the offer was "based on a total lack of appreciation of the magnitude of the problem."⁵⁶ During the frustrating negotiation process and based upon its assessment of UCC's unwillingness to give compensation to

⁵⁵ Robert Manning, "Deadlock over Bhopal," in *Far Eastern Economic Review*, 19 July 1985, p. 19.

⁵⁶ *Ibid*, p. 19.

its victims, the Indian government hoped that justice would be served in the American court system. However, this would not stop Union Carbide from continuing its attempts to negotiate a settlement with the Indian government.

The January following the Bhopal disaster, lawsuits were filed in the United States against Union Carbide on behalf of the victims and the government of India. Even though it may have been inadvertently responsible in part for the accident, the Indian government, and its legal representatives, undertook an active role in attempting to resolve the issues and negotiate a fair resolution for monetary damages for the victims. However, it was unknown at the time that this process would become anathema to the notion of justice.

The two issues that would, invariably, tie up the settlement and litigation process for years would be that of deciding the proper judicial forum and that of proving liability in the case of Union Carbide Corporation. However, what proved to be a formidable factor in the process were the tactics employed by Union Carbide. That is, Union Carbide's strategy of delay, denial, and refusal to comply became the primary stumbling blocks for justice to be done. Not surprisingly, this continued all throughout the process and, upon further examination of the litigation proceedings, is easily illustrated.

The first stage of the epic battle took place in New Orleans on the 24th of January in 1985. The judicial panel on multi-district litigation considered Union

Carbide's request to consolidate all the Bhopal suits into the Southern District Federal Court in Manhattan, New York.⁵⁷ At this stage, the legal claims for damages from the various suits filed in a number of districts in the United States added up to two hundred million dollars (US).⁵⁸ However, at this time, the government of India declined to join U.S. attorneys, and instead filed a separate suit in the court in April.⁵⁹ This was done so as to supposedly prevent the victims from being exploited by U.S. lawyers, referred to as 'ambulance chasers', who sought to represent the Indian victims. It was finally decided that the Indian government and one American representative from the numerous suits would act on behalf of the plaintiffs and consolidate the monetary amount of damages that were being pursued. Thus, the hearing to decide whether the suit should be adjudicated in the United States had begun.

The government of India's petition argued that:

- 1) Insofar as UC designed, constructed, owned and operated the plant from which the chemical escaped, the Company should be held absolutely liable.
- 2) The Company, in undertaking an activity that it knew was hazardous to the public at large, is strictly liable for the harm that was the material consequence of such activity, regardless of whether the harm resulted from a fault on its part or negligence.
- 3) The Company was negligent in designing, constructing, operating, and maintaining its plant, and thus failed to exercise its duty of care to protect the public from the dangers inherent in its plant and processes.

⁵⁷ "Union Carbide: First Where, Then Which," in *The Economist*, 12 January 1985, p. 25.

⁵⁸ "Union Carbide: Not Us," in *The Economist*, 23 March 1985.

⁵⁹ U.S. attorneys consolidated more than 65 pending claims and filed a joint suit in the federal court on the 28th of June 1985. India declined to be a part of these suits and maintained its supremacy in the matter, based on its claim of *parens patrie*, a legal theory which holds that a country has exclusive rights to represent its citizens. However, the India government recognized the right of the victims to obtain individual legal representation, based upon the Bhopal Disaster Act that it had passed in India in March 1985. Thus, in the federal court, the victims (or plaintiffs) were being represented by an attorney of the consolidated claims and by the Indian government. This became a difficult undertaking.

- 4) The Company is liable for a breach of warranty, in that it had expressly warranted that the design, construction, operation, and maintenance of its Bhopal plant would be undertaken with the best available information and skills in order to ensure safety, and that it failed to do so.
- 5) That the Company, in doing so, and in intending that the plaintiff would rely and act upon such assurances, is guilty of misrepresentation.⁶⁰

Thus, because all the decisions that were material to the case and whose execution set off the chain of events which culminated in the Bhopal disaster were taken by Union Carbide Corporation, headquartered in the United States⁶¹, the Indian government argued that the case should be looked after in the United States. Moreover, the evidence that it would require to substantiate the charges, whether relating to the design and manufacture of the equipment in question, or the structure of the decision-making within the corporation, is available only in the United States. This also applies to the case of witnesses. Therefore, the Indian government argued that the transfer of the case to India would prejudice its case.⁶² In addition, the transfer would increase the cost and administrative difficulties that the trial was bound to entail because much of the evidence and key witnesses were located in the United States.

Union Carbide, on the other hand, did not agree that the case should be adjudicated in the United States. According to UCC, the best outcome of its strategy would be to have all charges against it dismissed. However, given the great possibility

⁶⁰ Ward Morehouse and M. Arun Subramaniam, *The Bhopal Tragedy* (United States: Council on International and Public Affairs, 1986), p. 82.

⁶¹ *Ibid*, p. 82.

⁶² *Ibid*, p. 82.

that this would not occur, the next best strategy was to have the case heard in India, not the United States.

UCC preferred to have the case heard in India for a number of reasons. Firstly, UCC contended that the tragedy was entirely a local affair and that it was the Indian authorities' responsibility to have ensured safeguards.⁶³ Secondly, the jurisdiction of India was preferable because it was assumed that an Indian court might not be able to grab the assets of the parent company. Although the assets of UCIL, which were estimated to be at one hundred million dollars (US), would be at risk, a greater loss could be incurred if the assets of UCC were brought into the litigation, which amounted to close to ten billion dollars (US). Lastly, in keeping with the economic benefits of adjudication in India, UCC was aware of the substantial decrease in the monetary amount that would be awarded as opposed to that in the U.S. court system. If the accident had occurred in the United States, the compensation that would have been awarded would have, most likely, forced UCC into bankruptcy. However, in contrast, there has never been a wrongful death judgement in India of more than forty thousand dollars (US).⁶⁴ Therefore, the U.S.-based multinational corporation was disclaiming liability in the matter and maintained that, if its liability was proven in the courts, the compensation paid could not exceed the assets of the Indian subsidiary, and that the

⁶³ "Union Carbide: A Dismemberer's Guide," in *The Economist*, 11 January 1986.

⁶⁴ R.L. Stein, "The Settlement of Environmental Disputes: Towards a System of Flexible Dispute Settlement," in *Journal of International Law and Commerce*, p. 295. Cited in Trotter et al, p. 447.

Indian government, by failing to enforce safeguards, had its own share of liability. Thus, although UCC was attempting to avoid all liability and a trial, the preferred forum, as far as it was concerned, was India. Ergo, it was not surprising that UCC argued in the Federal District Court in New York that the U.S. courts were not the proper forum for trial, and that the Indian courts were quite able to deal with such massive and complex litigation.

UCC won its greatest victory on the 12th of May in 1986, when the U.S. Supreme Court held that the claims of the victims would not be heard in the U.S. on the grounds of *forum non conveniens*.⁶⁵ *Forum non conveniens* refers to the discretionary power of a court to decline jurisdiction if, in the interest of justice and the convenience of parties, the court considers that the case should proceed in another court of jurisdiction.⁶⁶ Most liability cases brought into the U.S. federal courts by foreign plaintiffs are summarily dismissed based on the U.S. Supreme Court decision *Piper v. Reyno*. That decision held that, except in rare circumstances, foreign victims should pursue their claims in the country where the injury occurred.⁶⁷ But there is a more basic presumption involved in invoking the doctrine. In declining to exercise jurisdiction over a case, the court must be satisfied that an alternative forum exists, which would be more

⁶⁵ Executive Committee Members, et al v. Union of India and Union Carbide Corporation; Union of India v. Union Carbide Corporation, et al, 108 S. Ct. 199; 98L Ed.2d 150. Cited in Trotter et al, p. 447.

⁶⁶ Trotter et al, p. 447.

⁶⁷ "No Access to Law," in *Multinational Monitor*, June 1988, p. 4.

suitable for the adjudication of the case.⁶⁸ Thus, Federal Judge John F. Keenan ruled that the lawsuits belonged not in the United States, but in India, for almost all the witnesses, injured parties, physical evidence, etc. were located there. Keenan concluded that it would be more convenient and save U.S. taxpayers' money to have the Bhopal cases tried in India.⁶⁹

Although India took an active role, it failed in its efforts to have the case handled in the United States. Thus, at first glance, it appeared that the amount of recovery would now have been substantially reduced in value because of the cultural differences regarding the value of life and injuries between the United States and India. Under U.S. law, the doctrine of 'strict liability' would require the company to pay damages, whether or not it was found to be negligent.⁷⁰ Although the doctrine is based on English common law, and would thus be applicable in both American and Indian courts, lawyers for the victims argued that bigger, and swifter, awards were given in American courts, as juries were more experienced in judging mass-disaster cases.⁷¹ Thus, if Keenan had decided that the U.S. courts had jurisdiction, damages awarded would have been substantially higher than if heard in India, and would have been more easily enforced. Therefore, the

⁶⁸ Morehouse and Subramaniam, p. 83.

⁶⁹ "Corporate Crime and Violence," in *Multinational Monitor*, April 1987, p. 9.

⁷⁰ "Strict liability" in tort is applied to "ultra-hazardous activity undertaken by a defendant: such activity is one which necessarily involves a risk of serious harm which cannot be eliminated by the exercise of utmost care. The party is liable, not because of fault or negligence, but due to the ultra-hazardous nature of the activity." See Trotter et al, p. 448-9.

⁷¹ R.L. Stein, "The Settlement of Environmental Disputes: Towards a System of Flexible Dispute Settlement," in *Journal of International Law and Commerce*, p. 295. Cited in Trotter et al, p. 447-8.

decision appeared to have put the Indian plaintiffs at a position of disadvantage.

However, in his remittance of the case to India, Keenan attached three important conditions which, in the Indian view, appeared to cancel out any strategic advantage UCC might have gained in successfully opposing U.S. jurisdiction in this matter. Keenan ordered UCC to fully submit to the jurisdiction of the Indian courts and to satisfy any judgement of these courts. In addition, Keenan allowed 'discovery' under the U.S. federal rules of civil procedure, which meant that the Indian courts could subpoena Union Carbide's records and documents in the United States and in Hong Kong.⁷² Thus, Indian officials hoped that these conditions would enable full and effective jurisdiction over UCC and also the enforcement of the judgment in the U.S., where the assets of UCC are mainly located. The Indian interpretation was that the judgement had left the procedural and compensation issues exactly as they would have been had the case been heard in a U.S. court.⁷³ Thus, in the absence of these conditions, U.C. could have challenged the jurisdiction of the Indian courts, refused to produce evidence held outside of India, and defied any verdict. Although this judgement was not what the Indian government and the American lawyers had hoped for, it seemed that it could still be beneficial for the cases. However, for a number of reasons, the decision was still not considered ideal, and, thus, the American lawyers for the victims decided to appeal the decision.

⁷² Moham Ram, "Victory in Defeat," in *Far Eastern Economic Review*, 29 May 1986, p. 24.

⁷³ *Ibid*, p. 25.

Firstly, there was great skepticism with regards to the conditions that Keenan had stipulated in his decision. Although he ordered Union Carbide Corporation to fully submit to and accept the jurisdiction and judgement of the Indian courts, UCC's prior statements and actions put this into question. In fact, what was most intriguing about Union Carbide's efforts to get the case thrown out of the American courts was that such efforts were preceded by UCC's express refusal to submit to the jurisdiction of the Indian courts.⁷⁴ This position is entirely consistent with what UCC has always argued. That is, UCC steadily maintained that they were not subject to the jurisdiction of the Bhopal court because UCIL was an Indian company, managed by Indians, and over whom UCC had no control whatsoever. From its brief from Keenan's court, it was clear that the preferred forum was India. But with the other hand, UCC argued that the Indian courts were not suitable either. Thus, it seemed that Union Carbide Corporation found no court suitable, and this concerned the American lawyers acting on behalf of the Indian plaintiffs.

In addition, in the eyes of the Indian plaintiffs, the battle to establish UC's legal responsibility for the disaster, the first step in gaining adequate compensation, was seriously delayed by the U.S. Judge Keenan. Before he announced his decision, Keenan stated that he "laboured long and hard to promote a settlement between the parties for over a year, to no avail."⁷⁵ Robert Hagar, a lawyer representing various religious and

⁷⁴ Morehouse and Subramaniam, p. 83.

⁷⁵ "While Bhopal waits, Union Carbide cuts its losses," in *Multinational Monitor*, March 1988, p. 3.

public interest groups, argued that, because of Keenan's delay and decision, the Bhopal victims had been "seriously prejudiced because Keenan laboured for a settlement too hard and too long." He continued that "Carbide and its powerful Wall St. owners stood to lose five billion dollars or more if the Bhopal case reached an American jury" and that "Carbide had to settle the case cheap, hide its assets, or get the case out of the U.S. courts to avoid, or at least postpone, potential bankruptcy."⁷⁶

Thus, Hagar, other American lawyers representing the plaintiffs, and the government of India all charged that, by permitting a year long delay before making his decision, Keenan had allowed Union Carbide ample time to liquidate substantial assets and make extra-ordinary payouts to its shareholders, reducing its equity available to pay for any judgement awarded the Bhopal victims. It has been estimated that the payments reduced equity from about 5 billion dollars before the disaster to less than 700 million dollars on the books by the end of 1985.⁷⁷ Hence, Hagar stated that "Carbide's depleted equity will now enable it to defend, by means of bankruptcy, against any Indian judgement substantially in excess of its settlement offers without significant loss to the company's pre-Bhopal owners."⁷⁸

Uproar over the decision was also based upon a fear of setting a dangerous

⁷⁶ "Corporate Crime and Violence," in *Multinational Monitor*, April 1987, p. 9.

⁷⁷ Ibid, p. 9. See also "Union Carbide: A Dismemberer's Guide," in *The Economist*, 11 January 1986, p. 58, for the more detailed explanation of this reduction in equity, including the sale of divisions.

⁷⁸ "Corporate Crime and Violence," in *Multinational Monitor*, April 1987, p. 10.

precedent. Because of the decision to have the civil trial in India, it was feared that this would send a clear message to giant multinational corporations. It would set a dangerous precedent for multinational corporations that operate in developing countries, for they would know that any damages done on foreign soil will be tried in that country, and at a lesser expense to the MNC. This may provide disincentive to begin or maintain safe operations in these countries, and therefore, upkeep a 'double standard'. Lastly, it should also be noted that one of the reasons that American attorneys were quick to appeal was the fact that, once the case was transferred to India, they could not maintain their status as legal representatives for the plaintiffs. The government of India would become the victims' sole legal representative. Because the plaintiffs could not afford to pay for American legal representation upfront, they were courted by American lawyers who stated that they would take no payment upfront in return for a portion of the compensation that would be awarded in the United States. Thus, the money that had been spent on the litigation process in the United States on behalf of the Indian plaintiffs would not be recovered now that the trial was shifted into the jurisdiction of India.

Given all these reasons for the disapproval of Keenan's decision, it was not surprising that the American attorneys decided to appeal.⁷⁹ Needless to say, the appeals were denied and the case was shifted to the jurisdiction of India where it was set to proceed almost immediately.

⁷⁹ What is interesting to note is that the Indian government did not appeal the decision. They readily accepted the ruling and proceeded to prepare for the case in India.

Litigation had begun in India following Keenan's decision. Predictably, Union Carbide continued its strategy of denial, delay, and refusal to comply while in the Indian courts. This proved to add years to the process and increase the frustration of the Indian government and the Bhopal victims, who sought the justice that was deserved.

Once the case was in India, Union Carbide switched its argument again. It claimed that the Indian courts were no longer capable and that the company's rights of due process were being violated time and again.⁸⁰ The question of due process was the sword which Union Carbide, and its platoon of Indian and American lawyers, used to try to intimidate the Indian courts and the Indian government. When Keenan ordered that the litigation be sent to India for trial, he also specified that Union Carbide must agree to accept the jurisdiction of the Indian courts, provided that the 'minimal requirements of due process' were met.⁸¹ However, the U.S. Court of Appeals, to which UCC appealed the District Court decision, deleted the word 'minimal' as well as the requirement that Carbide be subject to U.S. rules of 'discovery' in the Indian courts.⁸² Thus Carbide was able to threaten at every given turn in the Indian courts that its due process rights were being violated, whereas Carbide was, in fact, largely responsible for the violation of due process by their refusal to comply and other delaying tactics.

⁸⁰ Morehouse, p. 485.

⁸¹ Order of John F. Keenan, 12 May 1986, p. 63. Cited in Morehouse, p. 485.

⁸² U.S. Court of Appeals for the Second Circuit, Decision on Appela, 14 January 1987. Cited in Morehouse, p. 486.

Obviously, delaying the process became a key goal of Union Carbide. In addition to appealing Keenan's conditions, thereby lengthening the process, Union Carbide also did not file its response to the Indian government within the stipulated time after the case was moved to the Bhopal District Court. Six weeks later, they filed a response and, in June of 1987, they sought to adjourn the proceedings until October.⁸³ Virtually every decision of the trial court, even on minor procedural matters, was appealed--not just to the State High Court of Madhya Pradesh, but even to the Indian Supreme Court.⁸⁴ As well, by refusing to obey Indian court orders, it forced the Indian government to chase it back into the U.S. courts in order to compel it to obey those orders, thereby using up large additional periods of time.

From the beginning, this was a key element of Union Carbide's strategy: to delay a judgement. This strategy allowed UCC to do two things: to cut its losses by lowering its equity and to outlast its victims. However, the Bhopal District Court, recognizing the inherent injustice of a legal battle which one party with deep pockets can outlast the other, ordered Union Carbide to pay substantive interim relief of two hundred and seventy million dollars (U.S.). The original interim order was entered by Judge M.K. Deo in December of 1987 and predictably, Union Carbide refused to comply with this order and proceeded to appeal it to the Madhya Pradesh High Court.⁸⁵ It appeared to

⁸³ "While Bhopal Waits, Union Carbide Cuts its Losses," in *Multinational Monitor*, March 1988.

⁸⁴ Morehouse, p. 485.

⁸⁵ "10 Worst Corporations of 1988: Union Carbide Corporation," in *Multinational Monitor*, December 1988, p. 29; and Trotter et al, p. 448.

Union Carbide that Judge Deo was already convinced that Union Carbide was liable, for otherwise a judgement for interim relief would not have been made. However, to the surprise of many, following the upholding of his decision in April of 1988 by Judge Seth of the High Court, Judge Deo was dismissed. And although the decision of interim relief was upheld, the amount of relief was reduced to one hundred and ninety million dollars. Again, Union Carbide appealed this to the Supreme Court of India. Thus, the appeals process used up more than a year of additional time, and still a settlement or trial for a judgement was nowhere in sight.

After the order for interim relief, and the subsequent upholding of the decision by the High Court, Union Carbide became concerned over the implications of the decision, and of other actions against them. It was quite apparent that an interim relief order would not have been upheld if the Indian courts had decided that the liability of Union Carbide was questionable. Union Carbide could be held directly liable if the court held that the Indian corporation, UCIL, was an alter-ego of the parent, or that it had no independent existence or authority.⁸⁶ Therefore, the court dismissed the company's contention that the Indian subsidiary, and not the parent company UCC, should be held responsible. This was the view held by the Indian courts, and this would ultimately make

⁸⁶ A 1986 decision by India's Supreme Court stated that a company engaged in a hazardous activity is absolutely liable for damages from an accident. Thus, in order for Union Carbide to be included, or superior, in the charges of UCIL of absolute liability, it had to be shown that UCIL was owned, operated, and took its daily orders from the parent, UCC. Thus, the Bhopal magistrate and the High Court interpreted this to mean that UC is liable regardless of whether or not the accident was caused by negligence or sabotage. See "Bhopal: Absolutely Liable," in *The Economist*, 23 July 1988, p. 61.

Union Carbide directly liable for whatever verdicts would be awarded.⁸⁷

Therefore, it became quite clear that Union Carbide's carefully-organized plea of sabotage⁸⁸ was not applicable, and consequently would not affect a verdict. In addition, a judge in Bhopal also vetoed the company's effort to reach out-of-court settlements with the individual victims⁸⁹ and the Indian government was keeping a close watch on UCC's Indian assets so that divestures were not made that would compromise the compensation for the Bhopal accident.⁹⁰ Hence, it appeared that the walls were beginning to close in on Union Carbide. In fact, it appeared that the forum dodging that was occurring would also not save them from an embarrassing, and expensive, verdict.

It was widely held that even the American courts would enforce the foreign judgment, so long as the foreign court applied fair procedure and the decision did not offend American public policy. Experts believed that an American judge would decide that the Indian court had enough evidence to find UCC liable, that the proceedings were fair, and that the delays that affected due process were orchestrated purposely by Union

⁸⁷ Trotter et al, p. 449.

⁸⁸ As noted above, UCC engaged in another deceitful manoeuvre by claiming that the gas leak was caused by 'sabotage' by a disgruntled employee, although they never identified who that was. In any event, its Indian subsidiary, UCIL, had admitted later that the sabotage theory was false, arguing instead that three employees caused the disaster through negligent behaviour. But as a public relations ploy, the sabotage theory was admirable, for it enabled Carbide's management to argue that it was the victim, not the victimizer. See "Carbide Comes up with a New Theory in Bhopal Case," in *Pioneer*, 27 February 1993. Cited in Morehouse, p. 486.

⁸⁹ "Bhopal: Absolutely liable," in *The Economist*, 23 July 1988, p. 61.

⁹⁰ Lincoln Key, "Trussed in Red Tape," in *Far Eastern Economic Review*, 26 February 1987, p. 63.

Carbide.⁹¹ Therefore, UCC's only hope of survival was to quickly negotiate a settlement with the Indian government, whose claims on behalf of the victims had topped the three billion dollar mark.

Justice Served?

India's Attorney-General, R. Parasan, was continuing his weeks' long argument against Carbide's appeal of the High Court's judgement of interim relief to the Supreme Court when, on February 14, 1989, the Supreme Court proposed a full and final out-of-court settlement instead of the interim relief.⁹² The Court asked the plaintiffs whether they would accept a one-time payout of four hundred and seventy million dollars (U.S.) from Union Carbide Corporation and its Indian subsidiary for all civil litigation concerning the tragedy and also that the acceptance of this would end all criminal liability. This was accepted by the Attorney-General, as a representative of the Indian government and the plaintiffs, with an alacrity that shocked and outraged many.

This out-of-court settlement was a mere fraction of what was originally sought by the Indian government as compensation, yet it was accepted. Not surprisingly, Union Carbide welcomed the settlement, for it finally relieved it of all responsibility for the world's worst industrial disaster at a bargain price. However, not everyone was happy. Predictably, dismay and outrage were expressed and the government of Rajiv Gandhi

⁹¹ "Bhopal: Absolutely Liable," in *The Economist*, 23 July 1988, p. 61.

⁹² S. Ali, "Settling for Less," in *Far Eastern Economic Review*, 2 March 1989, p. 27.

came under attack for the surprise, final settlement acceptance.

Firstly, because Union Carbide Corporation had settled these cases out-of-court for a paltry four hundred and seventy million dollars, it thus avoided any damaging legal precedent on liability. The settlement, which blocked all civil and criminal proceedings, both at the time and in the future, had ramifications beyond the victims' health and compensation. Critics charged that the legal immunity that the settlement granted Union Carbide had set a precedent which limited victims rights and eliminated an important tool for holding multinational corporations engaged in hazardous activities accountable for their actions. That is, the settlement did not set a precedent against firms attempting to avoid financial liability, but rather, facilitated the opposite. Such a small settlement would represent no element of punishment whatsoever and, therefore, would provide no measure of retribution and no deterrent to another Bhopal.⁹³

As well, the actual amount of the settlement was a contentious issue, not only because of the question of adequate compensation for the victims, but also because of how very little retribution this was for Union Carbide for its role in a disaster of this magnitude.

There was no clue in the court order as to any formula that helped it arrive at the four hundred and seventy million-dollar figure. Considering the claims against Union

⁹³ Ali, p. 27.

Carbide totalled over three billion dollars, the settlement amount was a considerable decrease. But would it be adequate enough for the victims? There were, according to official government figures, death and injury claims of victims of 16,000 and 600,000, respectively.⁹⁴ Thus, the settlement, according to some estimates, will mean that compensation to individual victims will be as low as three hundred and thirty four dollars (U.S) for next-of-kin and permanently disabled, and far less for others. The highest estimates amounted to six thousand six hundred and sixty six dollars for fatalities and permanently disabled, and about half as much for others.⁹⁵ This was not enough to cover the victims' health care needs, let alone provide compensation. As well, social workers and doctors have stated that the long-term effects of the poisonous gases still cannot be determined, and, thus, there was a great potential for even more future victims. The settlement made no provisions for these potential future victims, nor for the long-term follow-up and treatment of the victims. As well, the settlement did not set aside any funds for the damage to crops, soil, water, or for the death of plants or animals. Not only was the amount inadequate to physically care for the victims, but also made no allowance for the environmental damage done, that also, incidentally, frustrated the economic livelihood of many of Bhopal residents. Overall, it can be easily concluded that the settlement was grossly inadequate.

⁹⁴ J. Karliner, "Toxin Town," in *New Statesman and Society*, 2 December 1994, p. 18.

⁹⁵ Ali, p. 27.

This, invariably, leads us into a discussion of just how trivial the amount of the settlement was in relation to Carbide's resources and capacity to pay. Firstly, in comparison to other similar class-action suits, the four hundred and seventy million-dollar settlement can be seen as just small change. Some comparative examples include the case where the U.S. courts had awarded 2.5 billion dollars for 60,000 claimants against Johns Manville Corporation for asbestos-related injuries; the 2.48 billion dollar fund created by A.H. Robins to settle 195,000 claims relating to Dalkron Shield injuries; and the 108 million dollars that the Monsanto company was ordered to pay the family of a single chemical worker who died of leukemia due to benzene exposure.⁹⁶ Thus, in comparison to these other settlements, it is evident that the amount of the settlement was totally inadequate to meet the needs of the current victims (approximately 600,000), let alone future ones.

Secondly, the amount of the settlement was not enough to cause any financial harm to Union Carbide, and thus, calls into question retribution. Under the court order for the settlement, Union Carbide was to deduct the five million dollars that it had paid initially to the International Red Cross for humanitarian relief.⁹⁷ Insurance covered two hundred million of the total amount. An additional forty five million dollars (payable in Indian currency) was paid out by its Indian subsidiary, UCIL. And lastly, the remaining two hundred and twenty million dollars was covered by a retroactive levy of fifty cents

⁹⁶ See Morehouse, p. 487; and Ali, p. 27.

⁹⁷ Ali, p. 27.

on the 1988 shareholder's dividend, reducing it from \$1.59 to \$1.09 a share.⁹⁸ This retroactive levy must be compared to the one billion dollar bonus paid out to shareholders in 1986.⁹⁹ As well, shareholders were also more than compensated for their reduced dividend by the \$2 rise in the value of Union Carbide's shares immediately after the settlement.¹⁰⁰ The company's management was thus able to announce, with apparent satisfaction, that its strategy of containment had worked and that the settlement would have no significant adverse impact on the company's finances.¹⁰¹ Hence, Union Carbide got off the hook cheaply at the expense of the victims.

But perhaps what was most disturbing was the apparent quickness of the Indian government to accept the inadequate settlement. In light of the compensation asked and the several offers previously rejected to due to the mediocre monetary amounts, the quick acceptance was shocking. Conceivably this occurred because the government was attempting to end the drawn-out tragedy and to prevent further suffering of the victims who were denied any compensation during the process. However, there are two other possible motives for the hasty decision. Perhaps this occurred because the government of India, itself, was potentially liable for negligence that contributed to the disaster. Afraid to take responsibility, the government sheltered itself behind the legitimacy of the

⁹⁸ See Pearce and Tombs, p. 138; Nandi, "Waiting for Justice: UC's Legacy in Bhopal," in *Multinational Monitor*, August 1991; and Ali, p. 27.

⁹⁹ Pearce and Tombs, p. 138.

¹⁰⁰ "Editorial: Remembering Bhopal," in *Multinational Monitor*, December 1994.

¹⁰¹ *Union Carbide Annual Report 1988*, p. 49. Cited in Morehouse, p. 487.

highest court in the land. Thus, a judgement against the Indian government, even for its small role in the disaster, could have been damaging, both monetarily and to its reputation. However, what was, most likely, the most compelling reason for this acceptance was that the Indian government did not wish to upset, or scare off, foreign investors by taking a more offensive position. Regardless of its motives, critics charge that the Indian government did not adequately protect or fight for the victims of the Bhopal tragedy.

Given all these factors, it was not surprising to learn that appeals were filed on behalf of the Bhopal victims. Prominent Indian public interest lawyers, working closely with the victims, challenged the Supreme Court to reconsider the grounds for the settlement. It urged the Supreme Court to consider a number of issues: the accuracy of the official count of the deceased and injured, the adequacy of the settlement, and the right of the Indian government to drop all charges without consulting the victims.¹⁰² The last of the appeals was heard in the Supreme Court in August of 1990. Although by this time Union Carbide had made payment to the Indian government, the money lay in an escrow account until the Supreme Court rendered its final verdict. Its judgement came in October of 1991.

The Supreme Court upheld the February 1989 settlement, and thus any further legal action in the Indian or American courts appeared to be effectively foreclosed. As

¹⁰² Nandi, "Waiting for Justice: UC's Legacy in Bhopal," in *Multinational Monitor*, August 1991.

recalled, with its acceptance of the settlement, the Indian government agreed not to pursue any criminal charges against Union Carbide or its employees. However, in its decision, the Supreme Court voided the grant of immunity and reinstated the criminal charges.¹⁰³ These criminal charges of manslaughter were attached to the Indian subsidiary, UCIL, and a handful of Union Carbide's top executives, including Warren Anderson, who was the company's chairman at the time of the accident.¹⁰⁴ Not surprisingly, these 'offenders' have not presented themselves to the Indian courts for trial.

It is clear that Carbide intended to take a hard line on criminal charges, almost certainly compelling the Indian prosecution to chase them back into the U.S. courts in order to get them to submit-- if indeed the U.S. courts would order them to do so.¹⁰⁵ The Indian courts have summoned, ordered, and re-ordered the Indian government to seek their extradition in the United States.¹⁰⁶ The Indian government, however, appears to have upheld its position and actions of passive acknowledgement, and has dragged its feet in seeking extradition. This can be attributed to the state's abandonment of its traditional nationalist orientation. That is, the Indian government was seeking foreign

¹⁰³ Morehouse, p. 487.

¹⁰⁴ Jayanta Sarkar, "A New Chapter," in *Far Eastern Economic Review*, 29 September 1994, p. 70.

¹⁰⁵ Morehouse, p. 496.

¹⁰⁶ "Editorial: Remembering Bhopal," in *Multinational Monitor*, December 1994.

investment for its program of economic development-- and a move so bold as to impose criminal liability for the avoidable deaths of thousands would send the wrong message to foreign investors. As well, given the fact that relations between India and the U.S. had substantially improved over the years, it was also feared that such a move would banish this relationship back into the 'frostier' stage. Thus, although they would never again be held civilly liable, it is also highly unlikely that Union Carbide would ever be criminally accountable for its role in the tragic industrial disaster.

With regards to the settlement, as mentioned previously, Union Carbide did pay the settlement amount and, considering its prior tactics of delay, did so with remarkable expediency. Once the monies were released from escrow after the October 1991 Supreme Court judgement, it was expected that monetary relief would finally be had. Alas, yet again, this was misguided optimism on behalf of the long-time sufferers of Bhopal and, yet again, the Indian government had failed in its role as protector and advocate of the victims.

After a decade following the accident, the Indian government, plagued by inefficiency and corruption, had failed to end the suffering of the victims of the Bhopal accident. They had failed to disperse the small sum of money that was available. In the meantime, Bhopal residents have received a minimal payment of approximately seven dollars monthly; and these small payments will be deducted from the sums to be

eventually paid to the victims.¹⁰⁷ Undeniably, for the victims, this is a tragic end to a tragic accident.

Meanwhile, Union Carbide, stung by one of the worst public relations debacles in history, has managed to recover quite well. In the wake of the disaster, the company had to re-position itself; it has now divested itself of many of its operations--including UCIL, which it sold to a tea magnate in September of 1994 for ninety two million dollars.¹⁰⁸ This ended Union Carbide's almost century-long, profitable, and tempestuous history of operations in India. In addition, Union Carbide has tried to establish itself as an environmental leader in the chemical industry, although many contend that its operations remain particularly dirty and dangerous.¹⁰⁹ Aside from its strenuous public relations campaigns to gain back its reputation by painting itself 'green', Union Carbide, to the dismay of the victims and public advocacy professionals, has also managed to maintain a successful financial position. By 1996, well over a decade after the Bhopal accident, the corporate giant appears to have fully recovered from the accident. It is ranked a respectable 237 in a listing of the *Fortune Top 500 Corporations* in the United States. It showed annual revenues of over six billion dollars and a profit of five hundred and ninety three million dollars in the fiscal year of 1996.¹¹⁰ In addition, its assets are back to close

¹⁰⁷ "Editorial: Remembering Bhopal," in *Multinational Monitor*, December 1994.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid.

¹¹⁰ "The Top 500 Corporations in America," in *Fortune*, April 1997, p. F-9.

to pre-Bhopal levels, even though it had divested itself of many of its prior operations.¹¹¹

Although its annual growth rate, from 1986 to 1996, was -1.1%, this is not significant enough for one to suggest that they have been harmed as much as they have harmed.

Hence, has justice been served? Unfortunately, for the suffering and the lengthening list of victims, the answer is no.

The World's Worst Industrial Disaster: An Analysis

The Bhopal incident, and the ensuing years of litigation, brings to the forefront some interesting questions and analytical possibilities regarding the operations of multinational corporations in foreign states, and of the conflicts that arise with them. The accident has been described as a “preventable disaster of an industrial age that represents the failure ... to bring under control unbridled multinational power.”¹¹² Is it unbridled power, or perhaps the more interesting questions are how that power is used and from where it originates? Power, as one would recall, was defined as the ability to successfully achieve one's chosen outcome, or one that is favourable. As previously outlined, it can be argued that this power of multinational corporations is derived from structures. Thus, the basis of the ensuing analysis of the Bhopal accident will address elements of both structural power and domestic structures.

¹¹¹ According to its corporate report listing in *Fortune* (Ibid), Union Carbide's assets in the year of 1996 totalled over 6.5 billion dollars. As recalled, its assets at the time of the Bhopal accident were just under 10 billion dollars.

¹¹² Russell Mokhiber, “Death in Bhopal and the Corporate Double Standard,” in *Multinational Monitor*, September 1984, p. 3.

Multinational corporations, by virtue of their global purpose, structure, organization, technology, finances and resources, have it within their power to make decisions and take actions that could result in industrial accidents of catastrophic proportions and magnitude. Upon examination of the Bhopal accident, it appears that the key management personnel of multinational corporations exercise a closely-held power which is neither restricted by national boundaries, nor controlled by international law. But once in conflict with a state, one would assume that the power of the multinational corporation is superseded by the state in the outcome. However, in this instance, this was not the case. In this particular case, the ability of Union Carbide and its representatives to use, and abuse, the structural power ascertained by them and to play off the domestic legal structures of two different states (India and the United States) certainly enabled them to emerge successfully from the conflict. These will be analyzed more in detail.

As discussed in the introductory chapter, structural power can take many forms. Structural changes that have occurred in recent decades have been tremendously beneficial to multinational corporations. In fact, some have stated that these changes have allowed power to shift from states to multinationals.¹¹³ Thus, because of their ability to operate successfully within these changed ideologies and structures, it appears that multinationals have come to be more successful in influencing, or shaping, outcomes to their liking. Hence, the direct use of power of a multinational (such as lobbying) when

¹¹³ See Susan Strange, "Politics and Production"; and Jessica Mathews, "Power Shifts."

in conflict with the state may not be necessary, for victory can be achieved through other, more indirect, means.

Union Carbide did not exercise direct power against the Indian government in this conflict. That is, they did not offer bribes and nor did they lobby the Indian government. As stated previously, each state's domestic structure is unique, and Union Carbide obviously knew that this type of exercise of power was unnecessary for its struggle. Therefore, although the use of direct power may provide an explanation in certain cases, this cannot be used in this particular instance. As well, the sole economic strength of Union Carbide over those resources of the Indian state does not provide an adequate enough explanation. That is, although Union Carbide had economic assets of over ten billion dollars, it did not use its economic wealth to persuade the judges or court officials in both countries. Although, granted, its ability to finance hoards of lawyers and legal experts for its case on both sides of the Pacific illustrates its use of its financial assets, it must be emphasized that it was Union Carbide's ability to manoeuvre its way through the judicial procedures of two states that was a factor of more importance in explaining the favourable outcome. Thus, aside from direct power and economic clout, other factors must be examined in order to explain the influence that Union Carbide had over the outcome of the Bhopal incident. Hence, we should first focus our attention on how Union Carbide was able to utilize the structural changes that have occurred to its benefit.

The structural aspect can, in part, be associated with normative dimensions of society, such as the role of ideology. The tenacity of normative structures can be illustrated by the way in which, in modern economies, consistently higher priority is given to economic growth relative to other goals, such as environmental preservation and conservation.¹¹⁴ Another illustration of this concerns the assumptions and claims made about the conditions for the achievement of growth.¹¹⁵ That is, there is widespread acceptance of the view that economic growth is fundamentally dependent on investment and innovation by private business corporations. And it is this growth that allows states to remain and gain competitiveness in relation to other states. Consequently, acceptance of these assumptions means that governments have to be concerned with the cultivation of an appropriate 'business climate', or else investment may be postponed or foregone, and a recession, or negative development, may be precipitated.¹¹⁶ Thus, a government may certainly be constrained by the nature of the creation and maintenance of an appropriate business climate.

Within this normative assessment, it can be argued that multinational corporations have served as a principal means of satisfying the overwhelming desire of most countries in the world to attract foreign investment capital and technological capability. The initial inflow of capital improves the balance of payments picture; brings

¹¹⁴ Gill, "Global Hegemony and the Structural Power of Capital," p. 100.

¹¹⁵ Ibid, p. 100.

¹¹⁶ Ibid, p. 100.

in advanced technology not available domestically; creates jobs locally; effects savings on research and development; enhances the technical, productive, and organizational management skills of indigenous personnel; and exerts a continuing positive effect upon the balance of payments, both by elevating the host country's export capacity and by manufacturing for domestic consumption, thereby saving what would be spent on comparable imports.¹¹⁷ Therefore, it is easily understood how states have sought to create or maintain a positive 'business climate' to seduce multinationals to operate within its territory.

This structural aspect can certainly be illustrated by the behaviour and statements of the Indian government, even prior to the accident. Although in the 1970s, India 'kicked out' Coca-Cola and IBM rather than acceding to their terms of doing business, by the time of the Bhopal disaster, the Indian government had begun a process of liberalizing, privatizing, and globalizing its economy.¹¹⁸ In 1983, the government of Indira Gandhi announced an economic liberalization policy that was intended to enable more foreign companies to invest in India. Two years prior, the same government of India initiated a number of changes in its foreign investment laws so as to bring more technology into the country and encourage exports.¹¹⁹ As outlined by the Indian Investment Centre, the policies were designed to attract investment from U.S.,

¹¹⁷ Iain Wallace, *The Global Economic System* (London: Unwin Hyman, 1990), p. 255.

¹¹⁸ Karliner, p. 19.

¹¹⁹ Josh Martin, "An Interview with Indira Gandhi," in *Multinational Monitor*, September 1983, pp. 19-20.

European, and overseas Indian investors, and to be the vehicle for technology transfer.

Foreign investment is welcome where it is accompanied by a supply of advanced technology required by the country and in export-oriented ventures.¹²⁰

Thus, obviously investment in the form of capital was not enough. In fact, Douglas Burck, the director of the Overseas Private Investment Corporation, following a trade mission in India, stated that:

India doesn't need money. It needs technology. The amounts invested by American companies won't be as important as the factories that get tooled up. They've got to get high-tech and generate exports. The attitude of the Indian government is going to make this thing work.¹²¹

Therefore, it is evident that the Indian government, along with its state governments, was hoping that technologically-advanced multinational corporations would be the key participants in their economic development plans. In fact, it was recognized that, without importing technology, India may not have been able to raise the living standards of, or provide employment for its poor.

In addition, some industries were more actively encouraged than others, especially "those in chemicals, fertilizers, pesticides, drugs and pharmaceutical products."¹²² For investors in these fields, the government waived the normal forty percent ceiling on foreign holdings and investors were also offered a number of other incentives, including tax breaks, special concessions, and depreciation allowances. Give

¹²⁰ From material issued by the Indian Investment Centre. Cited in Martin, p. 20.

¹²¹ Martin, p. 20.

¹²² Ibid, p. 21.

the nature of its operations, not surprisingly, Union Carbide became a beneficiary of these policies.

In India, the production of pesticides was viewed as important, both for practical purposes and because of the technology associated with its production. Union Carbide, in the eyes of the Indian government, appeared to have not only sophisticated technology, but also export potential. Thus, the forty percent ceiling on foreign investment was waived and Union Carbide Corporation was allowed to hold the majority of stock of its Indian subsidiary, Union Carbide of India Limited (UCIL). It won permission to do so on the grounds that it was operating in a needed high-tech area and would be transferring head office know-how to India. In addition, it was partly in response to government incentives that Union Carbide launched its operations in Bhopal.¹²³

However, the 'investment climate' attractive to multinational corporations can have far-reaching ramifications. It not only dictates a minimum of government interference in matters like product safety and quality, it also means guaranteeing large pools of 'cheap' labour--preferably not unionized or at least not militant; it means tax incentives, freedom to compete with (and/or buy out) local industries, and a limit to price controls; and, above all, it means giving the corporations the freedom to produce and sell not necessarily what is most needed in the country, but what is most economically

¹²³ As previously explicated, there were a number of incentives to locate in Bhopal. Refer to note 12.

efficient from the standpoint of profits.¹²⁴ As stated earlier, the tenacity of normative structures can be illustrated by how consistently higher priority is given to economic growth relative to other goals. As such, the Indian government placed higher priority on 'seducing' high-tech multinationals in its program of economic development and less priority on regulations, such as those pertaining to the environment and the health and safety of workers. Thus, the 'free-marketeering' Indian government virtually ignored the country's environmental, health and safety protections so as to induce and maintain the investment flowing into India. As previously stated, India had a regulatory structure in place, but it was weak, especially in the sense that the agencies were small, underfinanced, and meagrely represented by citizens. As well, in addition to a weak regulatory structure, the Indian government appeared to have little political motivation to enforce these regulations. Hence, some blame for the tragedy at Bhopal must be deposited on the Indian officials, for their commitment to capitalist industrialization was responsible for the attitude conveyed to Union Carbide Corporation and other multinationals. However, in stating this, UCC did take advantage of this climate of 'benign' neglect, and unfortunately, the ensuing tragedy proved its malignancy. Therefore, the Bhopal accident can be considered a clear indication of the power of these normative structures, power that ultimately benefits multinationals, particularly Union Carbide Corporation.

¹²⁴ Robert J. Ledogar, *Hungry for Profits: U.S. Food and Drug Multinationals in Latin America* (New York: IDOC, 1975), p. 163.

What is intriguing, however, is the extent to which these normative structural aspects have become ensconced in the minds of statesmen. That is, given the catastrophe of the Bhopal incident, and its equally dismal outcome, one would assume that the Indian government would have made strengthening environmental and safety regulations a high priority. However, while India's national and state governments passed a spate of environmental laws in the immediate post-Bhopal era¹²⁵, many of these have been ignored, or unenforced, by the Indian government so as to keep investments pouring in quickly and smoothly. In fact, many of these environmental, health and safety protections have been rolled back as so as to keep growing foreign investment rolling in,¹²⁶ or because of the requirements of structural adjustment and GATT policies. The unsustainable export of natural resources has accelerated, prohibitions against siting factories in ecologically-sensitive zones have been eliminated, pesticide production has rapidly expanded, regulations on forestry have been loosened at the behest of the pulp and paper industry, and mining laws have been diluted as a result of pressure from the mining corporations.¹²⁷ One cannot help but wonder whether the Indian government is inadvertently setting the stage for another Bhopal. Through a laxity of its protections and regulations in favour of maintaining the all-too-important favourable business climate, another multinational may thrive in this neglect, and possibly inflict future harm.

¹²⁵ Such environmental laws included industry-wide controls on the petroleum, mining, chemical and pharmaceutical industries. See Trotter et al, p. 450.

¹²⁶ Karliner, p. 19.

¹²⁷ Ibid, p. 19.

Quite obviously, the normative dimensions of structure allowed Union Carbide to operate in an environment that was conducive to its own goals, without the hassle or concern about the environment or safety and health. This was apparent not only in allowing, or rather seducing, Union Carbide to expand its operations in India but also in the way that Union Carbide was treated by the Indian government in the years following the disaster. For instance, the Indian government, unlike the American lawyers, did not even attempt to appeal the Judge Keenan's decision. However, perhaps the best display of this passivity occurred with the quick, surprise acceptance of the settlement offer, especially considering the amount of the claims against Union Carbide. Although the decision could be viewed as humanitarian, in the sense that victims would no longer be denied monetary support and compensation, the more likely explanation for this acceptance was that the Indian government did not want to 'scare off' potential foreign investors and multinationals by displaying belligerency towards Union Carbide. This could have proved to be disastrous, especially in light of the economic liberalization process that was occurring. The Indian government felt compelled to 'go easy' on Union Carbide and maintain a favourable investment climate, rather than pursuing the victims' cases aggressively in the Indian courts and seeking extradition in the United States for the criminal charges that were laid. Therefore, despite the nationalist bravado and some sparring that went on after Bhopal, the Indian government treated Union Carbide with 'kid gloves', sending a clear signal to other multinationals that India would not deal too belligerently with them in case of another accident of this magnitude. Overall, because of India's ideological stance towards economic development, Union

Carbide was able to operate in India under favourable terms, accidentally cause a disaster of catastrophic proportions because of less-than-stringently enforced regulations, and was able to escape accountability.

Although Union Carbide was certainly able to successfully work within the normative structure to achieve its goals, this cannot be considered the sole reason as to why Union Carbide was able to influence the outcome of the conflict. In addition, as examined in the introductory chapter, domestic structures, too, play an important role in determining the outcome of a conflict between multinational corporations and the state. As one would recall, domestic structures encompass the organizational apparatus of the political, legal and societal institutions, their routines, the decision-making rules and procedures incorporated in law and custom, as well as the values and norms embedded in the political culture. The greater the linkages, or associations, with the various domestic structures and actors, then the greater the chances would be of the successful influence of the multinational. It has been hypothesized that this has great potential to provide an explanation as to how actors, such as multinationals, alter their behaviour to fit in and gain influence within the state. Union Carbide, however, did not use its association, or entrenchment in the domestic structures of the Indian state to exercise any influence, or power over the proceedings of the Bhopal cases. Although its operations were entrenched in India in the sense that they had been operating in India for a lengthy time and that its products were well-known in Indian households, this certainly did not provide them with any support. Nor could this be effective in understanding their

successful strategy in influencing the outcome. As well, although it is unknown whether Union Carbide had any influential or binding ties with other Indian business associations or 'elitist' type of groups, it can be stated that, even if these 'linkages' were in place, the effects of the use of these to shape the outcome would have been negligible.

Accordingly, at first glance, it would appear that the second condition, referring to domestic structures as determinants, is not applicable in this case of conflict. However, this is deceiving.

Despite the fact that Union Carbide was not ensconced in the domestic institutions of the Indian state per se, Carbide was very attuned to domestic structures and was able to use them to its advantage. Even if the multinational corporation is not embedded in them, these structures, and in this case the legal structures, still have to be taken into account. That is, it can be postulated that Union Carbide was very familiarized to the institutional and cultural differences between the states in jurisdiction, the 'plaintiff' state of India and its 'home' state of the United States, and used these differences to its benefit.

The fact that Union Carbide did everything in its power, both in the United States and in India, to avoid liability in the Bhopal litigation is only to be expected. After all, its very survival would be threatened were its liability proven. Hence, it sought to negotiate a settlement that would be as protective as possible of the interests of the company and its shareholders. The last thing that Union Carbide wanted was a civil trial. The damage

that this would have done to its reputation would have been debilitating and the potential compensation that it would have been forced to remit, if found liable, would have been economically damaging. But upon failure to produce a settlement, the legal structure in which Union Carbide preferred to work was that of India, and not the United States.

Union Carbide's greatest opportunity in preventing the disaster from destroying the company was the fact that the disaster occurred in India. Had the accident occurred in the United States in a city of comparable size, the company would probably have been destroyed in litigation. Union Carbide was well aware of the fact that exemplary and punitive damages were rarely allowed in Indian lawsuits¹²⁸, and therefore it would benefit greatly from legal proceedings held by a court in India. As well, Union Carbide was also well aware of another legal jurisdictional difference between the United States and India, and this, too, motivated Union Carbide to go to battle so as have the case dismissed in the American courts. That is, as an American-incorporated business with the largest share of its assets and equity held in the United States, Union Carbide knew that a judgement awarded against them in the U.S. would have been able to take all its assets into consideration when deciding just compensation. However, in India, it was perceived that the assets that would have been available to the Indian courts would have been those of its subsidiary, UCIL, which amounted to substantially less than the assets of the parent company. It was held that, legally, the Indian courts could not seize the assets of Union Carbide unilaterally. That is, if a judgement were awarded against Union

¹²⁸ Trotter et al, p. 443.

Carbide and above the economic value of UCIL, then the Indian courts would have to petition the U.S. courts to uphold and enforce its decision.¹²⁹ Therefore, predictably, Union Carbide fought a remarkable battle in the U.S. courts to not have these cases presided in the United States.

Union Carbide won what could be described as its greatest victory when it was decided in the U.S. Federal District Court that the case would be adjudicated in India. From that moment, Carbide was able to alter its strategy to that of prolonging the process of litigation based on its perceived capacities of the Indian court system.

As illustrated in the examination of the Bhopal incident, Union Carbide attempted, and was successful, in postponing the proceedings of the civil trial that was set to progress in Bhopal. Not only did it not file its response within the stipulated time, but it also sought to adjourn the proceedings. Time and time again, Union Carbide appealed decisions, even on procedural matters to the High Court of the state of Madhya Pradesh, and if this failed, then to the Indian Supreme Court. Union Carbide was well aware of the difficulties and the delays that it could impose in the Indian court system. In addition, by refusing to obey court orders, it was able to delay the proceedings even further by forcing the Indian government to go back to the U.S. courts so that its orders were enforced. Union Carbide knew that there was no international

¹²⁹ This is also an excellent example of how states are bound territorially, whereas multinational corporations, by their very nature, are able to exploit these differences in states to their benefit in addition to their own transnational capabilities.

judicial structure that could have impeded its strategy. That is, there was no 'international' judicial system that would be able to enforce the Indian court orders on Union Carbide, and that the Indian authorities would have to continue to file motions in American courts to get enforcement for its decisions. The company was able to drag out litigation until it was too late for many of the victims, who died awaiting their day in court.

To Union Carbide, the successful outcome of its strategy was to have been completely absolved of liability. This would not have occurred if the trial was adjudicated in the United States, especially given previous judgements. Their greatest hope lay in the Indian court system, but given that a prior Indian Supreme Court decision made this outcome highly unlikely, the next best outcome would be to prolong the proceedings, so that there would be fewer victims (hence less compensation and fewer witnesses) and that the additional time would allow Carbide to make substantial divestures so as to lower its assets and equity (hence less propensity to pay). As completely immoral and unethical as this strategy was, it appeared to work, largely due to the fact that Union Carbide was able to use, and abuse, the differences in the legal structures of the U.S. and India.

In conclusion, it can be effectively postulated that the normative element of structural power and domestic structures, particularly legal structures, were the key determinants of the outcome of the Bhopal tragedy. Therefore, the success of a

multinational corporation in its conflict with the state cannot only be explained on the basis of the relative power resources of the state and the corporation. From this analysis, it is quite apparent that, although Union Carbide's 'deep pockets', or economic resources, contributed to its durability, it cannot be the sole basis from which an analysis of the power to shape outcomes can be made. Thus, structural power and domestic structures cannot be ignored when analyzing the probability of an outcome in a conflict between the two. This is certainly true in the case of the Bhopal accident and Union Carbide, and this will be further illustrated in the ensuing chapter, regarding the Toshiba affair in the late 1980s.

**The Sales of Propeller Milling Machines to the Soviet Union
by Toshiba Machine Company:
Interdependence and Influential Friends**

There is little doubt that the Japan lobby in the United States is the largest and the most effective foreign effort to influence legislation, policy making, and public attitudes in this country.

*Ira Wolf,
well-known American lobbyist¹*

¹ As quoted in Peter J. Katzenstein and Yutaka Tsujinaka, "'Bullying', 'Buying' and 'Binding': U.S.-Japanese Transnational Relations and Domestic Structures, in Thomas Risse-Kappen, ed. *Bringing Transnational Relations Back In: Non-state Actors, Domestic Structures and International Institutions* (Cambridge: Cambridge University Press, 1995), pp. 95-6.

Introduction

In the early summer months of 1987, stiff U.S. sanctions against Toshiba Corporation seemed imminent and certain. It was revealed that one of its subsidiaries, Toshiba Machine Company, had deceitfully bypassed the regulations of the Coordinating Committee on Multilateral Exports (COCOM) and sold machinery that could help the Soviet Union make quieter submarines. Considering that this occurred during a period of tense Cold War relations, this breach of security could have proven to be particularly detrimental and was, not surprisingly, greeted with hostility and anger from the United States. Outraged American Congressmen smashed Toshiba radio/cassette players on Capitol Hill and introduced bills to penalize the company. At the very worst, these bills would have penalized Toshiba Corporation by barring it, and any of its subsidiaries, from the U.S. market for a period of two to five years. It had been estimated that these punitive actions would have cost Toshiba sales of 2.8 billion dollars of its goods a year. However, almost remarkably, Toshiba was able to avoid the imposition of sanctions, albeit with a little help from friends in high places. Hence, it is the purpose of this chapter to outline the details of the diversion, its repercussions, and its responses. As well, this case will challenge prevailing analytical frameworks that are based upon factors relating to the strength of the state (U.S.) or the importance of the issue area ('high' politics). Rather, this case shall illustrate the impact that structural power, domestic

structures, and direct power (public relations campaigns and lobbying) had on shaping the outcome in favour of the Toshiba Corporation.

Disclosure

In December of 1985, a disaffected Japanese employee wrote to COCOM, a Paris-based organization of Western allies and Japan which establishes guidelines and monitors strategic sales to the Communist Bloc, thus revealing the true nature of the shipments that Toshiba Machine Company (TMC) had made to the Soviet Union.

Kazuo Kumagai, the Moscow office manager of Wako Koeki trading company, one of the intermediaries in the sales, told officials at Wako and TMC that he would disclose the story of the illegal exports unless he was paid to remain silent.² His threat fell on deaf ears, which prompted Kumagai to write the letter which would disclose to the United States and Japan “one of the most egregious diversions of high-tech products to the Soviet Union in a decade.”³

The information was sent to the United States, and was eventually relayed to Japan. Toshiba Corporation, the parent company which held a 50.08% stake in TMC, denied ever receiving Kumagai’s threat, but stated that it would confront TMC with the allegations. The Japanese investigation barely moved forward, largely because TMC

² David Sanger, “A Bizarre Deal Diverts Vital Tools to Russians,” in *New York Times*, 12 June 1987.

³ Ibid.

denied the allegations and it was widely believed that TMC was truthful. The Japanese government found it difficult to believe that such a reputable company would act dishonourably and deceitfully and, thus, did not pursue the matter any further.

Meanwhile, in the United States, the Pentagon and U.S. intelligence officials continued an investigation into the allegations. It would be their perseverance that would uncover the deception that had been occurring for almost a decade.

U.S. intelligence officials discovered that sales of sensitive technology were made by Toshiba Machine Company and Kongsberg-Vaapenfabrikk, a Norwegian state-owned computer and weapon-maker, in the early 1980s.⁴ In essence, it all began in early 1980 when a spy, John Walker, Jr., alerted the Soviets to the reason why U.S. anti-submarine forces had the advantage.⁵ Once the Soviets knew that the noisy propellers were the cause of their disadvantage, they immediately sought to buy milling equipment to fashion quieter ones. Shortly thereafter, KGB agents and representatives of the Soviet Ministry of Foreign Trade quietly contacted the Moscow office of a small Japanese trading firm, Wako Koeki, in search of automated propeller manufacturing equipment. Wako Koeki then contacted the Toshiba Machine Company, which was producing equipment comparable to that of U.S. submarine-builders. Within a short period of time, executives from Toshiba Machine Company, Kongsberg-Vaapenfabrikk, and C. Itoh Company,

⁴ This brief summation of events that occurred are drawn from *The New York Times*, from information available from the U.S. investigations into the incident, published during the months of June and July 1987.

⁵ Marshall Goldman, "The case of not-so-simple machine tools," in *Technology Review*, October 1987, p. 20.

Toshiba's standard export broker, travelled to the Soviet Union and signed contracts on April 24, 1981.

The first contract specified the delivery of four giant milling machines from TMC. These were essentially computer-controlled industrial lathes with nine pivot blades that would enable the milling operation on large-sized propeller blades with accuracy and efficiency. With these machines also came a service and parts contract for five years. The second contract was with Kongsberg for a NC-2000 numerical controller, a computer that guides the cutting heads on the machines, and, similar to the arrangement with TMC, a service agreement was also included in the sale.⁶

The details were worked out with care. Another trading company, C. Itoh, which had a much more respectable reputation than Wako Koeki, acted as the exporter on record for both sales.⁷ On May 19, 1981, TMC then applied to the Japanese Ministry of Trade and Industry (MITI), the government ministry in charge of Japan's export controls, for a permit to export the model TDP 70/110 milling machines with two axes to a Leningrad electrical power plant.⁸ Toshiba machine stated that the machines were within the COCOM rules and were to be used for civilian purposes in the Soviet Union. Thus, TMC knew that the false-model machines were relatively unsophisticated and

⁶ "Where Toshiba went wrong," in *Multinational Monitor*, November/December 1987, p. 6.

⁷ *Ibid*, p. 6.

⁸ Goldman, p. 20.

were legal to export, which meant that the sale would not attract special attention. The machines were shipped to the Soviet Union on December 21, 1981.

Japanese officials and MITI officials did not realize that TMC had actually shipped the model MBF 110 milling machines, a far more technologically advanced instrument with nine independently-controllable axes, which were illegal to export to the Soviet Bloc. In fact, none of the trade ministry's 30 export control inspectors, who reviewed 200,000 applications a year, questioned the permit or the shipment. Not only did they not notice that the machines were different models than those listed on the license, but also overlooked the fact that the TDP 70/110 model was mentioned nowhere in Toshiba's sales brochures in the past several years. Hence, it was obvious that the system to control the exports of sensitive technology from Japan was not effective.

Like the Toshiba Machine Company, Kongsberg-Vaapenfabrikk applied to the Norwegian trade ministry for an export permit for a simple model and, when it came time to ship, substituted a more sophisticated one. Bernhard Green, the sales manager of Kongsberg trade, the marketing arm of Kongsberg-Vaapenfabrikk, applied to export a numerical controller that Kongsberg specifically manufactures for Soviet Bloc trade because it can only be used in less sophisticated two and three axes milling machines. Then Green, in keeping with the oral agreement with the Soviets, shipped a variant of the computer that could control a nine axes machine, compatible to the ones that

Toshiba was shipping.⁹ Unlike Toshiba's milling machines, the switch was more difficult to detect, as the difference was in the circuitry, but like Toshiba, no one challenged the claim. Consequently, in early 1982, Kongsberg shipped the software- not covered by COCOM restrictions at the time- directly to Leningrad. It then sent the numerical controllers for the milling machines to TMC in Japan, perhaps so as to hide their ultimate destination.¹⁰ At that point, an unknowing employee of another Japanese company carried it into the Soviet Union as a personal favour for a TMC official.¹¹ The machines were then ready for assembly.

To install and demonstrate the machinery, TMC and Kongsberg technicians travelled not to Leningrad's electric power plant, but to its shipyards. Early in 1983, the team of technicians were rushed to the heavily-guarded Baltic shipyards. There they painstakingly assembled more than 17 million-dollars worth of computer-controlled machine tools to make the ship propellers. Over the next eighteen months, they returned to Leningrad about a half-dozen times more to finish and fine-tune the machines, each of which stood two stories high and weighed a half-million pounds.¹² The last trip was to upgrade the software in June of 1984 and, thus, the Soviet goal to make quieter submarines would soon become a reality. It would take more than a year for the true

⁹ Sanger, in *New York Times*, 12 June 1987.

¹⁰ Ibid.

¹¹ Goldman, p. 20

¹² Sanger, in *New York Times*, 12 June 1987.

nature of the shipments to be revealed and an additional year before a full investigation was begun.

Repercussions

Not unexpectedly, the disclosure of the sales created quite a stir, with disbelief and outrage expressed from both sides of the Pacific. However, both Toshiba Machine Company and Kongsberg-Vaapenfabrikk appear to deserve the condemnations they received. Neither company innocently exported innocuous machinery. The sale involved espionage and deceit. Clearly both Toshiba Machine Company and Kongsberg knew that their actions were contrary to the export rules agreed upon by Japan and Norway in COCOM. These limits allowed the sale of only those machine tools that could turn a maximum of two axes and make propellers up to ten feet in diameter. But the Japanese machines, aided by the powerful Norwegian numerical controllers and software, could control nine axes and produce sophisticated curves in propellers up to forty feet across.¹³ This sophistication in milling is what reduces the noise that submarines generate and, thus, produces difficulty in their detection. Clearly both TMC and Kongsberg knew that their actions would eliminate what the U.S. had considered to be its primary sea-based advantage over the Soviets. Ultimately, the sales neutralized the major and unilateral U.S. missile threat to the Soviet Union: they provided the Soviets a virtually silent and undetectable nuclear missile fleet.

¹³ Jonathan Kapstein, "A leak that could sink the U.S. lead in submarines," in *Business Week*, 18 May 1987, p. 66.

The American Response

Not surprisingly, the disclosure of the sale of sensitive technology to the Soviet Union fuelled a drive on Capitol Hill to retaliate against Toshiba and Kongsberg. However, the outrage would be manifested primarily towards Toshiba, as public and official anger almost ignored the Norwegian company that was a partner in the deal.

Unfortunately for Toshiba, the exposure of the illegal sale occurred at a time when the feelings of resentment towards Japan were brewing in the United States. The furor over Toshiba's deal with the Soviets came in the wake of the U.S. decision to impose one hundred-percent tariffs on a range of Japanese goods. Administration officials explained that motion to be a direct retaliation to Japan's illegal dumping of semi-conductor chips in competition with U.S. companies.¹⁴ This, in combination with American discontent over the Japanese trade surplus and for not adequately opening its market to the U.S., provided an environment ripe for the subsequent 'Japan-bashing' that occurred. Unfortunately, the timing could not have been worse, and the disclosure would potentially have dire consequences for Japan, and especially for Toshiba.

Damage to Security

As previously explicated, the sale of the milling equipment and numerical controllers seriously compromised Western security. Unlike the often obscure impact of

¹⁴ Goldman, p. 20.

high technological leaks, this breach changed the notion of undersea warfare. With the acquisition of this equipment, the Soviet engineers were most certainly enabled to build propeller blades for its new class of submarines that eliminated the noise that allowed the U.S. to track its submarines.

Traditionally, the Soviet undersea fleet had made so much noise that it was easy for the U.S. navy to track it.¹⁵ In fact, the older Soviet submarines were detectable as far away as two hundred miles.¹⁶ However, in more recent years, the U.S.S.R. had been building more advanced submarines, with submarine-launch ballistic missile (SLBM) capability. With the new machines, the SIERRA and AKULA models, combined with the quieter propellers, the U.S.S.R. would now be enabled to get as close as ten miles from the American shore.¹⁷ This proximity would allow the Soviet missiles to reach the continental United States within ten minutes.¹⁸ Clearly, this was a ominous threat posed by the Soviet Union.

It was seen that the American Defence Department, and in particular the Navy, had a very critical problem in its midst. In the past, the Navy had spent tens of millions of dollars to reduce cavitation and blade tonals on its submarines, chiefly through highly

¹⁵ Kapstein, p. 65.

¹⁶ Jeff Copeland, Jane Whitmore, and Jeanne Sather, "The Battle over Toshiba," in *Newsweek*, 13 July 1987, p. 40.

¹⁷ Ibid, p. 40.

¹⁸ Kapstein, p. 66.

classified propeller designs.¹⁹ The U.S. depended on the difference in the acoustic signals generated by Soviet submarines and U.S. ones to give it the advantage. Given the fact that the Soviet fleet was about three times larger than that of the United States²⁰, the U.S. fleet was considered stronger because of superior technology, and it was this advantage that aided security. However, some of that advantage had been lost because of the new technology used on the Soviet submarines. Therefore, not only was American superiority threatened, but there was also a very tangible threat to security.

Officials in the Pentagon had questioned whether the Soviet Union had enough time to actually put the technology to use. However, they concurred that, with the acquisition, it would only be a matter of time. The U.S. Navy had originally estimated that it would cost the U.S. between one and thirty billion dollars to undo the damage that had been done to its advantageous position.²¹ However, a report prepared by the Defense Department disclosed that these original estimates were grossly overstated. Aside from various earlier attempts to assess the potential damage and implication of the diversion, the report was the first attempt to analyze the cost in a methodological way. The study estimated that developing the new technology to reestablish the American edge in tracking Soviet submarines would cost at least eight billion dollars over ten

¹⁹ Peter Kilbourn, "Submarine Case to Lift U.S. Costs," in *New York Times*, 29 July 1987.

²⁰ According to 1986 figures from American defence and intelligence officials, the U.S. had 96 attack submarines while the Soviets had 265. See David Sanger, "Bigger Roles of Toshiba Unit and Kongsberg Cited," in *New York Times*, 29 July 1987.

²¹ Sanger, in *New York Times*, 12 June 1987.

years.²² Nonetheless, the report did submit to the fact that an exact calculation was difficult because the Navy could proceed in a variety of directions, and none of the options was concrete in restoring advantages. Thus, assessing the actual damage to national security was difficult.

Even though exact estimates were not possible, what was tangible was that the U.S. would have to spend money on defense in order to recoup the loss that had been incurred. In fact, revelation about the Soviet quiet-submarines gave further ammunition to critics who had stated that, as an important leg of American and Western security, the U.S. Navy was seriously lacking. Thus, the illegal sale, and its consequences, gave impetus for some to argue for an increase in military spending. Because rectification was considered to be urgent, it was suspected that the Pentagon might attempt to use this to persuade Congress to relax the restraints imposed on the Department of Defence's budget. However, given the high priority placed on reducing the huge budget deficits, this did not appear to be likely and, consequently, other options of financing the endeavour would have to be considered. Given the deceitfulness in the way that events evolved, it was not surprising that Toshiba and Kongsberg became obvious targets from which to recoup the losses.

Although it was possible that the Defence Department was overdramatizing, perhaps to bolster its case in Congress for submarine development projects and

²² Kilbourn, in *New York Times*, 29 July 1987.

improvements, what was evident was that the newest submarines under development (the SEAWOLF class) would cost more than one billion dollars each. Thus, part of the anger towards Toshiba and Kongsberg originated from the fact that the U.S. would have to pay for their misdeeds. From this, the notion that the U.S. should insist that Norway and Japan share the cost of improving underwater detection systems developed.²³ Therefore, calls to put pressure on Japan and Norway to share the burden, or pay for their mistakes, would manifest itself in, what would prove to be, a Congressional witch-hunt of sorts.

A Congress Bent on Revenge

The American attacks on Toshiba and Japan began forcefully on June 30, 1987, when the U.S. Senate overwhelmingly approved amendments of the Omnibus Trading Bill that would impose stiff import penalties,²⁴ and it was expected that the House of Representatives would accept these. If these were passed, the amendments, sponsored by Senator Jake Garn (R-Utah), John Heinz (R-Penn) and eight other senators, would prohibit Kongsberg-Vaapenfabrikk and Toshiba Corporation, along with all its subsidiaries and affiliates, from exporting their products to the United States for two to five years. However, to prevent unnecessary hardship, included with the amendments were several waivers that were to be as protective as possible to both American

²³ Kapstein, p. 66; and Kilbourn, in *New York Times*, 29 July 1987.

²⁴ The amendments were passed in a vote of 92-5. See Jonathan Fuerbringer, "Senate backs import ban in Soviet trade deal," in *New York Times*, 1 July 1987.

businesses and security interests. For example, the U.S. Navy, on the President's decision, would be allowed to continue to purchase Penguin missiles from Kongsberg. The same would apply to products that were deemed to be essential for national defense. As well, U.S. manufacturers and businesses would be protected from the ban by allowing imports under previous contracts incurred before May 1, 1987, parts needed for U.S. production, and routine servicing.²⁵

As well, another punitive amendment that was put forth by the often-vocal Senator Jesse Helms (R-North Carolina) was also accepted. The Helms amendment would allow the U.S. government to seek civil damages through the courts against people and corporations involved in the illegal diversion of technology. That is, the president could lift the sanctions against a parent company that had no knowledge of the actions of the subsidiary, if the parent paid compensation.²⁶ In addition, this legislation would also require such mandatory retaliation for other violations of controls on exports, as applied to future ones and also to any past violations that may come to light, imposed by the U.S. and its allies. This amendment, in itself, parlayed the damage that the sales had done to both American and Western security. At that particular time, it was estimated that it would take billions of dollars to upgrade American submarines and potentially more to develop the appropriate counter-technology to the Soviets new-

²⁵ John Cranford, "Trade Bill Conferees search for Toshiba ban compromise," in *Congressional Quarterly: Weekly Report*, Vol. 45 no 46, 14 November 1987, p. 2813.

²⁶ "House and Senate Pass Omnibus Trade Bill," in *Congressional Quarterly Almanac*, 1987, Vol. XLIII (Washington, D.C.: Congressional Quarterly Inc, 1988), p. 651.

found parity, possibly superiority, in submarine military technology. As stated by

Senator John Heinz:

We're talking about billions of dollars to get the U.S. back to where it was on quiet submarines. We need to send a very clear message to the boards of directors of all companies that there will be severe penalties for such illegal diversions in the future.²⁷

Clearly, the Senate found this egregious breach of security to be no laughing matter. In fact, no one in Congress was amused. The sale of equipment and software to the Soviet Union by Toshiba Machine Company and Kongsberg-Vaapenfabrikk allowed the Soviets to manufacture submarine propellers so that they would run more quickly and quietly and, consequently, make the nuclear-equipped submarines far more difficult to detect. In a time of escalated Cold War tensions, this advantage was a dangerous threat to American, and Western, security. Although this was not the first time that such a 'leak' had occurred²⁸, it was an incident that would prove to be very expensive to rectify. Thanks to Toshiba, the submarine-based nuclear threat by the Soviets would cost the taxpayers of America billions.

Therefore, it is quite evident that this proposed legislation reflected the anger

²⁷ Fuerbringer, in *New York Times*, 1 July 1987.

²⁸ Export controls were, in fact, begun by the Carter administration after printing machines using high-tech ball bearings were sold to the Eastern Bloc in the spirit of detente. The apparently-harmless widgets turned out to be crucial precision elements used in guidance systems for land-based intercontinental ballistic missiles (ICBMs). They allowed the U.S.S.R. to upgrade the accuracy of its missile fleet, thus threatening the U.S. with deadly first strike capability. The widget sale not only influenced Carter to promote a system of allied export controls, but also forced him to upgrade the U.S. missile fleet with additional MX missiles at a cost of billion of dollars to American taxpayers. See John McLaughlin, "Tackling Toshiba," in *National Review*, 14 August 1987, p. 24.

towards the companies, especially Toshiba. Although this ban on imports applied to both companies, because Kongsberg sold virtually no consumer items in the U.S., much more Congressional attention focussed on Toshiba and the Japanese.²⁹ In addition to the Senate amendments to the trade bill, the House passed a bill that would ban sales of products made by Toshiba Corporation, or any of its subsidiaries, in all its military exchange stores. These actions, by both the House and Senate, were obviously prompted by anger over the illegal sales of the milling machines to the Soviets.³⁰ The breach of security provided the perfect opportunity to unleash the hostility towards Japan, and its corporations, that had been brewing in Congress. This was a most opportune time to send a strong message to U.S. allies, particularly Japan, whose export practices the U.S. considered lax. Not only did it reflect a growing anger at Japan for not immediately and adequately punishing the companies and people involved, but also showed annoyance with Japan about its trade relationship with the United States. On Capitol Hill, a pack of Congressmen ceremoniously smashed Toshiba radios with sledgehammers; others called for a nation-wide boycott of Toshiba products. This was a Congress hell-bent on revenge.

The Administration: Conscious of Realities

In direct contrast to the mood in Congress, the American administration, under

²⁹ Susan Rasky, "U.S. Seen Easing Stance on Toshiba," in *New York Times*, 20 July 1987.

³⁰ "Trade Notes: Toshiba Import Ban," in *Congressional Quarterly: Weekly Report*, Vol 45 No 30, 25 July 1987, p. 1636; and "House passes Ban on PX sales of Toshiba goods," in *Congressional Quarterly: Weekly Report*, Vol 45 No 31, 1 August 1987, p. 1728.

the presidency of Ronald Reagan, did not view it as wise to severely penalize the companies and countries involved in the diversion. In fact, Reagan had stated that he would veto the entire bill, including the comprehensive sanctions, if it reached his desk.³¹

Reagan, and his administration, had just causes for opposing the ban. His immediate problem, at that time, was to “try and prevent a Congress that [was] bent on taking revenge from taking actions that might disrupt relations with the Japanese and NATO allies.”³² In such, rather than being more interested in the punitive aspect, the Administration seemed more interested in preventing future violations.³³ In a statement released by President Reagan, the sentiments of his administration against the punitive measures were conveyed.

The Congress has offered a number of bills and amendments that would punish Toshiba and Kongsberg through mandatory sanctions and compensation. But the technology diversion problem is broader than specific violations of the firms that are currently the targets of legislation. The real problem lies in the shortcomings of national export control systems, and responsibility rests with allied governments to make and enforce the necessary changes. Therefore, the administration opposes these bills and amendments.³⁴

Thus, according to Reagan and his administration, the appropriate measure to prevent

³¹ Because he opposed so many other provisions in the bill, especially the protectionist measures, Reagan would veto the entire Omnibus bill even if he accepted the ban. See Susan Rasky, “U.S. Seen Easing Stance on Toshiba,” in *New York Times*, 20 July 1987; and McLaughlin, p. 24.

³² Steve Mufson, “Congress wants Toshiba’s Blood,” in *Business Week*, 6 July 1987, p. 46.

³³ From quote by unnamed MITI official, from his observations in dealing with the Administration about the affair. See Susan Rasky, “Congress cool to Japanese,” in *New York Times*, 16 July 1987.

³⁴ “Statement by Assistant to the President for Press Relations Fitzwater on Strategic Technology Export Controls,” 18 September 1987, in *Public Papers of the Presidents of the United States: Ronald Reagan*, 1987, Book II (Washington, D.C.: Office of the Federal Register, 1989), p. 1055.

future abuses would be to work with Japan and Norway to improve the control of exports.

The State department referred to the sanctions as “counterproductive” and “contrary to the spirit and practice of export control agreements.”³⁵ Since no U.S. citizens, companies, or technologies were involved in the sale, the State department advised that the “U.S. must depend upon strengthening international agreements to keep sensitive equipment and information from reaching the Soviet bloc.”³⁶ Thus, it was evident that, rather than punitive measures, the U.S. would attempt to prevent future violations through pressure on Japan and Norway, as well as other COCOM members, to toughen their export controls.³⁷

An advantageous result of the Toshiba diversion was that it allowed the United States the leverage that it had needed to persuade other COCOM members to agree to changes in export controls. This kind of leverage, the Administration told Congress, would work better than their method of blind vengeance.³⁸ Consequently, to its fellow members of COCOM, the U.S. urged stronger controls and enforcement.

³⁵ Fuerbringer, in *New York Times*, 1 July 1987.

³⁶ Barbara Crossette, “2 Leaders of Toshiba Resign,” in *New York Times*, 2 July 1987.

³⁷ Susan Rasky, “Toshiba, U.S. talk on Exports,” in *New York Times*, 3 July 1987.

³⁸ Mufson, p. 47.

Not surprisingly, Japan was singled out by the U.S. Administration to provide extra security measures. Understandably, the United States urged Japan to adopt more stringent export control laws. As well, it had also requested that Japan bring its defence and foreign ministry officials into the effort³⁹, that it increase the number of inspectors and licensing officials, and that it adopt a delivery verification system for the sale of technological goods.⁴⁰ In addition, the Administration also took advantage of perfect timing, and again asked Japan to take a larger role in COCOM, specifically to increase its yearly contribution past the usual forty thousand dollars.⁴¹

In addition to specific requests directed at Japan, the U.S. also tried to exploit the now-widespread shock and disbelief about the diversion so as to seek new COCOM rules that would require member nations to prosecute companies or individuals that violated the rules. As well, it also tried to persuade the other members that it would be in their best interests, and in the interest of greater collective security, if they could harmonize their methods of enforcement and their laws for punishing offenders.⁴² The U.S. also tried to play their 'trump' card. That is, member nations had been trying to

³⁹ At that time, the Ministry of International Trade and Industry (MITI) was solely responsible for the export control system in Japan.

⁴⁰ See Rasky, in *New York Times*, 16 July 1987, for a more thorough listing of the U.S. requests to strengthen export controls, both within COCOM and Japan.

⁴¹ Ibid; It should be noted that the United States spends ten times that amount. That is, it contributes five hundred thousand dollars a year to COCOM.

⁴² Susan Chira, "Japan ponders the price of Soviet trade," in *New York Times*, 19 July 1987; See also "Come On, COCOM," in *The Economist*, 11 July 1987, for a listing of desired American reforms to COCOM.

have the controls eased on less sensitive technology for some time now, yet their efforts had always been blocked by the United States. This time, the U.S. was prepared to trade this off with increased controls on more highly sensitive technology.⁴³ Thus, although the incident did harm U.S. security, it did allow the U.S. the added leverage that it needed to convince Japan, and the other members of COCOM, of the need to strengthen export control practices so as to prevent another 'leak' to the Soviet Bloc of this magnitude in the future. However, this was not the sole reason as to why the Administration opposed the proposed ban.

In addition to strengthening its position in altering COCOM practices, the U.S. Administration opposed the ban because of its fear of harming the relationship between the United States and Japan. It was felt that Congress was simply 'Japan-bashing', punishing Toshiba as a part of the current anti-Japanese sentiment in the U.S. debate on trade issues.⁴⁴ Ronald Reagan did not want a fresh trade confrontation with Japan, especially since relations were particularly strained after the U.S. imposed one hundred-percent tariffs on Japanese semi-conductor chips.⁴⁵ Although some of these tariffs were recently lifted, it was seen as counterproductive to exacerbate the already-fragile relationship further.

⁴³ Mufson, p. 46.

⁴⁴ McLaughlin, p. 24.

⁴⁵ 100% tariffs were imposed following outrage expressed by American chip-makers over alleged Japanese 'dumping'. At that point, some of the tariffs had just been lifted. See Gordon Bock, "Run silent, run to Moscow," in *Time*, 29 June 1987, p. 45.

The consequences of creating Japanese animosity towards the U.S. would, in the long run, be harmful to U.S. interests, especially economic and defence interests. It was feared that Japan, because of resentment due to hardships endured by U.S. actions, would decide to conclude that its national interests lay in putting distance between itself and the United States. Not only would this be a loss of important trade, but this could also potentially accelerate a trend towards an independent defence policy for Japan.⁴⁶

Allied support is crucial for hugely-expensive defence projects. At that time, the U.S. had already embarked on a joint defence project with its allies in its Strategic Defence Initiative (SDI) and this support was needed to make SDI-spending palatable to Congress and the citizens of the U.S.⁴⁷ However, if the ban created animosity with Japan and its technical companies, the potential for this necessary alliance could be irreparable damaged.

Japan's signing of a joint-SDI agreement in mid-July 1987 had been eagerly anticipated in the United States, but Toshiba was now considering withdrawing from any SDI competition to stave off further criticism.⁴⁸ And Congress' strong reaction had already intimidated a substantial number of electronics-related Japanese companies,

⁴⁶ Japan's push to develop its own fighter plane, rather than purchase U.S. ones, had already sparked friction with the United States. See "The Japan Problem: It will not go away," in *World Press Review*, August 1987, p. 16.

⁴⁷ McLaughlin, p. 24.

⁴⁸ *Ibid*, p. 24.

which suddenly appeared reluctant to work with the United States. Their knowledge, and their active participation, would be essential for the SDI program to function optimally.

Another negative aspect of the ban would be the effect that it would have on Toshiba-U.S. relations. As stated previously, the ban would potentially cost the Toshiba Corporation sales of 2.8 billion dollars a year to the United States.⁴⁹ Although the bill would have exempted Toshiba parts needed for American production, N. Ishizaka, the new president and CEO of Toshiba, had stated that Toshiba would have to evaluate whether to continue its U.S. manufacturing operations if other Toshiba business in the United States was forced to an end.⁵⁰ Thus, there was a fear of a loss of American jobs, for Toshiba had over 4000 employees in plants in California, Tennessee, and Texas. This, combined with the potential repercussions for Toshiba's American partners with which it engaged in extensive joint ventures, meant that the threat of a Toshiba pull-out from the United States would have ensured economic hardships for many. The Administration was aware of this, and although they decried the violations, they argued that:

imposing sanctions would be unfair to the innocent parent and other innocent subsidiaries. [The ban] would cost many of the 4000 jobs held by U.S. employees of the Toshiba

⁴⁹ "Toshiba: Hard Pounding," in *The Economist*, 11 July 1987, p. 64.

⁵⁰ Crossette, in *New York Times*, 2 July 1987.

empire and additional jobs at U.S. firms that relied on the 2.8 billion dollars annually in U.S. imports from Toshiba.⁵¹

Aside from these potential negative economic aspects of the ban, the State department also conveyed that the Administration was opposed to any legislation that required the president to demand compensation from companies that engaged in illegal diversions, or were found to have done so in the past.⁵² The rationale for this opposition was quite simple: such action would establish a precedent for similar claims against American corporations. Lastly, the Administration had felt that, although Japan and Norway had taken a great deal of time in waking up to the problem, they had both since responded vigorously (will be illustrated in the next section). Therefore, the Administration did not support the proposed punitive legislation.

Ergo, it appeared that the White House was more conciliatory than Congress. Obviously the Reagan administration rationalized that the Senate proposals would not have been the most effective measures to rectify the damage that had been done, nor would they have been in American economic or defence interests. Reagan appeared to have made a wise choice in not chastising Toshiba. However, in stating such, 'bashing' does have popular appeal. It appeared that Congress, and the American people were in a belligerent mood at the time. It would have been potentially politically damaging for

⁵¹ The position of the Reagan administration as stated during the House-Senate Conferences on the Omnibus Trading Bill. John Cranford, "Trade Bill Conferees Search for Toshiba ban compromise," in *Congressional Quarterly: Weekly Report*, 14 November 1987, p. 2813.

⁵² Ibid.

Reagan to go out on a limb and lecture Congress to exempt Toshiba from these punitive actions. However, he instead chose a route that would cause the least amount of damage to his credibility. That is, he chose to mask the true motives for his opposition by emphasizing that he was opposed to the many protectionist measures that the whole trade bill contained and to the inclusion of a provision on plant closures. Because of these, he stated that he would veto the entire bill. Therefore, one of Japan's, and Toshiba's, most influential allies in preventing the bill, and all its punitive measures, from becoming law was the Reagan administration.

The Japanese Response: Damage Control

Since the incident became known, the political impact proved to be widespread. The Japanese government was criticized for their non-involvement and for their lax export controls. Like the United States, Japan too feared the impact that this would have, not only in its relations with the United States, but also for the Toshiba Corporation, the parent company of the 'offending' subsidiary. Not surprisingly, following the complete disclosure of the incident, damage control by the Japanese government became high priority.

Part of the American irritation towards the Japanese government emanated from the fact that the U.S. believed that the Japanese government had dragged its feet in

dealing with the incident.⁵³ This appeared to be true, for the Japanese investigation of the incident, once revealed to it by American intelligence officials, barely moved forward throughout 1986. A Japanese foreign ministry official explained this by stating that:

There was widespread disbelief that a reputable company, as was Toshiba, could do such a thing. Thus, Toshiba Machine was believed when it had initially told MITI investigative officials that it had merely shipped two-axes machines.⁵⁴

In addition to the disbelief, investigation was stalled until more documentation was made available to the Japanese. It was not until Casper Weinberger, the U.S. Secretary of Defence, complained directly to Japan's defence minister that a full investigation began.⁵⁵ After further questioning by the Japanese police, the original explanations offered by Toshiba Machine executives began to crumble. The web of deception was revealed and, in May of 1987, MITI finally imposed on Toshiba Machine Company the maximum civil penalty then available under Japanese law: a one year ban on exports to the Communist Bloc.⁵⁶

Yukio Okamoto, a senior Foreign Ministry official, stated that the maximum sanctions were imposed because of the revelations that TMC had deliberately

⁵³ The Pentagon charged that Japan had permitted the technology to get away, and then dragged its feet for a year when presented with the evidence of the diversion. See Sanger, in *New York Times*, 12 June 1987.

⁵⁴ *Ibid.*

⁵⁵ *Ibid.*

⁵⁶ The expected losses to TMC originating from the ban were \$100 million. See "Where Toshiba Went Wrong," in *Multinational Monitor*, November/December 1987, p. 8.

misrepresented the sale, lied to investigators, and violated COCOM rules.⁵⁷ It was also promised by MITI that it would keep a close watch on the activities of TMC in the next year, so that it would not attempt to divert exports into the Communist bloc via entry into other countries.⁵⁸ In fact, Okamoto had stated that:

To my knowledge, no administrative sanction of this magnitude has ever been imposed on Japanese companies.⁵⁹

Thus, the Japanese government had begun its first steps towards damage control, and they were done quickly so as to stave off further criticism from the U.S. that they were again dragging their feet.

In June of 1987, Japan's Prime Minister Yasuhiro Nakasone was briefed about the incident and of the deceitful attempts by Toshiba Machine Company to continue to cover-up the truth. To no one's surprise, Nakasone was extremely disgusted and concerned. In fact, not only was anger expressed over the sale, but there was also worry about the potential damage that this would have on Japan-U.S. relations and to Japan's exports. Given the recent semi-conductor dispute, Nakasone did not wish to further aggravate trade frictions. Not only this, but Nakasone knew that his goals of persuading the Reagan government to allow Japanese companies to join in SDI could be compromised if the U.S. questioned Japan's ability to protect sensitive information.⁶⁰

⁵⁷ Ibid, p. 9.

⁵⁸ Sanger, in *New York Times*, 12 June 1987.

⁵⁹ Clyde Haberman, "Tokyo punishes two companies in sale," in *New York Times*, 16 May 1987.

⁶⁰ Haberman, in *New York Times*, 16 May 1987.

Upon hearing word of the punitive measures that the American Senate proposed, Nakasone and his ministers realized that rapid movement on the issue was imperative. Thus, the Japanese government appeared eager to confront the situation, not only because it was the honourable thing to do, but also to exercise damage control.⁶¹

In early July of 1987, Nakasone released a statement before the Japanese parliament condemning the actions of Toshiba Machine Company.

A Japanese company has not only damaged national defence but has also committed a crime of betrayal of the Japanese people because of its actions.⁶²

However, the Japanese government knew that it would take much more than a condemnation of TMC's actions by Nakasone to mollify the belligerent mood of the United States towards Japan and Toshiba. Understandably, the U.S., which spends far more than any other country on trying to track Russian submarines, was furious, not just at Toshiba but also the Japanese government. The COCOM enforcement machinery in Japan did not expose the incident, as it should have. The problem lay in the fact that,

⁶¹ It should be noted, however, that not everyone in Japan agreed with the strategy of the Japanese government. In fact, there was a great deal of skepticism in Japan with regards to the U.S. anger and the proposed Congressional sanctions. In the U.S., many Congressmen parlayed their anger because of the conceived notion that Japan, obviously, had no respect for COCOM restrictions. Herein lay the divergence of attitudes. Japan had stated that they were strong advocates of the COCOM system, but that the U.S. was exaggerating their neglect. In fact, it was thought that the U.S. was frequently alarmist about the severity of high-tech diversions, and was being, undeservedly, harsh, especially considering that, previously, U.S. companies had sold China computer equipment, which was then used in making missiles pointed at Japan. As well, many in Japan suspected that the underlying issue was technological rivalry, with the furor as an excuse to weaken Toshiba. Thus, many Opposition party members pointed these out and, consequently, charged the Nakasone government of being too willing to appease the United States. See Chira, in *New York Times*, 15 July 1987 and 19 July 1987.

⁶² An excerpt from Nakasone's speech, in Susan Chira, "Nakasone asserts Toshiba betrayed Japan with sales," in *New York Times*, 15 July 1987.

although the member countries swear that they will enforce its restrictions, few of them do so rigorously, or even effectively. Therein lay the American frustration and anger: for years, the Soviet Union has exploited this "sieve-like protection of Western technology to buy and steal the means to produce better military equipment much earlier and cheaper than it could have done on its own."⁶³ Japan knew that its export control system had been at fault and that the diversion could have been averted if the system performed effectively. In fact, Yoshifumi Matsuda, a spokesman for Japan's Foreign Ministry, verified this.

Toshiba Machine Company committed an illegal act. But the [Japanese] government was also responsible because of a rather loose framework of export controls and a shortage of manpower to supervise these exports.⁶⁴

From the ongoing investigations, it was revealed just how readily the export control system broke down in Japan. Firstly, on the export permit, the machines were referred to as model TDP 70/110. However, an important detail that had been overlooked by the inspectors was that this model was never mentioned in any of Toshiba's sales brochures. In addition, none of MITI's control inspectors noticed that the machines shipped were of a different model than specified on the export permit. Hence, perhaps due to overwork or lack of technological sophistication, the government inspectors did not challenge the company's claims about the capabilities of the equipment being exported. These factors, combined with the fact that MITI had simply trusted

⁶³ "Come on, COCOM," in *New York Times*, 11 July 1987, p. 16.

⁶⁴ Susan Chira, "Japan's efforts to soften U.S. anger on Toshiba," in *New York Times*, 18 July 1987.

Toshiba to be truthful because of its sterling reputation, made the diversion relatively simple. Therefore, had the export system been more effective, the sales may not have occurred.⁶⁵ The government knew that American criticism emanated from this fact and was prepared to enter into negotiations with the American government to rectify the system's shortcomings and to assuage the anger so to prevent the sanctions.

On the 13th of July, 1987, Japan's trade minister, Hajime Tamura, left for the United States to do just that.⁶⁶ Understandably, Tamura did not receive the friendliest of welcomes, but negotiations with the Reagan Administration, particularly with Secretary of Commerce Baldrige, managed to come to an amicable end, with many agreements being reached so as to prevent another occurrence of this sort. Baldrige, at the meeting, again emphasized the Reagan administration's position on the sanctions and rectificationary measures.

[We] think that the punishment of Toshiba, while important, is not nearly as important as having the whole Government of Japan shape their licensing, investigating, and enforcement. It would be better for the Japanese to punish their own company.⁶⁷

⁶⁵ It should, however, also be noted that the sale was also 'missed' by Western intelligence officials. That is, the many visits to Leningrad by both TMC and Kongsberg technicians went undetected, as did other clues. Although illegal exports to the USSR were not new, these were different because there were no excessively large pay-offs and there was little effort to conceal the goods' final destination (equipment was shipped to the USSR directly, not through a third country). Thus, even Western intelligence officials were 'duped' into thinking these shipments were innocent and legal, not just MITI. See Sanger, in *The New York Times*, 12 June 1987.

⁶⁶ Susan Chira, "Tokyo official plans U.S. visit on Toshiba case," in *New York Times*, 13 July 1987.

⁶⁷ Peter Kilbourn, "Japanese agree to U.S. demands on controlling technology sales, in *New York Times*, 17 July 1987.

Hence, to no one's surprise, many of the arrangements that were reached dealt with the strengthening of Japan's export control system.

After a meeting with Baldrige, Tamura had agreed to a number of U.S.

requests:

- 1) To pursue the investigation of the Toshiba affair with a view towards criminal prosecution. The Government would also ask the legislature to increase criminal penalties and to extend the statute of limitations, now three years, in such cases.
- 2) To dispatch teams to the United States to study the American system of export control with the intention of adopting a similar one.
- 3) To sharply increase Japan's financial support of the organization known as COCOM, which regulates exports of sensitive technologies. Japan would raise its contribution, from the current \$40,000/year, to a level more consistent with the size of its economy.
- 4) To join in holding non-COCOM members to uniform standards of export controls to prevent the diversion of sensitive goods.⁶⁸

All in all, the Japanese government and MITI officials were in agreement to tighten forces. Not only did the Foreign Ministry and MITI issue formal apologies, they also stated that they would immediately revamp the inspection system, including hiring more inspectors, and reorganize the internal auditing and oversight procedures. It was promised that, henceforth, they would be more assiduous in monitoring orders affected by the COCOM rules. As well, Tamura stressed that the two trading companies, C. Itoh and Wako Koeki, had been penalized and that the TMC executives involved in the sale were already facing criminal charges in connection with the Soviet sales. In addition, not only had Kazuo Iimura, the president of TMC, resigned, but that Shoichi Saba and Sugiichiro Watari, Toshiba Corporation's chairman and president respectively, had also resigned, as Japanese protocol demands. However, it was emphasized that Toshiba

⁶⁸ Ibid.

Corporation, the 'innocent' parent of TMC, had no knowledge of the sales to the Soviets and, thus, a grave injustice would be done if sanctions were imposed on the parent for the actions of a subsidiary for which it had no management control.⁶⁹

All told, in light of Congress considering a ban on all imports of Toshiba and of the possibility of strained relations and lost opportunities between Japan and the U.S., Japan chose to meet all the demands of the Reagan administration on the issue. Obviously there was a fear that the U.S. furor would further poison trade relations between the U.S. and Japan and would almost certainly ensure the passage of the harsh trade measures under consideration in Congress. Regarding the fact that, in 1986, the U.S. accounted for 38.5% of Japan's exports, or one-third of total Japanese trade⁷⁰, the possible repercussions were clearly unpalatable to the Japanese government. As Clyde Prestowitz, a former U.S. trade negotiator, explained:

The Japanese don't want a protectionist trade bill. They want the semi-conductor sanctions lifted. They don't want to be locked out of Strategic Defence Initiative research. They have enormous stakes in the United States. They are trying to save this at the cost of having someone of power go over and bow low and apologize. That's a pretty low cost.⁷¹

Hence, the obvious repercussions of not agreeing to American requests overwhelmed the Japanese government. Therefore, the Japanese acted rapidly, in the hopes that their

⁶⁹ "Toshiba: Hard Pounding," in *The Economist*, 11 July 1987, p. 64.

⁷⁰ Chira, in *New York Times*, 18 July 1987.

⁷¹ Ibid.

amicable responses to rectificationary measures would soften the U.S.'s anger towards the incident.

Toshiba Corporation: High Stakes, Powerful Lobbying

The Japanese government's efforts and agreements to assuage the anger of the U.S. over the diversion paled in comparison to the campaign launched by the Toshiba Corporation, the 'innocent' parent of the offending subsidiary Toshiba Machine Company. A ban on Toshiba exports to the U.S., which accounted for 10% of Toshiba's annual sales, would have had a devastating economic effect on the company, with an estimated cost of almost 3 billion dollars a year in lost sales.⁷² With the entire U.S. market at stake, it was not surprising that the Toshiba Corporation headed an all-out lobbying blitz to show that not only was it upset about the incident and taking appropriate measures to rectify the incident, but also to establish its innocence in the matter so as to stave off the proposed harsh legislation.

In the United States, the parent company, Toshiba Corporation, set out to try and block a growing movement in Congress to ban the imports of its products, and of its subsidiaries, for a period of two to five years. Unfortunately, even with the sanctions still pending, the widespread furor over the incident had already caused some damage to

⁷² Chira, in *New York Times*, 18 July 1987; and "Toshiba: Hard Pounding," in *The Economist*, 11 July 1987, p. 64.

Toshiba Corporation. At that point, the U.S. Pentagon had already delayed awarding contracts to Toshiba for personal computers and outright cancelled an agreement to buy Toshiba guided-missile technology.⁷³ As well, two contracts, valued at 1 million dollars apiece, for heavy electrical equipment had been cancelled, and competitors were winning business from Toshiba's medical equipment division.⁷⁴ The U.S. Commerce department refused to renew the export license of Toshiba's American subsidiary, Toshiba International. The company, consequently, had to apply for a separate export license every time it had to ship products from the United States. Because Toshiba's operations in Japan imported about 40 million dollars of goods a year from Toshiba International, this caused delays that slowed production of assembly in Japan. In addition to their corporate image being tarnished, Toshiba's sales were immediately hurt. Some U.S. retailers refused to stock or to handle Toshiba's merchandise, especially its most popular electrical and medical products.⁷⁵ Fear of this mood snowballing led Toshiba to move rapidly.

Toshiba Corporation attempted to convey its deepest regrets and anger about the actions of its subsidiary, but maintained that officials at the parent company were completely unaware of the transaction. Toshiba's former chairman, S. Saba, had emphasized that TMC was run as a totally separate company, without Toshiba

⁷³ "Toshiba: Hard Pounding," p. 64.

⁷⁴ Steve Dryden, "How Toshiba is beating American sanctions," in *Business Week*, 14 September 1987, p. 58.

⁷⁵ Chira, in *New York Times*, 13 July 1987.

Corporation's executives on its board, and without direct daily supervision from the corporate parent.⁷⁶ However, with the resignations of Toshiba Corporation's two top executives, the U.S. saw this as accepting blame and knowledge of the incident.⁷⁷ But in Japan, the resignations are a matter of cultural tradition that considers senior executives of the parent responsible for what occurred on their watch, regardless of knowledge. In fact, former president, S. Watari stated that he resigned because of this, not because of any misdoings, and that he felt that Toshiba was being treated with undue harshness. It was his belief that Toshiba Corporation should not face sanctions that were being debated in the United States because of the actions of a subsidiary which Toshiba did not control, did not have authority over its decisions, and by which it was deceived.⁷⁸ Thus, part of Toshiba's strategy to prevent the sanctions from being imposed was to prove that they were innocent parties to the diversion.

In June of 1987, Toshiba Corporation hired a "blue-ribbon panel of truth-seekers who would be guided by independent American counsel."⁷⁹ The joint mission of Price Waterhouse, a management consultancy firm, and the American law firm, Mudge, Rose, Guthrie, Alexander & Ferndon, was to ascertain whether, evidence withstanding, anybody in Toshiba Corporation knew what was happening and to uncover the

⁷⁶ Ibid.

⁷⁷ Chira, in *New York Times*, 18 July 1987.

⁷⁸ Sanger, in *New York Times*, 12 June 1987.

⁷⁹ William Buckley, Jr., "Punish Toshiba?" in *National Review*, 18 December 1987, p. 62.

individuals in Toshiba Machine Corporation who were involved and aware. It was hoped that, through investigation of the sales by two very well-known and very reputable American firms, Toshiba Corporation's innocence would be proven, its credibility repaired, and the proposed sanctions revoked in the United States.

In the meantime, Toshiba Corporation continued to emphasize its deepest regrets in the matter. Not only did it recount the apologies and resignations of its top officials to the American public, but it went several steps further in executing, what would prove to be, an extensive lobbying and publicity campaign. At the same time as Tamura's visit to mollify U.S. officials over the incident, the Toshiba Corporation issued formal letters of apology to each member of the House and Senate. These letters, signed by the new president, Joichi Aoi, regurgitated the company's apologies for the incident and stated that measures were being taken internally to get to the heart of the matter. The letter described Toshiba Machine's actions as "reprehensible in the harm it has [sic] done to both Japan and the United States."⁸⁰

The next leg of the campaign observed the Toshiba Corporation spend a small fortune in publishing an open letter of apology to the American public. The letter not only apologized, but also outlined the steps that were being undertaken to 'clean-house' and the new rules and procedures devised to prevent any future occurrences of this sort. The letter advertising campaign was a full-page ad run in over 50 major American

⁸⁰ Susan Rasky, "Congress cool to Toshiba," in *New York Times*, 16 July 1987.

newspapers and magazines and was estimated to have cost Toshiba over 100 million dollars to enact⁸¹ (See Appendix 1 at the end of this chapter for a copy of the full letter). In addition, Toshiba hired some of America's top-guns to plead its case to Congressmen. It was hoped that with the acquisition of Leonard Garment as special counsel for Toshiba in the U.S., who was one of America's best-known attorneys and lobbyists, and with James Jones, the former House Budget Committee chairman, that their connections would prove to be invaluable.⁸² With the goal of swaying Congress and the American public, Toshiba appeared to be pulling out all the stops.

In addition to the obvious economic losses that would have been incurred, the ban would have made it enormously difficult for Toshiba to pursue an international operation that did not include the world's most important market, the United States. Also at risk was Toshiba's goal to become more involved in the U.S. defence market, especially SDI. Understandably, credibility and security were high on the list of preconditions for acceptance and Toshiba needed to illustrate that it was trustworthy. Another negative aspect was related to the corporation's recovery after a shutdown. The lengthy sanctions proposed would have been especially hard for a firm, such as Toshiba, which operated in dynamic high-technology markets. That is, even being a few months behind the product leaders could prove to be fatal in such a highly-competitive, rapidly-innovative field. It would have been certain that Toshiba's Japanese rivals, such

⁸¹ "Toshiba: Playing tat for tat," in *The Economist*, 25 July 1987, p. 61.

⁸² Dryden, p. 58.

as Hitachi, Sony, NEC, and Fujitsu, or rival American firms would have been quick to step into the void, and market share, left by Toshiba.⁸³ Hence the urgency of Toshiba's efforts.

Toshiba's publicity and lobbying efforts may have served them well, but, arguably, the efforts that were the most consequential were those made by American corporations. That is, it can be argued that, had it have not been for the lobbying efforts of American corporations in opposition to the bills, Toshiba might well have completely failed in its efforts to appease Congress and the American public.

In mid-July, some very large and politically-powerful American corporations that would be affected by the ban began to lobby Congressmen in Washington on behalf of themselves, and thus Toshiba, so as to convince them that the proposed ban would do considerably more damage to U.S. businesses than to Toshiba. In addition to medical equipment sold to hospitals and medical centres, Toshiba also manufactured consumer electronics products, including radios, stereos, microwaves and cellular phones, under its own name and on specific orders from U.S. companies that marketed the product under their own names. But the products of concern to the major corporations that began to come forward were generally high technology components or parts that were used in computer systems sold or purchased by U.S. companies at home and overseas.⁸⁴ One

⁸³ "Tora! Tora! Angry Lawmakers torpedo Toshiba," in *U.S. News and World Report*, 13 July 1987, p. 42.

⁸⁴ Susan Rasky, "Powerful Lobby Fights Ban on Toshiba," in *Globe and Mail*, 15 September 1987.

such corporation, and one of the first to publicly oppose the ban, was Apple Computer. Spokesmen for the corporation stated that desktop printers were made for them by Toshiba and that the costs of locating a new supplier would have been devastating. It was assured that Apple would most certainly suffer financially and competitively in its home market if the proposed legislation banning imports of Toshiba products were adopted by Congress.⁸⁵ Needless to say, other American corporations appeared to be in the same predicament and also chose to join the lobbying effort.

Another such corporation was Audiovox. The company, which has 1200 employees in seventeen states, primarily made automobile cassette players. But the cellular telephones that it had Toshiba manufacture under the Audiovox name accounted for half its business and 40% of the U.S. cellular telephone market.⁸⁶ Thus, American corporations affected would not only be the ones that relied on Toshiba components for products they manufactured, but also original manufacturers that contracted with Toshiba to make products and then market them under their own labels in the United States. Hence, dozens of major companies, hundreds of small and medium-sized manufacturing businesses, and billions of dollars would be affected by the arrangements with Toshiba, and consequently by the imposition of the ban.

The list of American companies grew longer as the summer months progressed,

⁸⁵ Susan Rasky, "U.S. companies fight proposal to ban Toshiba," in *New York Times*, 14 July 1987.

⁸⁶ Ibid.

and by the start of the House-Senate conferences in September, the list was rather lengthy and read like a 'who's-who' of American giant businesses. The companies engaged in efforts included not only Apple and Audiovox, but also Hewlett-Packard, Motorola, Westinghouse, General Electric, Honeywell, IBM, Rockwell, United Technologies, Xerox, Texas Instruments, and a long list of other smaller manufacturing operations.⁸⁷ As explained by Andrew Manatos, a former Carter administration official who represented the Audiovox Corporation:

Since Toshiba exports only approximately 10% of its products to the U.S., that is the upper limit of the penalty that can apply to them. But many of these original equipment manufacturers will have as much as 90% of their products affected. The Senate legislation is nicking a Japanese giant, ricocheting off and seriously wounding Americans.⁸⁸

Although Senate sponsors of the measures attempted to draft them with sufficient exemptions to avoid harm to U.S. companies, officials in the electronics and high technological industries had begun to realize that their relationships with Toshiba and other foreign high-technology companies were so complex and intertwined that there was no way to avoid serious economic damage.⁸⁹ In fact, a Congressional aide described the awakening as:

if people suddenly realized that Toshiba had 20 billion dollars (U.S.) a year in worldwide sales and 600 worldwide subsidiaries. Toshiba has some kind of supply arrangement or sole source deal with seemingly every company in the United States.⁹⁰

⁸⁷ Rasky, in *Globe and Mail*, 15 September 1987. See also letters to the editor by Jerry Junkins, President/CEO of Texas Instruments and John Moore, President of Bio-Imaging Research Corporation, in *New York Times*, 29 July 1987.

⁸⁸ Rasky, in *New York Times*, 14 July 1987.

⁸⁹ Rasky, in *Globe and Mail*, 15 September 1987.

⁹⁰ Quote by an unnamed Congressional aide. *Ibid.*

Consequently, lawmakers had been hearing from distributors of Toshiba merchandise, corporate customers, contractual allies, and from employees of Toshiba-owned subsidiaries in the United States who all feared that their livelihoods would be threatened by the import ban.

Important support also came from trade groups in the United States. In addition to the Computer & Communications Industries Association, which played a significant role in leading the lobby, other influential associations involved included the American Electronics Association, the Business Roundtable, the Computer & Business Equipment Manufacturers association, and the National Association of Manufacturers. It was argued that, on top of Toshiba's 4,500 workers, an equal number of jobs, if not more, that depended on Toshiba parts could be at risk as well.⁹¹ Concerns over the ban were further articulated by Edward Black, the Vice-President and general counsel for the Computer & Communications Industries Association. He voiced that:

[Although] there is [sic] no major company that would go under because of the sanctions, we are talking about whole product lines or market areas where a company could be so hobbled that it would be forced to withdraw from the market.⁹²

Consequently, representatives of the industry groups not only publicly conveyed their concerns about the potential widespread economic impact, but also urged high-level

⁹¹ A statement from a spokesman for the Electronics Industry association, quoted in Steve Dryden, "How Toshiba is beating American sanctions," in *Business Week*, 14 September 1987, p. 58.

⁹² Rasky, in *Globe and Mail*, 15 September 1987.

lobbying by the Administration in making its case to Congress.⁹³

In addition, Toshiba's status as an important investor also enlarged its circle of friends. That is, more important and politically-influential individuals came to its defence. However, this time it was from the state level where, ironically, in the past the Japanese had found so few allies. Prompted by executives at Toshiba's colour television and microwave plant in Lebanon, Tennessee, Governor Ned McWherter wrote to his state's eleven Congressmen warning that "retaliatory measures directed at Toshiba would have a direct impact on over 600 employees in Tennessee."⁹⁴ Robert Orr, the governor of Indiana, also publicly denounced the ban. Similar to McWherter, Orr also urged his state's representatives to oppose the sanctions, not because of existing plants, but because he was in the process of trying to persuade a Toshiba affiliate to locate in Indiana. Therefore, Toshiba's American operations, its supplier and contractual arrangements, and its important investor status well-positioned Toshiba to stave off the proposed punitive measures, albeit with help from 'friends' in high places.

At the same time the lobbying efforts became full-force, Toshiba Corporation made the report it commissioned public. As was stated earlier, it was hoped that this

⁹³ It should be noted that, in the first week of September 1987, representatives from these trade groups met with Robert Dean, a special assistant to Ronald Reagan for national security affairs. They expressed their concerns about the impact that the ban would have on American industries and that they feared that the Administration officials did not sufficiently publicize the steps that had already been undertaken by the Japanese government and Toshiba to strengthen their export controls. See Rasky, *op. cit.*

⁹⁴ An excerpt from a letter written by McWherter on the 11th of August, 1987, to Tennessee's Congressmen. See Dryden, p. 58.

independently-done report would, once and for all, prove the parent's innocence in the actions of its subsidiary, restore its credibility, and sooth the anger of American lawmakers so that sanctions would not be legislatively imposed. True to their word, Toshiba Corporation was found innocent in the matter of the illegal diversion.

The report, which was initially presented to the board of Toshiba Corporation, cleared the parent of any wrongdoing in connection with the sales by its subsidiary, Toshiba Machine Company, of which it owned 50.08%. It stated that:

No one at Toshiba Corporation knew of, or had reason to know of, the wrongful activities of Toshiba Machine Company. As a world leader in its own field of business, Toshiba Machine Company conducted its business independently of Toshiba Corporation and therefore Toshiba Machine Company did not report to or consult with Toshiba Corporation about individual business transactions. When MITI first inquired into the sales in December 1985, neither Toshiba Machine nor MITI advised Toshiba Corporation of the inquiry. The fact that diversionary sales may have taken place first came to Toshiba Corporation's attention from press accounts in late March 1987 of information provided by a U.S. government source. In response to Toshiba Corporation's immediate and repeated demand for a full explanation, Toshiba Machine flatly denied to Toshiba Corporation that there had been any violation of law, stating that there had been no wrongdoing and that the matter was purely a misunderstanding that Toshiba Machine would be able to clarify to MITI. The wrongdoing was exposed and finally admitted by Toshiba Machine only when Tokyo Metropolitan police seized Toshiba Machine Company's files and the personal diaries of involved employees, and conducted intensive interrogations of the personnel involved.⁹⁵

Despite all the tawdry details, the report did help Toshiba Corporation quell anger in Washington, since the investigation concluded that the subterfuge was confined

⁹⁵ Excerpt from the *Summary of Investigation into Sales of Propeller Milling Machines to the Soviet Union by Toshiba Machine Company Ltd.*, written by Donald J. Zoeller, of Mudge, Rose, Guthrie, Alexander & Ferndon; reprinted in "Where Toshiba went wrong," in *Multinational Monitor*, November/December 1987, p. 8.

to Toshiba Machine Company. Aside from the actual machinery and related tooling that was exported, it was also soothing to discover that there was no transmission of propeller design data, or of Japanese or U.S. defence secrets or of U.S. technology or products.⁹⁶ Ergo, Toshiba's own lobbying, as well as lobbying efforts by high-profile American corporations and trade associations, the opposition of the ban by the Reagan administration, and the release of the report were all factors that, it was hoped by Toshiba Corporation, would assuage the anger in Congress and prevent the proposed ban and other amendments from becoming law.

Disaster Averted

On August 23, 1988, U.S. President Ronald Reagan signed the Omnibus Trade Bill (HR 4848) into American law. Included in the bill was a provision devoted to the Toshiba-Kongsberg sanction, but it was in a very different form than was originally proposed and anticipated. According to the provision in the Act, the United States would:

impose three year prohibitions on imports from Toshiba Machine Company of Japan and Kongsberg Trade of Norway, and on government contracting or procurement from those firms. The bill would prohibit for three years U.S. government contracting or procurement from the parent firms, Toshiba Corporation and Kongsberg Vaapenfabrikk. Exceptions could be made for goods needed for national security purposes; spare and component parts; routine servicing and maintenance; and service, information and technology and items imported under contracts signed before June 30, 1987. The sanctions were responses to illegal sales of controlled technology by the subsidiaries to the USSR.

In the cases of future infractions, [the Act] would require import and U.S. government procurement bans of two to five years against any entity whose sales violate

⁹⁶ Stephen Koepp, "Beware of Machines in Disguise," in *Time*, 21 September 1987, p. 53.

COCOM regulations and seriously affect the strategic balance of forces. [The Act] would make sanctions optional for a sale that does not have serious adverse impact on the balance of forces. The same exceptions as for the retroactive sanctions would be permitted.⁹⁷

In addition to the three-year prohibition on government procurement or contracts from the parent Toshiba Corporation, the defence appropriations bill for its 1989 budget also contained provisions against Toshiba. The provision called for a three-year prohibition of the sales in military exchanges of products made by the Toshiba Corporation or any of its subsidiaries or affiliates.⁹⁸ However, given the comparison of these measures to those originally put forth by the Senate, it can be stated that Toshiba Corporation was successful in its goal of preventing all-out sanctions on its goods to the United States.

It seemed highly unlikely that Toshiba Machine Company (or Kongsberg) would escape sanctions in the United States. Given the full disclosure of the incident from various investigations, this appeared to be quite justified, as even Japan's MITI imposed a one year ban of its goods to the Soviet bloc. Thus, the three-year ban of its goods to the United States seemed appropriate, especially given the fact that Toshiba Machine Company would lose sales of 100 million dollars a year.⁹⁹ However, the contentious

⁹⁷ Excerpt from the final draft of the Omnibus Trade Bill, "Provisions of Omnibus Trade Bill (HR 4848)," in *Congressional Quarterly: Weekly Report*, vol 46 No 32, 6 August 1988, p. 2220.

⁹⁸ It should be noted that exempted from the ban was Toshiba microwaves that were assembled in Lebanon, Tennessee. Governor Ned McWherter was obviously successful in minimizing the impact that Toshiba sanctions would have on his state. See "After the Impasse, Defence Bill Becomes Law," in *Congressional Quarterly Almanac* 1988, Vol XLIV (Washington, D.C.: Congressional Quarterly Inc, 1989), p. 408.

⁹⁹ Cranford, in *Congressional Quarterly: Weekly Report*, 14 November 1987, p. 2813.

issue in Congress was in deciding the appropriate response to Toshiba Corporation, the innocent parent of the subsidiary Toshiba Machine.

In the end, although the Omnibus Trade Act did impose punitive measures against Toshiba Corporation, these were not as economically threatening as would a complete ban on its products to the United States have been. As well, because of the exceptions written into the government contracting and procurement provision, Toshiba stood to lose very little, if anything at all. With regards to the Defence department's appropriation bill, Toshiba Corporation would not be able to sell its goods at military-run stores. But the annual sales of Toshiba products in the exchanges totalled about 23 million dollars.¹⁰⁰ If one considers that Toshiba Corporation had annual sales in the United States of 2.8 billion dollars, this amount was small change compared to the losses that Toshiba would have incurred with a comprehensive ban on its products. Therefore, Toshiba Corporation appeared to have successfully battled what would have been detrimental legislation.

The Toshiba Incident: Analysis and Conclusions

The Toshiba incident is a fertile example of the impact that structural power and domestic structures have in enabling a multinational corporation to influence an outcome to its preference. In fact, an analysis of these factors could aid us in understanding

¹⁰⁰ "After the impasse, defence bill becomes law," p. 408.

exactly how Toshiba Corporation was able to escape with sanctions that, at worst, would only make a slight dent in its annual U.S. sales of 2.8 billion dollars. It would be too rudimentary to suggest that the minimized sanctions were solely the result of a full-blown and very successful political campaign by Toshiba Corporation to stop the imposition of comprehensive sanctions. And although this form of direct power did, undoubtedly, have an impact on the final outcome, other factors, such as structural power and domestic structures, may have contributed more to Toshiba's success.

As one would recall, structural power is the power to shape and determine the structures of the global political economy within which states, their political institutions, their economic enterprises, etc., have to operate.¹⁰¹ Structural power is that the possessor is able to change the range of choices available to others, without apparently putting pressure directly on them to take one decision or to make one choice rather than the other.¹⁰² As opposed to lobbying, this type of power is more indirect and less visible, but no less potent. In the case of the Toshiba incident, the structural power of the Toshiba Corporation was certainly conspicuous and was an important determinant of the outcome.

¹⁰¹ Susan Strange, *States and Markets* (London: Pinter Publishers, 1988), p. 24.

¹⁰² *Ibid*, p. 31.

As Susan Strange has suggested, the internationalization of production has shifted power into the hands of transnationally mobile firms.¹⁰³ Toshiba Corporation is certainly no exception. One of the ways in which this structural power was manifested was in the control and integration that the Toshiba Corporation had over the manner or mode of the production of its goods. Thus, Toshiba Corporation was able to control what it would produce, in what quantity, where production would be situated, and with whom it would enter into arrangements, which awarded them great power, especially in the United States. Another significant element of Toshiba's structural power was its ability to withhold valuable knowledge, and technology. That is, structural power can be exercised by those who possess knowledge and who can wholly or partially limit, or decide, the terms of access to it.¹⁰⁴ These elements of structural power, control over production and knowledge, gave the Toshiba Corporation important status in the eyes of the Reagan administration, state political officials, and with other American corporations with which it had business alliances.

As was illustrated in the case study, the Toshiba Corporation was as an important entity in the U.S. economy and in its security structures. It had a number of plants situated in the United States, numerous contractual and supplier arrangements with a myriad of American firms, and played an important role in providing technological goods for the upkeep of American, and Western, defence. Therefore, comprehensive sanctions

¹⁰³ Ibid, p. 63.

¹⁰⁴ Ibid, p. 28.

against the Toshiba Corporation would have had adverse economic and security impacts. As was addressed previously, if the ban were to have been imposed in the form of the original Senate endorsement, N. Ishizaka, the new president of Toshiba Corporation, stated that Toshiba would have to evaluate whether to continue its U.S. manufacturing operations if other Toshiba business in the United States was forced to an end. Clearly, this 'pull-out' of American operations would have had a negative impact on the Toshiba Corporation, but would also have had adverse repercussions for the United States as well.

Because of the potential economic and security impact that such sanctions would have had on American industry, employment, and security, this prompted many in the United States to publicly oppose and fight the ban, on behalf of themselves, and consequently benefitting Toshiba. The 'teeth' were taken out of the sanctions because of their efforts in making American lawmakers aware of the destructive consequences of such measures. Toshiba Corporation had grassroots support all across the U.S. from American corporations that either bought from Toshiba or supplied components to its production facilities in the United States. These corporations were also backed up by extensive lobbying campaigns of their related trade associations. In addition, two state governors were also pressuring their respective Congressmen to oppose the sanctions. At the same time, the Reagan administration was also working to take the 'sting' out of the sanctions. In the end, the sanctions were reduced to a level that would not have a vexatious effect on Toshiba, for as Representative Don Bonker (D-Washington)

illuminated: "We [wanted] to punish the violators, but not the U.S. high-tech firms who had no involvement in this at all."¹⁰⁵ Therefore, because of the role that Toshiba played in the economic welfare and competitiveness of the United States, and because of the role that it could play in the development of defence technology, it appears that the cold realities of interdependence ruled out 'tough' action, and this was reflected in the lessened sanctions.

As well, the structural aspect can also be associated with the normative dimensions of society, such as the role of ideology. The tenacity of normative structures can be illustrated how, in modern economies, consistently higher priority is given to economic growth and competitiveness relative to other goals.¹⁰⁶ In such, the Toshiba incident illustrates that, even in issues of high politics, such as security, economic interests prove to be an important compellent for decisions and actions, or inactions. Thus, the lobbying efforts in the U.S. because of the sanctions helped shift the focus of the emotional debate in Congress from national security to economic issues. In the end, U.S. economic interests overrode the desire to penalize a major security lapse, as well as the interest of maintaining good relations with allies, especially during defence and

¹⁰⁵ Quote by Representative Don Bunker (Democrat-Washington), who was the chairman of the International Economic Policy and Trade Subcommittee of the Foreign Affairs panel of the House-Senate Conferences on the Omnibus Trade Bill. See John Cranford, in *Congressional Quarterly: Weekly Report*, 14 November 1987, p. 2813.

¹⁰⁶ Stephen Gill, "Global Hegemony and the Structural Power of Capital," in Gill, ed. *Gramsci, Historical Materialism, and International Relations* (Cambridge: Cambridge University Press, 1993), p. 100.

technological projects, and research and development.¹⁰⁷ As well, this normative aspect can also be illustrated by the shift in the goals of states towards economic liberalization and trade integration, for most of the world's governments are convinced that this is the surest path to growth and increased competitiveness. Consequently, this ideological shift has brought many states together in trade arrangements and other collective, or joint, arrangements. This was most certainly the case in the U.S.-Japan relationship. These arrangements reinforce the emphasis that collegial relationships between states are necessary in order for these arrangements to be beneficial to both. Thus, this was also another compelling reason for the United States to become an ally in the opposition of the sanctions, for these would have aggravated an important relationship with Toshiba's home country, Japan, an important trade and security partner.

Clearly these factors of structural power shaped the actions, and inactions, of American government officials and business representatives to be compatible to Toshiba's goal - that of minimizing the sanctions imposed. This structural power allowed Toshiba to meet its targets indirectly. However, structural power alone is not adequate to explain the successful outcome. Domestic structures, too, played an important role as determinants of outcome, and had it not have been for functional and diffused linkages, the outcome may have been very different.

As expressed earlier, domestic structures encompass the organizational apparatus

¹⁰⁷ McLaughlin, in *National Review*, 14 August 1987, p. 24.

of the political and societal institutions, their routines, the decision making rules and procedures, and other domestic actors, such as business entities.¹⁰⁸ Competitive pressures encourage multinational corporations to alter their behaviour or organize themselves in ways that allow them access to a state, to interact effectively with and within states, and with others within states. Thus, how they organize themselves within a state will differ depending on the state, as sources of 'influence' vary. In the case of Toshiba, its 'linkages' with some very influential actors within the United States gave them added power in determining the outcome to its preference.

Functional linkages are connections or associations with other competitive, complimentary, or cooperative entities within the state, such as domestic firms, financial institutions, suppliers, and the like.¹⁰⁹ Building relationships with other domestic actors, or organizations, further integrates the multinational corporation into the state and creates 'interdependencies'. These interdependencies could prove to be vital to the operation and survival of the multinational corporation in that state. This was most certainly the case with the Toshiba Corporation, as without the lobbying efforts and support of the large number of politically influential American firms and their trade associations, Toshiba may have faced detrimental sanctions. Because of the importance of economic interests, and the influence that these economic entities had in the American

¹⁰⁸ Thomas Risse-Kappen, "Bringing Transnational Relations Back In: Introduction," in Risse-Kappen, ed. *Bringing Transnational Relations Back In: Non-state Actors, Domestic Structures, and International Institutions* (Cambridge: Cambridge University Press, 1995), p. 20.

¹⁰⁹ A.H. Meleka, "The Changing Role of Multinational Corporations," in *Management International Review*, Vol. 25 No. 4 (1988), p. 42.

political process, the sanctions were minimized, in favour of the American businesses that would have been affected because of their alliance and, consequently, in favour of Toshiba. Thus, the ability to form alliances, or 'coalitions', with other important domestic actors, which then, in turn, creates mutual dependencies, gave Toshiba the much-needed support and leverage to influence the outcome.

In addition to functional linkages, the Toshiba incident is an excellent example of the importance of diffused linkages. Diffused linkages are those linkages that are not associated with any 'formal' organization, but that are strengthened by the integration into the state's political and professional milieu, by virtue of forging and fortifying relationships with political factions and intellectual elites.¹¹⁰ Usually the promise of money, in terms of financing research or political campaigns, is a useful tool in building these relationships. In fact, many relationships that are built by Japanese corporations come in this form¹¹¹, and give them status, not only politically, but also as being beneficial to society. However, in the case of Toshiba, this strengthened relationship with certain state governments came in the form of the promise of foreign investment, or the cancellation of investment. Hence, Toshiba's status as an important foreign investor,

¹¹⁰ Meleka, p. 43.

¹¹¹ Japanese corporate philanthropy in the United States is an important method for Japanese corporations to infiltrate the institutions of the American state and to gain powerful friends so as to have influence in policy decisions. Much financial support, in the past and present, has gone into funding research in universities, and other activities by museums, think tanks, and public television stations. Perhaps what has been the most controversial in the United States is the amount of financial support that comes from foreign firms for election campaigns. Although the current wave of discontent is aimed at China for the recent Clinton presidential campaign, in the late 1980s this anger over foreign campaign financing was directed at the Japanese. See Thomas Omestad, "Selling off America," in Jeffrey Frieden and David Lake, eds. *International Political Economy: Perspectives on Global Power and Wealth* (New York: S. Martin's Press, 1995), pp. 196-198.

one that would create jobs and stimulate the regional, or state, economy earned them allies such as Ned McWherter and Robert Orr, who strongly promoted the anti-sanction stance to their respective Congressmen.

Obviously, Toshiba Corporation was well-entrenched into some very important domestic structures in the United States. These alliances certainly provided it with much needed allies and support in a time of dire need. The lobbying and publicity efforts of these groups and individuals were certainly effective, as they made American lawmakers aware of the intricate and interdependent relationship that existed between them and Toshiba. Thus, harm that was done unto Toshiba would also be harm done unto themselves. It can be safely concluded that these 'linkages' were vital to the minimization of the proposed sanctions. However, in addition to structural power and domestic structures as important determinants of the outcome, the lobbying efforts of Toshiba Corporation cannot be dismissed as insignificant.

To protect and enhance the value of their investments, many foreign firms engage in lobbying activities. It has been estimated that Japanese companies are the most active foreign firms engaged in lobbying in the United States. According to 1987 figures, Japanese corporate interests had more registered representatives in the United States than any other nation.¹¹² Lobbyists and lawyers representing Japanese interests are

¹¹² In 1987, Japanese firms accounted for 112 registered representatives in the United States. The total had risen by 23% from the previous two years. See Gordon Witkin, "Samurais for hire," in *U.S. News and World Report*, 5 October 1987, p. 50.

frequent visitors to Capitol Hill, federal agencies, state legislatures and city halls. It has been estimated that Japanese companies spend between 50 and 60 million dollars a year hiring these lawyers, public relations consultants and other lobbyists to promote their image in the United States.¹¹³ However, their style is inobtrusive, and is very much in line with the networking and buying of access that is also very important in Japanese politics.¹¹⁴ The emphasis is on obtaining the best hearing with legislators and high-level bureaucrats, providing to them the most up-to-date information, and gathering the most useful intelligence.¹¹⁵ As has been illustrated, the Toshiba Corporation was certainly no exception to this, and whole-heartedly engaged in a full-blown lobbying campaign to stop the imposition of sanctions.

When it became clear in 1987 that one of its subsidiaries, Toshiba Machine Company, had sold sensitive technology to the Soviet Union, the Toshiba Corporation confronted a possible comprehensive economic boycott in Congress. The Toshiba Corporation waged a sophisticated public relations campaign that succeeded in undercutting the political forces in Congress that favoured the embargo. Certainly big-money lobbying helped, and the sheer scale of the effort was impressive. Moving rapidly to stave off sanctions from an angry Congress, the Toshiba Corporation staged a savvy

¹¹³ "Toshiba: Playing tat for tat," in *The Economist*, 25 July 1987, p. 61.

¹¹⁴ Peter J. Katzenstein and Yutaka Tsujinaka, "'Bullying,' 'buying,' and 'binding': U.S. Japanese transnational relations and domestic structures," in Thomas Risse-Kappen, ed. *Bringing Transnational Relations Back In: Non-State Actors, Domestic Structures, and International Institutions* (Cambridge: Cambridge University Press, 1995), pp. 97-99.

¹¹⁵ Witkin, p. 50.

damage control effort, replete with letters, lawyers, lobbyists, media advisors, and the like. As was stated previously, the very first leg of the campaign included efforts to make public the regrets of the Toshiba Corporation, its innocence, and the measures it was taking to get to the heart of the matter. Copies of this letter were given to every Congressman. As well, Toshiba published an open letter of apology to the American public, published in over 50 major American newspapers and magazines. Then, to provide proof of its innocence, Toshiba commissioned Price Waterhouse and a well-known American law firm to investigate and report on the incident. And lastly, Toshiba hired several well-connected lobbyists/lawyers, including former political heavyweights Leonard Garment and James R. Jones, to plead their case to Congress. Hence, it appears that Toshiba certainly went all-out in its efforts to restore its credibility, assuage Congressional anger, and to prevent the comprehensive embargo. And according to accounts of many journalists, Congressional aides, and academics, it seemed that their skillful lobbying certainly played an important role in defusing the unmitigated disaster that it faced when the incident was disclosed.¹¹⁶

Although sanctions were not entirely discarded, the proposed sanctions were certainly softened. In fact, they were softened so much that the sanctions, at worst, would barely make a dent in Toshiba Corporation's annual U.S. sales of 2.8 billion

¹¹⁶ See John Cranford and David Rapp, "Trade Conferees inch ahead while avoiding major issues," in *Congressional Quarterly: Weekly Report*, Vol 45 No 45, 7 November 1987, p. 2742; Katzenstein and Tsujinaka, pp. 83, 103; Witkin, p. 50; and Dryden, p. 58, which all concur that part of the success of the minimized sanction must be credited to the lobbying campaign waged by Toshiba.

dollars. Toshiba's direct lobbying, although it was an important facet in lessening the sanctions, would not have been as effective had there not have been the elements of structural power, such as production and knowledge, the normative aspects associated with these, and domestic structures to reinforce it. In fact, it had been stated that the softening of Congressional attitudes towards Toshiba had less to do with visits and apologies by Japanese officials and Toshiba executives, but more to do with the visits, telegrams, phone calls, etc. from American companies that told Congress how much they would be harmed by such a ban.¹¹⁷ Therefore, it can be concluded that structural power, in the sense that Toshiba exerted influence indirectly by creating political leverage through investing in American plants, forming alliances or arrangements with American firms, and through the high-technological nature of its operations and sales, was certainly a key element in altering the range of choices and actions for American businesses, the Reagan administration, and Congress towards the sanctions. However, the alliances, or interdependencies, that Toshiba had made itself a part of in the United States were also significant determinants in the successful outcome. Thus, Toshiba's ensconcement in the domestic structures of the United States enabled it to exercise influence, although indirectly and passively.

In conclusion, the details of the Toshiba incident and the preceding analysis suggest that approaches that examine the relationship between multinational corporations and the state based upon assessments of 'resource' power leave much to be

¹¹⁷ Rasky, in *New York Times*, 20 July 1987.

desired. For in this instance, because the United States held, by far, the most 'power' resources in comparison to Toshiba, this would then suggest that the comprehensive sanctions would have been easily imposed. Although the U.S. certainly had the 'raw' power to do so, it was hindered in applying its power by the realities of such an action. That is, such an action would have harmed its own interests, especially domestic economic interests. Thus, although this approach may have its merits, as an effective explanatory tool of the outcome of MNC-state conflicts, it falters.

As well, analyses that emphasize the 'issue' at hand as being the most important determinant are also too simplistic. Again, if used in the incident at hand, it would assume that, because security issues were of high importance in politics, the results would be more in favour of penalizing offenders that breached this security. The U.S. used this incident as a tool for tightening COCOM regulations and, thus, this would appear to be consistent with the usage of strategic issues as a basis of analysis. However, this can be challenged for, clearly, in the end, outrage over security was overwhelmed by economic concerns. Using the importance of the issue as a basis of analysis, one would have expected Toshiba to have been severely punished. However, Toshiba Corporation was not severely penalized and this suggests that this basis of analysis is clearly overwhelmed by other factors with more explanatory power, such as structural power and domestic structures.

In conclusion, this chapter confirms that more than an analysis of issue-areas and direct power is needed to provide an explanation of the determinants of the outcome of conflicts between states and multinational corporations. Ergo, as in the case of the Bhopal tragedy, the Toshiba incident illuminates that structural power and domestic structures must be considered in ensuing analyses. This, again, shall be depicted in the subsequent chapter, which examines the impact of pharmaceutical multinational corporations in Canadian patent protection measures. In sum, structural power and domestic structures can be effective predictors and provide potent explanations as to the outcome of these conflicts.

Appendix 1

TOSHIBA CORPORATION EXTENDS ITS DEEPEST REGRETS TO THE AMERICAN PEOPLE

Toshiba Corporation shares the shock and anger of the American people, the Administration and Congress at the recent conduct of one of our 50 major subsidiaries, Toshiba Machine Company. We are equally concerned about the serious impact of TMC's diversion on the security of the United States, Japan and other countries of the Free World.

Toshiba Corporation had no knowledge of this unauthorized action by TMC. And the United States and Japanese Governments have not claimed that Toshiba Corporation itself had any knowledge or investment.

Nevertheless, Toshiba Corporation, as a majority shareholder of TMC, profoundly apologizes for these past actions by a subsidiary of Toshiba.

-As a measure of *personal* recognition of the grievous nature of TMC's action, both the Chairman and the President of Toshiba Corporation have resigned. *For the Japanese business world, this is the highest form of apology.*

-In TMC, the subsidiary where the diversion occurred, wrongdoers are now being prosecuted.

For the future, Toshiba Corporation takes full responsibility to insure that never again will such activity take place within the Toshiba Group of companies.

-We are working with the Governments of the United States and Japan in this endeavour.

The relationship of Toshiba Corporation, its subsidiaries and their American employees with the American people, one marked by mutual trust and cooperation, has developed over many years of doing business together. We pledge to do whatever it takes to repair, preserve, and enhance this relationship.

Toshiba Corporation already has begun to take corrective measures throughout its hundreds of subsidiaries and affiliate companies.

-We immediately directed all our companies to institute stringent measures guarding more securely against this kind of misconduct.

-We obtained the resignation of the President of TMC and the three other Board members who had corporate responsibility for the conduct of those TMC employees actually involved.

-We also obtained TMC's commitment to stop exports to the Soviet Bloc countries for an unlimited time.

-We have authorized an extensive investigation to find all the facts concerning TMC's actions and to design safeguards to prevent repetition of such conduct. This investigation is being directed by American counsel, assisted by a major independent accounting firm.

-We will discharge all officers and employees found to have knowingly participated in this wrongful export sale.

-We have appointed the former senior auditing official of Toshiba Corporation to TMC's Board with direct responsibility for Toshiba's policy of full observance of the law and of Japan's security arrangements with its allies.

-We are going to develop a rigid compliance program in cooperation with the Governments of Japan and the United States.

-We intend to establish Toshiba's new compliance program as a model for all future export controls throughout the Japanese industry.

In its 22 years of doing business with the United States, Toshiba Corporation has been a leader in introducing American products to the Japanese market, and also has significantly shifted the balance of manufacture of Toshiba products to the United States. At a time when many of the US-based corporations competing with Toshiba are moving production facilities and jobs abroad, Toshiba's American companies are steadily expanding the extent to which their products are manufactured in the United States. Today, Toshiba employs thousands of Americans in 21 states from New York to Texas to California. It is these Americans who have played a large and crucial part in earning Toshiba its reputation for producing top quality products, reliable service, and ongoing innovation that millions of American consumers and industrial customers know they can trust.

These bonds of cooperation are signs of our commitment to America. We earnestly wish to continue our efforts to develop our relationship with America.

We ask our American friends to work with us and help us to do so.

**Joichi Aoi, President/CEO
Toshiba Corporation**

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**The Demise of Compulsory Licensing:
Multinational Pharmaceutical Companies in Canada**

*Multinational investment is good for Canada. It is needed in Canada.
But it is the kind of investment that has to be done in the way Canada determines
not to be decided by the multinationals by twisting the arm of this government.
It is in this context that the multinationals have appeared to be successful
in telling government what to do.*

*Jack Harris (MP- St. John's East)
From a speech to the House of Commons,
Canada, 24 August 1987*

p. 183

Introduction

Pharmaceutical multinational corporations have been a particularly powerful force in the global political economy in recent decades. The industry is one that is considered to be non-polluting, recession-proof, knowledge-intensive, and ripe with high-paying, high-tech jobs. Not surprisingly, these factors are important to states, which are competing against each other economically in the global economy. Pharmaceutical corporations, understandably, are ranked by states as important 'engines', or tools, for their growth, and this awards them much influence with states and within states. This was certainly the case in Canada, where pharmaceutical multinationals were able to successfully achieve their desired outcome - full patent protection rights and the consequent demise of the system of compulsory licensing.

The debates in Canada over the issue of compulsory licensing were some of the fiercest ever witnessed in Canada's history - not to mention one of the most aggressive lobbying spectacles ever seen. In the end, the brand-name pharmaceutical multinationals, at the expense of the Canadian consumer and generic drug industry, emerged victorious. Compulsory licensing had been effectively eradicated, and full patent protection for their innovations, prescription drugs, became Canadian law. Through an examination of the events leading to the changes in legislation, it will become evident that the issue area was

important, however, not in the sense that pharmaceuticals are a 'high' issue in political considerations, as are military and territorial security matters. But rather, it is valuable to approach the issue as a further assessment of the role of structural power and domestic structures in enabling these pharmaceutical multinationals to successfully shape the outcome of the debates, and ultimately the final decision. In addition, Canada's role, or perceived strength, in the international system will also be examined as a possible explanation of the outcome. But it will be illustrated that this factor had a truly minimal effect. Rather, it will be illuminated that structural power and domestic structures were much more compelling reasons for the multinationals' successful outcome. As well, in this instance, the exercise of direct power, both domestically and internationally, will be illustrated as having a great impact on the outcome in favour of the pharmaceutical multinationals. These assertions will be examined more in detail later, but in order to analyse these, the events that occurred in Canada over the system of compulsory licensing of pharmaceutical products must be examined.

The Global Pharmaceutical Industry and Intellectual Property Protection

The pharmaceutical industry is an excellent example of a knowledge-intensive, vertically- integrated international oligopoly. There are four stages in the industry: the research and development stage (which includes basic and applied research, and clinical testing), the production of fine chemicals, preparation and packaging into dosage form,

and marketing and sales.¹ The research stage is usually carried out near the parent's headquarters, where products are developed for sale on the world market. Clinical testing is usually done in the final sales market, unless the country accepts clinical results from elsewhere. The production of fine chemicals is characterized by substantial economies of scale such that one or two plants can satisfy the global demand for a particular active ingredient. It is the most capital-intensive stage, located usually in the home country and in one or two others, depending on costs and available materials. The preparation (blending the fine chemicals with other ingredients and production in dosage form) and packaging stage is footloose, since it has few economies of scale. Preparation/packaging is usually done in the least-cost location or in the domestic market, depending on the content policy of the local government. Marketing and sales are domestic functions which are located near the final consumers. Thus, of the four stages, all but the last can be imported. In most host countries, at least the research and chemical stages are imported.²

The pharmaceutical industry is essentially dominated by a relatively small number of giant firms. These major drug multinationals are, for the most part, headquartered in six countries: the United States, Germany, Switzerland, Britain, France, and, to a lesser extent, Japan. The pharmaceutical industry is one of the most wealthy and profitable of

¹ From Harry C. Eastman (Commissioner), *The Report of the Commission of Inquiry on the Pharmaceutical Industry* (Ottawa: Supply and Services Canada, 1985), cited in Eden, p. 247.

² Eden, p. 247.

industries. According to the World Investment Report 1996, compiled by the United Nations Conference on Trade and Development, ten multinational pharmaceutical corporations are in the top-100 of transnational corporations in terms of foreign assets.³ As well, in terms of size of annual product, pharmaceutical multinationals are also well-positioned.⁴ Although the combined global share of the top 10 drug companies fell slightly in 1988 (28.5%) from 1983 (32%), the industry is still considered to be a bonafide money-maker, as this percentage is considered high compared to other industries. In addition, the payoffs from research and development are great. A successful drug, on average, returns a profit of \$0.45 on every \$1 sold, and in some cases this can exceed \$0.60.⁵ The industry is also virtually recession-proof. That is, prescription drugs will always be needed and may, in fact, be more in demand when one considers the aging population in the industrialized world. The combination of all of these facets of the industry, in addition to the importance of knowledge-based industries in today's economy, makes it understandable that many nations compete to have these pharmaceutical multinationals become an integral part of their domestic economies. This, in itself, inadvertently awards these multinationals a great deal of power. However, in order for nations to compete for investment by these pharmaceutical 'engines-of-

³ United Nations Conference on Trade and Development, *World Investment Report 1996: Investment, Trade, and International Policy Arrangements* (New York; Geneva: United Nations, 1996), pp. 30-32.

⁴ In a ranking of countries and corporations by annual product, five pharmaceutical/chemical multinationals were in the top-100. Source: *The Economist*, Vol. 22, 1992, p. 53. Cited in Charles W. Kegley, Jr. and Eugene Wittkopf, *World Politics: Trend and Transformation, 5th ed.* (New York: St. Martin's Press, 1995), pp. 180-1.

⁵ See Lawrence Surtees, "Market Share Medication," in *Globe and Mail*, 14 August 1990.

growth', one very important prerequisite is demanded: patent protection.

Patents are government-granted monopolies on inventions. That is, patents create a temporary period of exclusivity, or monopoly, on the sale of a new product. Patent protection is crucial in many R & D intensive industries, and in particular the pharmaceutical industry. Since in pharmaceuticals the costs of R&D are so enormous and it is so simple and cheap to make the product once discovered, it is precisely in this industry where the patent is so valuable and necessary. The development of a new drug now requires the concerted effort of a small army of chemists, biochemists, toxicologists, pharmacologists, and clinical scientists over a ten to twelve year period. It must survive a rigorous series of tests and regulatory hurdles. Only 1 in 2000 to 10000 compounds researched makes it to the marketplace, and each chemical entity that is commercialized costs some 230 million dollars. The cost of manufacturing the drug is usually trivial compared to the cost of discovering and developing it. However, even after the drug's approval and manufacture, there are no guarantees that the drug will survive in the market. In fact, very few of the new compounds become serious revenue producers.⁶ As well, R&D costs continue to escalate, which adds even more pressure, for a corporation essentially needs a 'blockbuster' drug to remain solvent. Without the guaranteed period of exclusivity to begin to recoup the costs, the risks are too great for anyone to even

⁶ Refer to Dr. Louis Lasagna, Centre for Drug Development, Sackler Medical Centre, Tufts University. Cited in Michael Hodin, "Canada's protectionist drain on technological progress," in *American Review of Canadian Studies*, Summer/Autumn 1991, p. 217; Kenneth Sheets and Robert Black, "For Health and for Wealth," in *U.S. News and World Report*, 6 June 1988, p. 41; and John Edward, "Drug Bill Can Reduce Health Care Costs," in *Globe and Mail*, 23 December 1992.

rationality contemplate. Thus, given the risks and financial expense involved in innovation, it comes as no surprise that the industry is vigorous in defence of its profits and aggressive in its pursuit of adequate patent protection for its innovations.

As stated, patents grant the inventor a temporary period of exclusivity. This enables the inventors to recoup the expense of the initial research and development, and secure their economic position. Thus, the primary goal of the patent system is to create the incentive necessary for further invention and investment. In such, patents create a strong incentive for the growth of new technology. As well, another potential benefit of patents is that they will also contribute to the increased stock of knowledge of the society by encouraging the inventor to disclose his secrets, or transfer technology, knowing that a period of exclusivity will be upheld. In sum, by guaranteeing exclusive rights to the inventor for the use of his inventions, and by providing the protection against the imitation of these, patents will not only induce inventive activity, but will also increase the stock of knowledge of the society and increase private sector investment by guaranteeing monopoly returns to the inventive activity.⁷

However, in addition to its perceived benefits, granting patent protection also has its costs. For instance, a monopoly over an invention typically leads to higher prices and

⁷ See Arman Kirim, "Reconsidering Patents and Economic Development: A Case Study of the Turkish Pharmaceutical Industry," in *World Development*, February 1985, p. 220.

limits the use of the patented technology. As well, patents could hinder competition.⁸ For example, strategic uses of patents, such as ‘sleeping’ patents or ‘defensive’ patents, could discourage others from innovating and competing. Particularly in developing countries, patents can be, and have been, instrumental in blocking the development of domestic R&D as well as the development of local enterprises. By raising the barriers of entry into the important therapeutics markets, patent holders may, consequently, be enabled to charge anti-competitive prices. The gap between the price and production cost is seen as necessary in order to recoup the costs of R&D, but critics argue that the prices charged can be excessive, especially when one considers that the costs of promotion far outweigh the R&D costs. Ergo, it is questionable whether patents are primarily used as a basis for further R&D, or to recoup the costs of marketing and promoting the drug.

It has also been argued that, with regards to the transfer of knowledge to society, this does not occur in the manner that is expected. That is, much of the pharmaceutical firm’s highly-sensitive R&D takes place in the home country. In other countries, clinical trials and production of the compound may be performed, but these are not technically sophisticated operations for most drug products. Thus, some technology transfer does occur, but it is not necessarily the same technology transfer that is anticipated by governments.

⁸ Ibid, pp. 220-221.

Lastly, the necessity of patents for all 'new' drugs is also questionable. Many 'new' drugs are not really 'new', nor do they offer substantial therapeutic benefits. According to U.S. statistics, of the 'new' patented drugs, 10% offer substantial therapeutic gains, 22% offer modest therapeutic gains, and 68% have little or no therapeutic advantages over existing remedies.⁹ The statistics are remarkably similar for those patented in Canada. Again, the majority of drugs approved for patent fall under the latter two categories, with only 5%, or three drugs a year, considered to be 'breakthrough' or of substantial therapeutic value.¹⁰ The last two categories are also the most profitable for a pharmaceutical firm, as these do not require the initial intensive capital outlay and research and development as in development of a truly innovative drug. The last category is referred to as 'line developments', or 'line extensions', and includes such changes as the colour, shape, and size of the original drug, which makes it relatively inexpensive and simple to reformulate for a 'new' drug. Ergo, it is questionable whether patents for the vast majority of the 'new' drugs produced are truly necessary.

Clearly, patent protection is an absolute requirement from the perspective of the pharmaceutical industry. As stated, the development and marketing of a new drug is expensive and there is a great risk of failure in its development. Hence, a period of

⁹ Eastman, p. 159.

¹⁰ Dr. Joel Lexchin, University of Toronto, from a paper presented at symposium, "Controlling Drug Costs," in Montreal, 16-17 August, 1996.

temporary exclusivity provides the inventor the opportunity to recoup the costs, turn a profit, and, it is hoped, provide incentive to reinvest in further innovation.

Understandably, pharmaceutical corporations are more likely to invest in a country that has patent protection laws. That is, the existence of a system of patent protection is an important element and indicator of the protection of private property in the country in question, which in turn leads to an improvement in investment climate, encourages direct investment, and consequently introduces the patented technology necessary for the economic development and competitiveness of the particular country.¹¹ Not surprisingly, with economic competitiveness as a primary goal, states began to awaken to the importance of patent protection.

Canada: The System of Compulsory Licensing

Although compulsory licensing had existed in Canada since 1923, prior to 1969, it was not viable for Canadian generic drug manufacturers to become licensees to the brand-name products. During that time, Canada awarded a 17-year patent life on drug products by process. The small Canadian market, coupled with the restriction that licensees must manufacture the drug (this rule encompassed the fine chemical stage), meant that licenses were unprofitable and few existed.¹² By the mid-1960s, it was uncovered by several studies that brand-name manufacturers were charging far higher

¹¹ Kirim, p. 220.

¹² Eden, p. 248.

prices in Canada than abroad.¹³ The public perception that sickly consumers were being gouged by multinational companies galvanized the Liberal government of Pierre Trudeau, which came to the aid of the then-tiny generic industry by introducing legislation that provided them with more incentives to copy brand-name drugs. This legislation, C-102, amended the Patent Act in 1969.

The original developers of the drug were required to license generic firms as soon as their own new product hit the market. The Act was amended to allow licensees to import and/or manufacture the patented drug upon demonstration of equivalency and payment of a 4% royalty to the patentee. Effectively, section 41(4) reduced patent life to six to seven years, since a generic copy needed about five years to meet clinical test requirements and another two years to gear up production.¹⁴ As a result, in some prescription classes multiple sources existed for drugs. This created competition between brand-name and generic drugs, and consequently lower prices for Canadian consumers.

Aside from lower drug costs, another result of these changes was the growth of the generic industry in Canada. By the mid-1980s, there were about 130 firms in the drug industry. Of these, the vast majority were still foreign-owned companies (100),

¹³ The 1965 Hall Commission concluded that Canadian drug prices in the 1960s were among the world's highest. See Eden, p. 248; and Rob McKenzie, "A Hard Pill to Swallow," in *Canadian Business*, February 1994, p. 46.

¹⁴ Eden, p. 249.

mainly U.S.-based, but 30 generic firms had joined the ranks as well as a handful of genetic/organic manufacturers. The generic firms appeared to be doing quite well. At that time, the segment was dominated by four firms, Apotex and Novopharm, Canadian-owned and located in the Toronto area, and Horner and ICN, U.S. owned and located in Montreal. These firms held 47% of all licenses and 79% of all working licenses. They represented about 8.5% of the total market.¹⁵ In comparison to the foreign-owned patent-holding firms, these figures certainly seem insignificant, but when one considers that the generic industry did not really exist prior to 1969, these were significant gains.

Although the Canadian market was relatively small and that compulsory licensing decreased their period of market exclusivity, the patent pharmaceutical companies were doing well. Canadian sales represented about 2%, or 1.3 billion dollars, of the global drug industry and the corporations were almost wholly located around Montreal and Toronto. Similar to other host countries, minimal R&D work by these foreign-owned research-based pharmaceutical companies was done in Canada,¹⁶ whereas the majority of pharmaceutical employment was in the marketing and sales portion of the industry, with 33-34% of employees. Most fine chemicals were still imported and the preparation/packaging stage was evenly distributed between imports and domestic production.

¹⁵ Eden, pp. 249-250.

¹⁶ In the mid-1980s, 3-5% of employees were involved in R&D, with R&D expenditures broken down as such: 15% basic, 25% applied research, and 60% clinical testing. Data originally taken from Eastman (1985), P.K. Gorecki, *Compulsory Patent Licensing of Drugs in Canada: Have the Full Price Benefits been Realized?* (Ottawa: Supply and Services Canada, 1986). Cited in Eden, pp. 249-250.

Hence, for years the system that was put in place in 1969 appeared to work quite well. Led by Apotex and Novopharm, generic companies grew as they seized the opportunity to manufacture pharmaceuticals by importing the ingredients and paying a 4% royalty to the patent-holder. Compulsory licensing was also a boon to consumers. Drug prices fell, and this saved \$211 million in 1983 alone.¹⁷ The major drug multinationals, mostly U.S.-based, also reaped rewards. During the 1985-1987 period, their pretax rates of return on equity hovered above 40%, the highest figure among the 87 manufacturing industries surveyed by Statistics Canada, and about triple the average.¹⁸ However, all was not well, and the system of compulsory licensing, unique to Canada, soon came under siege.

Compulsory Licensing Under Siege: The First Battle

Seldom have Canadians seen such acrimonious debate as in the controversy over compulsory licensing of pharmaceuticals, which resulted in the passage of Bill C-22 in December of 1987. C-22, the bill of amendments to the Patent Act affecting prescription drugs, slowed down government business and created a political storm in Canada for more than a year. Under the terms of the new act, producers of brand-name drugs would have patent protection for new drugs for seven or ten years from the time the drug was patented. The time before compulsory licenses could be issued to generics

¹⁷ Eastman (1985), in Eden, p. 250; and McKenzie, p. 46.

¹⁸ McKenzie, p. 46.

would be determined on the basis of whether indigenous or imported chemicals would be used in the manufacture of the substitute. A compulsory license would be granted to a generic firm after seven years if the chemical was manufactured in Canada, and 10 years if the chemical was imported. Given that most generic substitutes were made from imported chemicals, this provision increased patent protection for the brand-name pharmaceutical companies and, thus, was considered a setback to the Canadian generic industry, and consequently to the cost of prescription drugs in Canada.

As a result of C-22, the uniquely-Canadian system of compulsory licensing was weakened. However, given the growth of the Canadian generic industry and the decrease of drug costs under the prior system, one must question the motives of the Canadian government's decision to take the first step in dismantling the system. Through an examination of the altercations over the change in legislation, it will be discernible that multinational pharmaceutical companies had an integral role in the outcome of the debate, and successfully achieved the first step in undoing a system which was anathema to their goals.

The rates of return on equity for the multinational drug companies indicated the salubrity of the industry under C-102. In addition, a commission that was headed by Harry Eastman to study the pharmaceutical industry in Canada confirmed their viability. The Commission's report argued that licensing had very few harmful effects on the foreign-owned pharmaceutical multinationals. In addition, compulsory licensing had

created an active, mainly Canadian, generic component and had lowered drug costs substantially.¹⁹ However, there were also other studies that argued against compulsory licensing, and the multinational pharmaceutical companies certainly parlayed their distaste for the system, one which legally allowed for the transfer of their hard-earned profits to the 'pirates' who copied and capitalized on their innovations. Two camps had formed and the battle was set into motion.

As stated, opinions about compulsory licensing in Canada conflicted sharply. On the one hand, the Eastman Commission had concluded that compulsory licensing was a positive piece of legislation. In agreement was the Canadian Drug Manufacturers Association (CDMA), the group comprised of Canadian generic companies, which lobbied for the retention of compulsory licensing. As well, the provinces were suspicious of the drug multinationals and of the bill that was proposed.²⁰ Because of the increased cost-consciousness in health care policies and because prescription drugs accounted for about 3% of their health care costs, the provincial governments were naturally concerned about the perceived increased costs associated with the amendments proposed to the Patent Act. On the other hand, other findings illustrated that the system was detrimental. A study by Myron Gordon and David Fowler, from the Canadian Institute for Economic Policy, concluded that compulsory licensing had caused the pharmaceutical

¹⁹ Conclusions of *The Report of the Commission of Inquiry on the Pharmaceutical Industry* (1985), Harry C. Eastman (Commissioner), cited in Eden, p. 250.

²⁰ Although this will be discussed more in detail later, it should be noted that many in Quebec, and especially the Chambers of Commerce and municipal government of Montreal, were supportive of the bill, largely because many pharmaceutical multinationals were located there.

multinationals to shift production and R&D work outside of Canada and to over-invoice imports, thereby shifting out excessive funds to decrease taxation ('transfer-pricing'). Although a developing generic industry had succeeded in reducing the price of drugs, Gordon and Fowler also noted that the vast majority of drugs were not licensed and those prices had risen, leaving overall prices basically unchanged.²¹ Thus, with regards to the issue of patent protection, a definite schism developed. However, it would be the pharmaceutical multinationals which would be most effective in persuading the government.

The Brand-name Multinationals

Pharmaceutical multinationals held the view that the Canadian system of compulsory licensing was unacceptable. Through its industry group, the Pharmaceutical Manufacturers Association of Canada (PMAC), their views were vociferously communicated. PMAC, at that time, was comprised of 64 multinationals, and strenuously lobbied for a return to the pre-1969 policy. Compulsory licensing was viewed as a dangerous precedent that other countries, especially developing countries, might be tempted to follow.²² PMAC also argued that, as long as compulsory licensing was in place, R&D in Canada would decline, as there was no incentive to incur the risk and expense involved in innovation. As well, it placed the blame on compulsory

²¹ Myron Gordon and David J. Fowler, *The Drug Industry: A Case Study of the Effects of Foreign Control on the Canadian Economy* (Toronto: Canadian Institute for Economic Policy, 1981), cited in Eden, p. 250.

²² Eden, p. 250.

licensing for the closure of the Ayerst and Hoffman-LaRoche plants in the early 1980s and went even further by suggesting that generic drugs were not as safe as the brand-name ones.²³

PMAC's lobbying was intense. In fact, according to Judy Erola, the then-Minister of Consumer and Corporate Affairs, the lobbying was perhaps the strongest she had ever seen.²⁴ As part of its campaign, PMAC took the opportunity to lobby intensely the Government of Canada, Members of Parliament, officials of the relevant departments, and Ministers. It spent large amounts of money²⁵ on lobby firms and print and television advertisements so as to convince the Canadian government and public that the generic firms were costing Canadians more than the savings in drugs. That is, research-based pharmaceutical multinationals were being dissuaded from further investment in Canada because of insufficient patent protection as compared to the U.S. and Europe. Therefore, there were fewer jobs, less original research, no investment in plants, and other foregone opportunities from the system of compulsory licensing. It was promised by PMAC, on behalf of its largely foreign-owned multinationals, that if stronger patent protection, such as that awarded in the United States, was given, then there would be increased investment and R&D spending, particularly in Quebec, which

²³ Ibid.

²⁴ In Canada, *House of Commons Debates*, 2nd session, 33rd Parliament, Vol. VII (1987), 24 August 1991, p. 8350. It should also be noted that, on March 30, 1987, Judy Erola ceased to be the minister and, ironically, became the president of PMAC and headed the lobbying efforts.

²⁵ It had been estimated that well over \$100 million was spent on the campaign.

translated into more jobs and the promise of greater technological advancement. This, to the Mulroney government, was an offer that couldn't be refused.

The promise of the creation of jobs and increased R&D in Canada were, undoubtedly, important factors in the final decision. However, there was a dimension to the whole affair that cannot be dismissed. Although PMAC was a strong lobbying force in its own right, it held in its corner a number of political heavyweights. Firstly, in March of 1987, the Minister of Consumer and Corporate Affairs, Judy Erola, resigned as minister and member of Parliament and became the president of PMAC. Notwithstanding the apparent irony of the matter, it was a brilliant move by PMAC. Who better to represent their interests than the former minister herself? Erola had extensive knowledge of the ministry and of Parliamentary procedures, had the right connections, knew who to target, and understood how to effectively manoeuvre the political system in a manner that would provide a greater assurance of victory. In addition, PMAC also hired some very effective lobbying firms. The lead lobbying firm was Government Consultants International (GCI). GCI was the firm set up by some of Prime Minister Mulroney's closest friends, including Frank Moores, the former premier of Newfoundland, and Gerald Doucet, whose brother was a senior advisor working on the patents issue in the Prime Minister's Office.²⁶ Hence, it was obvious that forming the

²⁶ Stevie Cameron, "How the drug-makers influence the policy-makers," in *Globe and Mail*, 30 November 1992.

‘right’ domestic political connections was an important goal of PMAC, one which would give them greater influence in patent protection policies.

The U.S. and Bilateral Trade Negotiations

In addition, and perhaps of greater relevance, was the fact that the United States government was a strong advocate of the amendments. The Canadian Ambassador in Washington had, himself, stated, on record, that the pressure to amend the Canadian patent law was quite substantial. In fact, it was declared very clearly that this was a priority of the United States administration and that the United States wanted this passed, and passed very quickly.²⁷ This, in fact, had much to do with the free trade negotiations that were slated to begin shortly between Canada and the United States. It was hoped that the agreement would provide comparable treatment for both Americans and Canadians in both countries, and this included intellectual property rights.²⁸ In addition, the U.S. wanted a multilateral agreement on patent protection. Within the General Agreement on Tariffs and Trade, the Americans wanted rules on intellectual property protection to be on the agenda for Uruguay round of negotiations, which began in September 1986.²⁹ They wanted Canada to become an advocate in the TRIPS agenda

²⁷ Recount of a meeting that occurred between David Dingwall, MP-Cape Breton/East Richmond, and the Canadian ambassador in Washington. In Canada, *House of Commons Debates*, 2nd session, 33rd Parliament, Vol. VII (1987), 21 August 1987, p. 8304.

²⁸ From letter written by U.S. President Ronald Reagan to Senator Bob Packwood regarding the forthcoming trade negotiations. Read aloud by Dingwall. Ibid.

²⁹ Charlotte Gray, “The drug bill: To the Americans it’s only a start,” in *Canadian Medical Association Journal*, 15 January 1988, p. 150.

in the round, but this could not be possible unless Canada discarded compulsory licensing and adopted stronger patent protection laws for itself.

Hence, the battle that took place in Canada can be seen in the wider context of a war that the U.S. was waging against 'intellectual pirates'. The Reagan administration was very committed to improving the protection of U.S. intellectual property rights abroad. It argued that stronger intellectual protection was necessary to increase worldwide R&D levels and to prevent U.S. consumers from footing the world's R&D bills. However, in addition to being motivated by domestic interests, the U.S. asserted that stronger intellectual property right protections for pharmaceutical drugs were actually in every country's interest because of the putative positive impact of new policies on private sector R&D investments.³⁰

The United States had concentrated on bilateral agreements to strengthen protection of intellectual property rights. When that strategy did not work, it resorted to unilateral actions to protect American products. It threatened or initiated trade actions against Korea, Mexico, Brazil, Thailand, Argentina, Chile, and Indonesia to secure patent protection. For these countries, as for Canada, access to the vast U.S. market was vital.³¹ Thus, the threat of trade barriers put a very powerful card in the hands of the

³⁰ Ralph Nader and James Love, "A letter to Michael Kantor, U.S. Trade Representative, on Health Care and IPR," 9 October 1995, p. 6.

³¹ Gray, in *CMAJ*, 15 January 1988, p. 150.

United States, and Canada was certainly aware of this.

Canada was seen as one offender of patent protection, but it was feared that other countries, particularly developing ones, would adopt the same compulsory licensing system that Canada had. Given the unspoken bargaining power of the U.S., especially in the importance of maintaining market access to the vital U.S. market and of securing greater access through the up-coming trade arrangements, it was understandable that the Canadian government would be susceptible to the desires of the U.S. government. Thus, given the upcoming negotiations for the Canada-U.S. Free Trade Agreement and the Uruguay round of GATT negotiations, this appeared to be the opportune time for Washington to stress its wishes to the Canadian government.

However, the role of the United States in the patent amendments can be considered misleading. That is, the U.S. government may be, mistakenly, awarded more credit than it is due. In fact, it can be stated that the American government, too, was not immune to the intense pressure that was exerted by its pharmaceutical corporations. Much of the push to extend patent protection so that it would be similar to that of the U.S. and Europe, including Bill C-22 in Canada, was coming from pharmaceutical multinational corporations, especially from those based in the United States. The high profile of the pharmaceutical issue was no accident. It had much to do with the emphasis placed on it by the powerful U.S. Business Roundtable, the Fortune-500 lobby with a direct link to the White House. The head of the roundtable, Edmund Pratt, was also

chairman of the U.S. giant drug company, Pfizer. He almost singlehandedly put pharmaceutical patent protection, and the broader theme of intellectual property rights, near the top of the Reagan administration's trade policy agenda.³² The issue mainly concerned large lesser middle-income or developing countries, such as India or Brazil, but how could the U.S. press for improved patent protection in these developing countries if they allowed Canada, its largest trading partner and member of G-7, to discriminate against the makers of brand-name drugs through its system of compulsory licensing? In its strategy, the international pharmaceutical industry, backed by diplomatic pressure from the U.S. and European governments, complained that the Canadian system of compulsory licensing made a mockery of patent protection and endorsed piracy of intellectual property. Thus, the giant global pharmaceutical multinationals demanded that Canada conform to their norms.

Through the U.S. government, and the opportunity to exploit the current trade negotiations, U.S. pharmaceuticals were able to push their agenda onto countries that it felt were not providing adequate enough patent protection. Canada was certainly one of them, and the pharmaceutical multinationals wanted to see, and pressed hard, for what they believed was a long overdue cleanup of a law that gave Canadians a free ride on their backs, as they were the ones who spent the money to develop the drugs. Canadian compulsory licensing was exploitative behaviour and they wanted it stopped.

³² Giles Gherson, "Patent Protection issue heats up again despite success of Bill C-22," in *Canadian Medical Association Journal*, 15 July 1991, p. 142.

At the same time as C-22 was being debated in Canada, the GATT negotiations had begun. The U.S. Pharmaceutical Manufacturers Association took an active role in ensuring that intellectual property rights would be on the agenda. The justification for this aggressive campaign was perhaps best expressed by Gerald Mossinghoff, the PMA president and a former U.S. Commissioner of Patents and Trademarks. At that time, Mossinghoff was fond of frequently listing the countries that the PMA had identified as having inadequate intellectual property protection. On that list were mostly middle-income countries, including Canada, and it was understood that middle-income countries, as a group, attached little importance to intellectual property protection. Increasingly, according to World Bank statistics, they were trading among themselves or with developing countries, where this protection is weak or non-existent.³³ Thus, Mossinghoff complained that:

We could be moving towards a trading system where one group of countries creates and protects intellectual property, while the other group takes and exports it.³⁴

Clearly, to pharmaceutical multinationals, this was unacceptable and they pressed for a concerted effort around the world for pharmaceutical patent protection.

The Opposition

However, as previously stated, many did not agree that the Canadian system of compulsory licensing should be altered. At the forefront of this debate was the CDMA,

³³ From the *1985 World Development Report*, published by the World Bank. Cited in Gray (1988), p. 150.

³⁴ Gray (1988), p. 150.

the Canadian generic equivalent to the PMAC and also its arch-enemy. The bill would effectively raise the period before a new generic comes onto the market from seven or eight years to seventeen or eighteen. Given the short product life-cycle of most drugs, generics would be less profitable under the new legislation, and there would also be great potential for this segment of the industry to decline.³⁵ Obviously the threat to their livelihood propelled CDMA members to become extremely vocal as they conveyed their sentiments to the government and public about the bill. They argued that not only would the cost of prescription drugs rise dramatically, but also that an industry in infancy would be maimed and kept from developing. They added that the pharmaceutical multinationals, which would benefit significantly from the bill, were motivated by excessive greed for profits, even though they were one of the most profitable of industries, at the expense of the Canadian consumer. In addition, the CDMA charged that the government was ignoring the cry from Canadians about the bill, while appeasing the Americans and their giant pharmaceutical companies. This would be the focal point of the heated debate that was occurring, as the Mulroney government would be continuously accused by contenders of the bill of selling out to the interests of Americans and their multinationals.

Again, many agreed with this assessment. The Consumers Association of Canada appeared before the government committee to outline reasons as to why they opposed C-22. As well, the Canadian Hospital Association, the National Poverty

³⁵ Eden, p. 260.

Organization, the Federal Superannuates Association, the National Pensioners and Senior Citizens Federation, Green Shield Prepaid Services, the Canadian Labour Congress, the Canadian Nurses Association, and the Canada Council on Social Development all expressed their opposition to the bill and its ramifications.³⁶ And if this was not enough evidence to support the opposition of many in Canadian society, six of the provinces were also skeptical of the bill and wanted several amendments to improve the bill, especially by having the promises of more investment and R&D by the multinationals written into the bill.³⁷ However, by far, the most vociferous opposition to the bill came from within the House of Commons, most notably from the Liberal and New Democrat members.

Prime Minister Mulroney came under attack by the opposition parties for his weakness in succumbing to pressure by the United States and its pharmaceutical multinationals. David Dingwall, the Liberal member from Cape Breton/East Richmond, was one who was most actively involved in the debate. Throughout the year of the debates, he effectively summarized the positions of those in opposition.

In bowing to the wishes of the multinational corporations the Government is assisting these corporations to increase their massive profits. And the profits of these companies are, by any measure, outrageous...The Tories say that "we have to give the pharmaceutical industry a longer period of exclusivity." That is not so the industry will be just a little more profitable, but that it will be much, much more profitable. In turn, these multinationals with headquarters in the U.S. and Europe are going to promise - not give us a consummated contract - that for all that money we have given them, they will do some

³⁶ As stated by David Dingwall, MP-Cape Breton/East Richmond, during debate in the House of Commons, 21 August 1987. In Canada, *House of Commons Debates*, 2nd Session, 33rd Parliament, Vol. VII (1987), pp. 8301-5.

³⁷ *Ibid*, pp. 8288-8289.

R&D. There is no written contract, no guarantee, none whatsoever...The Government is giving away much of the taxpayers' money in the hope, with the prayer and on the whim that maybe somebody out there will put research and development dollars into Canada...This Government has abdicated its responsibilities to Canadian consumers and is being hosed by multinationals as a result of Bill C-22.³⁸

The NDP-MP from Windsor/Walkerville, Howard McCurdy, was yet another one who communicated his distaste.

The Canadian government was far more anxious to listen to those from outside the country than to those within it. We had the President of the United States, the Vice-President of the United States, who is a former chairman of Pfizer, we had Edmund Pratt, the Chairman of the President's Advisory Committee on Trade, who is also a big wheel in a drug company, we had American after American come up here and say, "Look, better pass this bill."... It is surely an inherent part of the democratic process that a government be willing to listen to all sides and to achieve through the traditional mechanism of politics and reasonable compromise a piece of legislation that would be far less offensive to Canadians and our own national welfare. But I guess that is not possible for a Government that takes its orders from Washington.³⁹

Hence, the Conservative government of Brian Mulroney was castigated for the bill. There were marches, write-in campaigns, impassioned speeches, and a number of other illustrations of opposition to the bill. However, more fuel was added to the fire about C-22, as opposers tied the bill into the ongoing Canada-U.S. free trade debate, which was also another cause of fiery emotions in Canada. To many, in addition to denouncing the bill as harmful, it was also seen as just one more giveaway by the Mulroney government, this time to the American pharmaceutical multinationals.

³⁸ Excerpts from speeches made in the House of Commons on August 21 and 24, 1987. In Canada, *House of Commons Debates*, 2nd Session, 33rd Parliament, Vol VII (1987), pp. 8300-8301, 8308, 8349-8350.

³⁹ Excerpt from speech by Howard McCurdy, NDP-Windsor/Walkerville, 24 August 1987, in Canada, *House of Commons Debates*, 2nd session, 33rd Parliament, Vol VII (1987), pp. 8324-8325.

C-22 is Passed

On November 19, 1987, the bill was passed through the Senate, to the relief of the Government. Many Liberal Senators were opposed to the bill, and it was hoped by opponents, particularly the CDMA, that the Senate would put up a good fight and, even possibly, put an end to the bill. Senator Allan MacEachen, the Liberal leader of the Senate and the chief strategist of those opposing the bill, took one last opportunity to rail against the bill.

[C-22] is sought more by President Reagan, the Mulroney government and the multinational pharmaceutical lobby than by the people of Canada.⁴⁰

Even his thirty-minute impassioned speech was to no avail, for, in the end, the bill was passed, with 32 Liberal senators abstaining from voting. On December 7, 1987, C-22 came into effect. Although compulsory licensing still existed in Canada, C-22 ensured that it was in a weaker form.

The drug multinationals and the Conservative government had also successfully resisted efforts to have the promises of further investment and R&D written into the legislation. However, to counter the part of the opposition to the bill, the Patented Medicines Prices Review Board (PMPRB) was created to be an independent agency that would report to the federal minister of Consumer and Corporate Affairs. The PMPRB was a new monitoring board devised to observe the promised R&D levels and that the brand-name drug prices did not exceed the Consumer Price Index. The board was also

⁴⁰ In Gray (1988), p. 149.

empowered to sanction offending drug companies by removing or withholding the exemption from compulsory licensing. However, many were sceptical of the role of the new board and whether it would be effective.

One such critic was, not surprisingly, the CDMA. The PMPRB was regarded as 'toothless' because it required only voluntary compliance, and, consequently, it could not enforce research requirements or roll back prices. Leslie Dan, the president of Novopharm, one of Canada's top generic firms, called the board a "well-intentioned smokescreen."⁴¹ However, what perhaps upset them, and others who were opposed to C-22, was that, in addition to the 'giveaway' from the bill, another piece of legislation had been altered. This, too, was to the benefit of the pharmaceutical multinationals. The research-based multinationals would receive a generous tax amendment, where Revenue Canada would grant large tax credits, a 35-40% write-off, for applied research and development.⁴² That is, the tax write-off would be granted for preclinical and clinical work that proved the potency and the potential uses for compounds.

This, too, proved to be controversial, as it was argued that this would ensure that the truly innovative R&D would still occur offshore at the multinationals head offices. The amendment provided no incentive for this transfer, but rather increased the

⁴¹ Charlotte Gray, "Drug manufacturers say report proves fears of price increases unfounded," in *Canadian Medical Association*, Vol. 142 No. 2 (1990), p. 154.

⁴² This was verified by Lou Seguin, an auditing official from Revenue Canada from the research and development division. 21 May 1997.

probability of relatively less innovative work, clinical trials, to be done in Canada.

Skepticism over the results that were promised by the multinationals and hoped for by the Mulroney government was prevalent. Howard McCurdy, an MP, perhaps best expressed this view.

Is this investment the kind that will establish the concerted centres of excellence in this country that will pursue basic research?... [The Minister of Consumer and Corporate Affairs] knows nothing about basic research if he thinks that what the drug companies will do is basic research... There are very few companies, certainly not American, Swiss, British, or German ones, with their research centres in their home countries, which will disperse their research efforts in Canada.

When we consider tax concessions for research, the new arrangements for matching funds between industry and NSRC for funding university research, the increasing average age of the population and therefore the increased demand for pharmaceuticals, and when we look at the projections of the increases in rates of expenditures for research over the last five or ten years, we must conclude that by 1995 there will be an additional \$1.3 billion more spent on research. In addition to that sum, there would be something in the order of \$2 billion spent on additional capital expenditures. This translates into an empty promise in the sense that that promise will be based on a set of facts that would have existed, with or without C-22.⁴³

However, as the bill had already been passed, only time would validate or dismiss these suspicions.

Ergo, with the passing of C-22, it was expected that, given its number of opponents during its debate in Parliament, there would always be this kind of skepticism towards it. However, one would believe that with its passing, the U.S. government and the pharmaceutical multinationals would have been jubilant. This was not the case. C-22 was considered to be a good start in strengthening intellectual property rights, but in the eyes of the U.S. and its pharmaceutical companies, it did not go far enough. Emory

⁴³ Supra note 38.

Simon, of the U.S. Trade Representative's Office, summarized the American reaction to the bill.

We're glad to see your bill passed, but we want more than C-22. We want a concerted effort around the world, and in Canada, for stronger pharmaceutical patent protection.⁴⁴

Firstly, the American government had hoped for a concrete commitment from Canada on the issue of IPR in the bilateral free trade agreement. This did not occur, as no agreement was reached on intellectual property rights, so that Canada and the U.S. patent laws were not harmonized as the U.S. had hoped. However, the commitment to pass C-22 was part of the deal to enter into the agreement, and Mulroney hoped that its passing would be a step in smoothing the bilateral trade irritant. And although IPR was not included in the free trade deal, an article outlining Canada's future commitment to it was.

The Parties shall cooperate in the Uruguay round of multilateral trade negotiations and in other international forums to improve the protection of intellectual property.⁴⁵

Thus, it was apparent that C-22 would not be the end of this, as this commitment effectively foreshadowed the next battle to further amend Canadian patent laws.

During the bill process, PMAC fought a well-financed, vigorous campaign that was not as successful as they had hoped. It was successful in the sense that C-22 was

⁴⁴ Gray (1988), p. 150.

⁴⁵ Canada-U.S. Free Trade Agreement, 9 December 1987, Article 2004: Intellectual Property. Cited in Hodin, p. 219.

passed, but unsuccessful in that C-22 did not go as far as it was hoped in extending patent protection. Jay Kingham, the senior vice-president of PMA, stated that C-22 was “a step forward, but it doesn’t really improve our position.”⁴⁶ That is, in the eyes of the research-based pharmaceutical multinationals, C-22's provisions were not strong enough to shift Canada to the category of creator country from that of exploiter. Consequently, it was questioned whether the new provisions were enough to propel the industry to uphold its promises of greater investment and R&D. Aside from this reason, the PMA was also uneasy about its commitments to increase its investment in Canada, for it was considered to be “a potentially bad precedent for other countries with which we’re having the same battle because it could distort the market.”⁴⁷ In sum, according to the pharmaceutical multinationals, C-22 was a good start towards adequate patent protection, but it clearly was not the result that was hoped. That is, the drug multinationals wanted the same protection as what was offered in the United States and Europe - an exclusivity period of twenty years. Their battle to remove compulsory licensing from Canada was not over.

And so ended round one of the political struggle between the international brand-name drug companies (the research-based side of the industry) and the upstart Canadian producers of generic drugs (and their supporters). The bill was passed largely because of the promises made by the multinationals to increase their R&D spending, and because of

⁴⁶ Gray (1988), p. 149.

⁴⁷ As commented by Jay Kingham, senior vice-president of the U.S. PMA. Cited in Gray (1988), p. 150.

the top priority given to patent protection in the upcoming trade arrangements. Ergo, it can be concluded that in a knowledge-intensive foreign industry like pharmaceuticals, compulsory licensing in Canada offered economic benefits, but at a high political cost. Bill C-22 reduced the economic benefits and the political risks.⁴⁸ Brian Mulroney, the Canadian prime minister, did not miss the fact that these brand-name firms were clustered in the electorally vital provinces of Ontario and Quebec, and that they picked up his mantra of “jobs, jobs, jobs” by promising to create thousands of research positions if more protection was given. In addition, the anticipated results may have been able to quell the disenchantment that was being expressed in Quebec towards the inadequacies of the federal government. However, the pressure from the United States, originating from pressure exerted by its multinationals, could also be cited as another main reason for its passage. That is, the agenda to include a strong form of patent protection, one that was harmonized with European and U.S. standards, was the main goal of diplomatic engagement. The U.S. made it quite clear that strengthened protection, more than the current C-22, would be a prerequisite for inclusion in future trade arrangements. Thus, although C-22 was a good start in that direction, it still did not meet the demands of the industry. Given the round of GATT negotiations occurring, and the prominence of intellectual property on the agenda, it would come as no surprise that C-22 would not end the pressure on Canada. In fact, it will be illustrated that pharmaceutical multinationals, both through their efforts in Canada and in making protection a high-priority issue in the multilateral talks, would effectively put greater pressure on Canada

⁴⁸ Eden, p. 262.

to eliminate compulsory licensing when the bill's review was due. 1992 would be the year that they would succeed.

The Battle that won the War: Bill C-91

Under C-22, after the four year anniversary of its passing, an internal review process was to occur. Using the reports and recommendations of the Patented Medicines Prices Review Board, the government could then decide to remove some or all of the new protection, if the reports were negative. Obviously, this result was hoped for by the generic firms in Canada, who, throughout the years, had been continuously complaining that the bill was adversely impacting its industry. However, a roll-back in patent protection would most surely have angered and alienated the pharmaceutical multinationals, especially because of the guarantees that they had given to increase their investment and R&D in Canada. Given the fact that the reports found that the multinationals had lived up to their promises, and that the results of C-22 appeared to be favourable to Canada, this roll-back appeared highly unlikely. Thus, the pharmaceutical multinationals were well-positioned to begin the next leg of the war - to completely eradicate the system of compulsory licensing in Canada. This was part of environment in which the review was to occur, with the generics pitted against the multinationals, yet again. However, the review process was also occurring in the same time period as were the multilateral GATT talks and the negotiations to extend the Canada-U.S. Free Trade Agreement to include Mexico (NAFTA). What all this meant was that Canada would

soon observe another battle over the issue of patent protection, this time more tempestuous than the last. The Pandora's box was opened once again.

Pharmaceutical Multinationals Prepare for Another Fight

Even prior to the four year review, PMAC had already begun its publicity and lobbying campaign. This stemmed from the releases of PMPRB reports which presented evidence that PMAC members had kept their promises. As one would recall, the first of these promises was to double their research spending in Canada. At the time of C-22, research by the Canadian subsidiaries of the international firms stood at about 5% of sales, and PMAC agreed that its members would double this by 1996. As well, to allay fears about price gouging, the brand name industry promised to exercise moderation in drug pricing. Both promises were to be monitored by the new agency, PMPRB, which would collect data from all PMAC member firms and publish annual reports on their activities. The 1989 and 1990 reports confirmed that the pharmaceutical multinationals had kept their promises.

The rate of increase in prices paid for drugs had dropped in the few years following the passage of C-22. It was, prior to C-22, 2% higher than the rate of increase in the Consumer Price Index; it was, in 1989 and 1990, 2% lower. This certainly was good news to consumers, private health insurers, and the provinces, who had expressed great concern over the possibility that C-22 would have increased drug prices. As well, the reports also confirmed that the multinationals had increased their R&D spending in

Canada. The ratio of research and development to sales had improved from 4.9:100 in 1987 to 6.1:100 in 1989, to 8.8:100 in 1990.⁴⁹ Thus, the findings of the report worked out to be in the advantage of the brand-name pharmaceutical companies, as it proved that they had upheld their end of the bargain with Ottawa. John Pye, a senior spokesman for PMAC, stated that, since the instatement of C-22, the PMAC members were eager to prove that their prices were not outrageous so that they would gain credibility for their position for stronger patent protection. He stated that:

We are anxious to prove that brand-name drugs give you value for your money. Prices are reasonable and you get research. So the report is ammunition we can use to make our case, because it has third-party credibility.⁵⁰

Thus, PMAC argued that, because its members had kept their promises, it was now time for the Canadian government to provide more patent protection.⁵¹ Again, the incentive for stronger measures was the same as with C-22 - 'give us more patent protection and we'll give you more R&D'. However, this request was also a thinly-veiled threat. It was also subtly implied that if the industry was not rewarded for its good showing, then it might be difficult to persuade head offices to even maintain the R&D level that had already been reached. Colin Mallet, the president of the Dorval, Quebec-based subsidiary of Sandoz, perhaps best expressed the repercussions of not granting full patent protection.

⁴⁹ Figures from PMPRB annual reports, 1989; 1990. Cited in Gray (1990), p. 154; and Gherson, pp. 142-3.

⁵⁰ Gray (1990), p. 154.

⁵¹ Gherson, pp. 142-3.

We [research-based pharmaceutical companies] feel that we've fulfilled the government's expectations for more research here as a result of getting partial patent protection under C-22. But now Canada should move to full patent protection. With other countries moving to increase patent protection, Canada risks slipping behind. Sandoz Canada will fight for research money, but we're placed at a disadvantage.⁵²

Therefore, at stake was the possibility of a sizeable drug R&D base in Canada, if full patent rights were guaranteed. If not, the decrease of R&D in Canada was distinct possibility.

PMAC regurgitated this sentiment, as it, too, claimed that the present patent regime in Canada was inadequate. It argued that, since the passing of C-22 four years ago, international circumstances have changed. Many countries had already given, or were in the process of serious consideration of, greater extension periods of patent protection to the drug companies. The U.S., Japan, and the European Community had already moved towards further extensions of their drug patent protection beyond the twenty year norm.⁵³ As well, even the outriders had accepted the need for full patent protection for pharmaceuticals. Korea, Taiwan, and Indonesia quickly got the message, and they improved their patent rights. As well, Eastern European countries, such as Bulgaria and Czechoslovakia, in setting forth conditions of democratic capitalism, also realized that the restoration of property rights, and the adoption of good patent laws for pharmaceuticals, were important steps towards their goal of economic development.⁵⁴ In

⁵² Gherson, p. 142.

⁵³ Ibid.

⁵⁴ Hodin, p. 218.

fact, even by late 1991, the notorious Latin countries, long-known for their piracy of pharmaceuticals, had come to the conclusion that technological progress and the creation of better societies rested on the pillar of private property rights, including patent rights for pharmaceuticals. Mexico's new law was considered to be outstanding by the pharmaceutical companies, for its high standards would allow it to join the ranks of, and compete effectively with, the U.S., Europe, and Japan.⁵⁵ Thus, PMAC argued that all of these changes had effectively undercut Canada's 1987 improvements.

If Canada was to compete with other countries, stronger patent protection rights for pharmaceuticals would be necessary. PMAC disclosed that, although the 8.8% level of R&D achieved in Canada from C-22 was a positive effect, it was hardly 'dazzling' in comparison to R&D levels in other countries that had full patent protection laws. In the U.S., for instance, drug companies reinvested 16% of sales back into R&D.⁵⁶ Hence, it could be argued that, when it comes to attracting major league pharmaceutical investment, a country's patent protection laws are what really counted. With other countries moving to increase patent protection, Canada, with its 'paltry' 7 to 10 years of protection, risked slipping behind in luring these companies to invest and perform research and development. In the eyes of the pharmaceutical multinationals, Canada was still viewed as a haven for generics, so then why should it be rewarded by increased investment by them?

⁵⁵ Ibid.

⁵⁶ Gherson, p. 142.

PMAC argued forcefully for the dismantling of compulsory licensing. Like its previous argument for C-22, PMAC stated that the industry needed a longer patent protection in order to recoup the ever-soaring costs of developing, testing, and bringing the drug to the marketplace. Its second argument for extending the period of patent exclusivity stemmed from the changed international environment. Industrial countries, PMAC stated, were in a head-to-head battle to lure this lucrative high-tech research, and thus, had to offer a sufficiently attractive domestic environment. PMAC did not want to see Canada exclude itself, but rather to bring itself into line with other countries.⁵⁷ Hence, PMAC used these factors to argue forcefully that Canada increase its monopoly term for pharmaceuticals to the twenty year norm. Again, it reiterated the sentiment of its members, the foreign-owned pharmaceutical companies, that C-22, as it stood, offered little incentive to undertake expensive R&D if these innovations were to be copied and sold by generic companies after only seven to ten years. They argued that not only was longer patent protection necessary in order to harmonize Canada with other countries, but also to signal that Canada was a good place to conduct its business. Change to the patent protection law was imperative. In the words of Judy Erola, PMAC's president, "We want it [the change] badly."⁵⁸

In fact, they wanted that change so badly that their campaign was in full-force by

⁵⁷ As stated by John Pye, PMAC public affairs spokesperson. Cited in Joan Cohen, "Calm over drug patent law will not last," in *Winnipeg Free Press*, 15 September 1991.

⁵⁸ Rod Mickleburgh, "Hammer and Tongs on the Hill," in *The Globe and Mail*, 16 November 1991.

the time the bill's review process began. Canadian sales of prescription drugs, by 1991, amounted to about \$4 billion a year in a virtually recession-proof industry considered to be one of the most profitable in the world.⁵⁹ With this at stake, high-priced lobbyists and heavy-duty advertising campaigns were mounted in Canada. PMAC launched a television campaign that aimed at softening up a public that polls showed to be deeply suspicious of the brand-name industry. The annual PMPRB reports provided the ammunition that was needed for PMAC's members to gain credibility in the eyes of the public.

In addition to the in-house political expertise of Judy Erola, its president, the list of lobbyists, statisticians, and strategists hired by PMAC was impressive. In fact, the group's use of these consultants and lobbyists reached such a high level in the campaign that, when it hired its sixth firm in October of 1992, *The Lobby Monitor* newsletter's editors wrote: "PMAC adds yet another (yawn) lobbyist to its side."⁶⁰ The hired guns included: again, Government Consultants International (GCI), which was one of the top-4 lobbyists in Canada and with the additional prestige of having close personal links to the prime minister; Fred Doucet Consultants International, the firm founded by the brother of GCI's Gerald Doucet; Earnscliffe Strategy Group; Hill and Knowlton, a multinational firm; Marion May and Associates, an Ontario-based firm; and the

⁵⁹ Ibid.

⁶⁰ I. Austen, "Ottawa's plan to expand drug protection has been a boon to lobbyists," in *Montreal Gazette*, 5 December 1992.

establishment law firm, Gowling, Stratny, and Henderson.⁶¹ Sean Moore, the editor of another of Ottawa's newsletters, *Lobby Digest*, referred to PMAC's efforts as:

a rare but classic example of a multifaceted, all fronts lobby. It's so broad based that it has a lot of caucus focus. And this one has massive amounts of advocacy advertising, both print and broadcast, and a heavy use of direct mail.⁶²

In addition to using PMAC and its strategists, various pharmaceutical multinationals also took no chances and lined up their own lobbyists and headed their own personal campaigns. Merck Frosst Canada, which was considered by most participants in the fight as the most aggressive manufacturer in its demand for patent protection, placed advertisements in leading Canadian newspapers and magazines outlining the positive findings of PMPRB's reports, its arguments for further patent protection, and announcing its commitment to the Canadian consumer.⁶³ Merck placed a great deal of emphasis on the fact that it has been a positive force in Canada. It reminded the public of the almost-finished \$200 million research facility in Quebec and that it spends, in Canada, about \$30 million annually on R&D.⁶⁴ As well, Merck hired GCI and Fred Doucet Consulting International to lobby for them. With the Canadian market for prescription drugs at stake, the effort put forth by Merck, and other pharmaceutical multinationals, was certainly understandable.

⁶¹ See Stevie Cameron, "Drug lobbying hard to swallow, MP finds," in *Globe and Mail*, 21 September 1992; and Austen, in *Globe and Mail*, 5 December 1992.

⁶² Stevie Cameron, "How the drug-makers influence the policy-makers," in *Globe and Mail*, 30 November 1992.

⁶³ Ibid.

⁶⁴ Gherson, p. 144.

The strategy of the pharmaceutical multinationals was quite simple: show the Canadian public that they were an invaluable part of the economy. With the newspaper, magazine and TV ads, the multinationals attempted to convey to the public that they had kept their promises and that they were a positive force in the economy - investing, creating jobs, and providing R&D. Thus, they tried to win over a Canadian public that was deeply suspicious of the companies' motives for an extension of patent protection. As well, to gain more support for their goals, the lobbyists played this as a research-and-development bonanza with increased R&D by the PMAC firms and more money for medical schools. With promises of greater R&D and investment, the drug-makers hoped to win over the provinces of Ontario and Quebec, where they were primarily located and whose proportion of MPs were large enough to make a difference in Parliament, and also to garner support from Canadian universities involved in pharmaceutical and medical research. Lastly, the lobbyists also played the 'national unity' card. As one would recall, the majority of PMAC firms were located in Quebec, particularly in suburban Montreal. Hence, their argument was that, by keeping the drug-makers happy, then Quebecers would be happy, and keeping them happy was good for national unity.⁶⁵ With these tactics, the brand-name drug-makers, and their entourage, set out to make sure that their objective of increased patent protection would be met.

Therefore, it can be concluded that the members of PMAC - the brand-name pharmaceutical multinationals - had an aggressive campaign with the best strategists and

⁶⁵ Cameron, in *Globe and Mail*, 21 September 1992.

lobbyists that money could buy. In fact, it had been stated that “[PMAC and its members] had hired everyone, so that no one else could get them.”⁶⁶ With their promoters and campaign in full force, and with the efforts of the U.S. PMA in the trade accords, the pharmaceutical multinationals set out to flatten the opposition and to make sure that, this time, compulsory licensing truly became a part of Canada’s history.

The Generic Industry Mounts Its Campaign

However, the CDMA, the association of Canada’s 19 generic companies, also entered the debate forcefully. They contended, as they did four years ago, that increased restrictions would severely damage a domestically-owned industry and send drug costs soaring. According to Leslie Dan, the president on Novopharm, one of Canada’s top-2 generic producers:

The brand-name companies can recoup their R&D investment on a new drug in six to eight years with their worldwide sales. Giving them more than ten years of market exclusivity is just a license to print money.⁶⁷

He later added that:

No matter what you give them [PMAC], it’s never enough. We just hope that the politicians won’t be hoodwinked by their campaign again.⁶⁸

However, the figures from the PMPRB reports put the generics at a disadvantage. Their position appeared to be worsened when it was revealed that Benoit

⁶⁶ Quote by John Chenier, writer for the *Lobby Monitor*, as cited in Cameron, in *Globe and Mail*, 21 September 1992.

⁶⁷ Gherson, p. 143.

⁶⁸ Mickleburgh, in *Globe and Mail*, 16 November 1991.

Bouchard, the Minister of Health and Welfare, looked favourably on PMAC's request for longer patent protection, because its members had kept their promises.⁶⁹ Yet, perhaps what damaged their credibility was their continuous argument that the restrictions from C-22 would severely damage their viability as an industry. By 1991, their market share of prescription drugs had not dropped, but rather remained steadfast at 8% of the total Canadian market. Despite dire predictions about the effects of longer patent protection, the generic industry did not appear to be suffering. Rather, the industry had thrived, with revenue growth as high as 30% a year.⁷⁰ As well, Apotex and Novopharm, whose sales accounted for 80% of the generics Canadian sales, had shot from nowhere to top spots on the top-10 list of drug companies in Canada and were the top suppliers of prescription drugs.⁷¹

However, these did not stop the generics from vociferously arguing that extended patent protection would, consequently, send drug costs soaring and be the demise of a Canadian-owned industry, which employed 2000 people and saved Canadians \$400 million a year in the costs of prescription drugs. Regardless of the perceived setbacks of the reports, their arguments were still potent. One of their assertions was that their competition was what kept drug prices lower. Joel Lexchin, a University of Toronto professor, physician, and author of a book on the Canadian pharmaceutical industry,

⁶⁹ Ibid.

⁷⁰ Gherson, p. 143.

⁷¹ Ibid.

upheld their argument. He stated that:

without the lower prices of generic drugs, provincial drug benefit plans would no longer be affordable. Studies have shown that when there is one generic available, it sells on average for 80% of the brand-name drug. When there are four or five, the difference is down to 50%. It's clear that this has produced significant savings in drug costs.⁷²

As well, a U.S. government report also confirmed that drug prices in Canada were lower because of increased competition due to a lack of full patent protection. The report stated that consumers in the U.S., where patent protection was at the internationally-proposed term of twenty years, paid an average of 62% more for prescription drugs than Canadians.⁷³ Thus, the generics argued that, if Canada dismantled compulsory licensing completely by awarding full patent protection, drug costs would soar and provincial drug plans would be unaffordable.

The PMPRB reports also came under attack. As one would recall, the board ruled that price increases should not exceed those of the Consumer Price Index. The reports substantiated that this did not occur, and thus suggested that the brand-name pharmaceuticals had exercised restraint in their pricing practices. However, it was disclosed that the manufacturers were compensating this loss of revenue by putting their new, therapeutically-advanced products on the market at inflated prices.⁷⁴ Thus, the

⁷² Mickleburgh, in *Globe and Mail*, 16 November 1991.

⁷³ Ibid.

⁷⁴ Joan Cohen, "Calm over patent law will not last," in *Winnipeg Free Press*, 15 September 1991.

practices of the pharmaceutical multinationals, especially considering their promises, was called into question.

In addition, if full patent protection was awarded to the pharmaceutical multinationals, Canada's growing domestic generic industry would suffer irreparably. That is, it was argued that, by the time the twenty year patent protection expired, many patent drugs would have already become obsolete by newer and better products under new patents.⁷⁵ Consequently, generic substitutes would have no, or very minimal, value. It was also questioned as to why the pharmaceutical multinationals felt so threatened by the generics that additional patent protection was needed. Jack Kay, the chairman of the CDMA, stated that he couldn't understand why the pharmaceutical multinationals wanted them to disappear. With only 8% of the Canadian prescription drug market, surely the generic industry could not be considered a threat to their profitability. By providing full patent protection, the brand-name industry would have 98% of a market in which they already had a 92% share. Greed, Kay stated, was obviously their motive.⁷⁶ Leslie Dan, president of Novopharm, also questioned their motives.

Sure, we're [the generic manufacturers] not lining up at the Scott Mission. But we don't make the money that the multinationals do. How could we? We charge thirty to forty per cent less for our drugs and we're still only a very small part of the market. We're not some terrible ogre that's going to swallow the multinationals. But that doesn't impress them. They want us to totally disappear.⁷⁷

⁷⁵ Joan Cohen, "New drugs carry a higher price tag," in *Winnipeg Free Press*, 15 September 1991; and Rod Mickleburgh, "Ottawa attacked over drug patent legislation," in *Globe and Mail*, 16 January 1992.

⁷⁶ Rod Mickleburgh, "Generic drugs in danger, group says," in *Globe and Mail*, 19 December 1991.

⁷⁷ Mickleburgh, in *Globe and Mail*, 16 November 1991.

In this context, the generic companies set out to make sure that the pharmaceutical multinationals did not get their wish. They knew that they didn't have as much political clout as the multinationals⁷⁸, but this was 'sink-or-swim' time and a great effort was needed. The CDMA lobbied the government just as vigorously as PMAC, but for a reduction in the ten year monopoly. However, this time, rather than placing too much reliance on the Senate to help fight their battle, they spent most of their resources on top-flight lobbyists and statistical analysts. The CDMA, on behalf of the Canadian generic companies, hired one of the top lobbyists in Canada, Government Policy Consultants. As well, it also hired the consulting firm Infometrica to buttress the statistics and economic arguments that PMAC put forth regarding their achievements. Later, McIlroy and McIlroy, another lobbyist, and Canlac Corp., which represented the fine chemical manufacturers that supplied the generic companies, were also engaged.

Their strategy was to lobby provincial health ministers, so as to inform the public of the costs of extending patent protection.⁷⁹ As well, another strategy was to bombard the provincial and federal government officials with studies. One such study found that most scientists at universities were only testing drugs developed in other countries, not

⁷⁸ An example of this 'clout' was the opening of Merck's new research facility in suburban Montreal. John Duncan, a government analyst, remarked that "anytime you get 4500 people out to one of your events, plus the Prime Minister and several cabinet ministers, shows something. They really know what they're doing. They're one of the more effective lobbies in the country." Cited in Mickleburgh, in *Globe and Mail*, 16 November 1991.

⁷⁹ Cameron, in *Globe and Mail*, 21 September 1992.

doing basic research as claimed by PMAC.⁸⁰ The CDMA also sent lobbyists on regular jaunts to Europe to try to ensure that Canadian negotiators did not surrender compulsory licensing in the GATT talks. They brought with them analyses of patent issues and public opinion polls that supported their anti-patent position.⁸¹ Hence, all this suggests that the Canadian generic industry was not willing to go down without a fight. Compulsory licensing, they argued, was not only important to them, as an industry, but also to consumers of prescription drugs. They would fiercely voice this in the months to come.

Trade Negotiations: Environments of Influence

Again, like the environment of C-22, there was also an international dimension. Patent rights were prominent on the agenda at the General Agreement on Tariffs and Trade in Europe and in North American free trade discussions among the United States, Canada, and Mexico. In both venues, Canada was under great pressure to restrict the production of generic drugs by strengthening patent protection periods for pharmaceuticals. In fact, it was well-known that the enormously influential U.S. pharmaceutical industry would make sure that the U.S. administration made this a high priority for both agreements. However, it would be the GATT agreement that would solidify Canada's commitment to intellectual property rights, and the NAFTA agreement was expected to mirror the multilateral text on intellectual property.

⁸⁰ Ibid.

⁸¹ Austen, in *Montreal Gazette*, 5 December 1992.

Like during the Canada-U.S. free trade negotiations, the U.S. pharmaceutical companies played an integral role in elevating intellectual property rights to be a key issue on the agenda of both the GATT and NAFTA negotiations.⁸² Ralph Nader, a world-renowned consumer advocate, outlined their effectiveness in influencing the U.S. administration.

In these international forums, the U.S. government works closely with pharmaceutical, software and other industry groups. U.S. officials in the Departments of State and Commerce, and in the Office of the U.S. Trade Representative, often act as if their overriding mission is to advance the narrow interests of these industry groups.⁸³

Because of its position as the most powerful state in the international system, not surprisingly, the U.S. was well-positioned to further the objectives of these groups in the international arena of trade. From its forceful arguments for the inclusion of intellectual property rights in the draft GATT agreement, it appears that the U.S. was able to effectively voice the views of its pharmaceutical industry.

Despite C-22, Canada still remained the only Western industrialized country to retain compulsory licensing, as most countries had, at that time, provided full patent protection for seventeen to twenty years. The demands from the brand-name pharmaceutical multinationals were voiced through the U.S., Switzerland, and the other

⁸² The big multinational drug firms were a driving force behind the GATT TRIPS deal, which also encompassed trademarks, copyrights, and computer software. They argued that patents are essential to innovation. The drug firms also promised that good intellectual property protection would encourage investment in developing countries. For more about the TRIPS agreement in GATT, see "Intellectual property...is theft," in *The Economist*, 22 January 1994, pp. 72-3.

⁸³ Ralph Nader and James Love, "Letter to Michael Kantor, U.S.T.R.," 9 October 1995.
<www.essential.org/cpt/pharm/kantor.html>

pharmaceutical powers to get Canada to tighten its drug patent rules. As John Crosbie, the former trade minister of Canada, lamented:

We're being put in the same camp as Third World countries like Brazil and India when it comes to protecting intellectual property rights in the pharmaceutical area. It's embarrassing.⁸⁴

Consequently, in the GATT negotiations, Canada came under great pressure to scrap the system.

The politically-powerful U.S. pharmaceutical industry was worried that if a major industrial country, like Canada, could get away with giving its generic industry compulsory licensing rights on drugs that were still under patent protection, then other countries might be tempted to follow suit. That is, it was feared that Canada was setting an example to the rest of the world - particularly developing countries - on how to control drug costs through an open market of generic competition.⁸⁵ Thus, if Canada were convinced to scrap compulsory licensing, by virtue of its inclusion in these important trade arrangements, then it would make it much easier to get the lesser developed countries to cave into providing greater patent protection.

Canada's brand-name drug companies were counting on the Uruguay Round of trade negotiations and the North American free trade negotiations, which began in June of 1991, to produce intellectual property agreements that would bind Canada to

⁸⁴ Gherson, p. 14.

⁸⁵ Roxanne Snider, "Patents and profits," in *New Internationalist*, August 1993, p. 20.

strengthening patent protection for drugs. As stated previously, the Canadian subsidiaries of the pharmaceutical giants complained that Canada's weak patent laws placed them at a disadvantage within their own companies as other subsidiaries, in nations with stronger patent laws, received most of the head office's funds for further investment and R&D. However, if Canada was not under enough pressure already, more pressure to submit to a twenty-year norm came in May of 1991, when U.S. President George Bush's administration once again placed Canada on its special "watch-list" of countries that violated fair trade rules. As was stated by a senior U.S. trade official:

Canada is being cited, but not as a priority nation for retaliatory action. We hope that there will be progress on pharmaceuticals in the up-coming free trade negotiations.⁸⁶

Hence, this was a not-so-subtle warning to Canada to agree to full patent protection. If not, retaliatory action by the U.S., its largest trading partner, may occur. In addition, because Mexico had already instituted full patent protection in preparation for its entrance into NAFTA, this, too added pressure for Canada to harmonize itself with Mexico and the United States in the issue. Canada was under the gun, and it appeared unlikely that compulsory licensing would continue to remain in Canada if Canada wished to be included in these trade arrangements.

Therefore, the international and continental trade negotiations, which settled on twenty years as the standard for all patents, could be viewed in the sense that if Canada wished to share in the benefits of trade, then it must also share in its costs.⁸⁷ It was quite

⁸⁶ Gherson, p. 144.

⁸⁷ "Patent laws and patent falsehoods," in *Globe and Mail*, 24 June 1992.

obvious that the pharmaceutical multinationals would not allow Canada to free-ride on their research, and that the trade negotiations were excellent forums to express this.

Michael Wilson, Canada's Minister of International Trade, was well aware of the repercussions of maintaining compulsory licensing. In fact, he clearly stated that:

Canada would give up its system of compulsory licensing if that meant reaching an acceptable deal [in GATT] in such areas as agriculture or textile products... If there is a recommendation to abolish compulsory licensing and the other 107 GATT countries are prepared to sign the overall agreement, then Canada might not have any other alternative but to also sign, even if we are opposed to that.⁸⁸

Not surprisingly, the draft text of the GATT agreement contained a section on intellectual property rights. The GATT proposals were designed to set common standards in intellectual property protection for all its member countries: a full twenty years of patent duration. It would abolish compulsory licensing in Canada, although licenses that were issued before the draft text announcement on December 20, 1991 would be allowed. Canada had, finally, agreed to support the proposals, and now it came time to harmonize its domestic law with the proposed multilateral trade agreement. This would prove to be no easy feat.

The Announcement

On January 14, 1992, Michael Wilson announced Canada's decision in the GATT negotiations to agree to extend patent protection for twenty years. The GATT measures:

⁸⁸ Mickelburgh, in *Globe and Mail*, 19 December 1991.

will encourage increased research and development in Canada. High paying skilled jobs for the medical and scientific communities would result and Canada's international competitiveness would be enhanced.⁸⁹

This announcement paved the way for the Parliamentary introduction of a bill that would harmonize Canadian patent laws with the GATT proposals, and with the laws in the United States and Mexico. However, even before Bill C-91 was introduced in the House, the announcement of the intention to extend patent protection created quite a stir.

Predictably, Wilson's announcement was greeted with approval by the makers of brand-name drugs. Judy Erola hailed the decision to support the GATT text as "another major step forward in providing patent protection in Canada."⁹⁰ In fact, almost immediately after the announcement, commitments to build plants and increase R&D in Canada began to pour in by the pharmaceutical multinationals. Glaxo Canada started the trend with its declaration that it would be moving ahead with its plans to build a \$70 million manufacturing facility in Mississauga, Ontario. Soon after, other PMAC members also announced intentions and commitments for new research or manufacturing facilities worth a total of \$310 million.⁹¹ These announcements certainly appeared to substantiate Wilson's rationale for the intention to dismantle compulsory licensing.

⁸⁹ Quote by Michael Wilson, Canada's Minister of International Trade. Cited in David Spurgeon, "Brand-name drug companies appear to hold winning hand in GATT talks," in *Canadian Medical Association Journal*, 15 April 1992, p. 1430.

⁹⁰ Portia Priegert, "Ottawa set to protect drug patents for 20 years," in *The Vancouver Sun*, 15 January 1992.

⁹¹ Ibid.

Others agreed that Canada was in a win-win position. Generics would continue to produce copies, albeit not as soon as they wanted, and multinational pharmaceutical companies and small Canadian innovators would be under the gun to keep their prices down and their R&D levels up. Hence, it was argued that, although Canada was a relatively small market for sales, there was a good possibility that Canada would become a leading base for scientific research because of its high standards of education, health care, and scientific credibility.⁹² The province of Quebec was also supportive of the GATT announcement, largely due to the fact that many of the brand-name drug-makers had their research facilities located there. A parliamentary assistant to Quebec's health minister, Marc-Yvan Cote, called the GATT proposals a fair compromise.⁹³ However, expectedly, not everyone in Canada was pleased and nor did they regard the GATT proposals as fair.

The generic drug manufacturers were not content with Wilson's announcement. "It's going to destroy our industry," said Nicholas Leluk, an executive director of the CDMA. "Mr. Wilson pre-empted the GATT talks. They were to be concluded on April 17, 1992, and we fail to understand why a government would make this kind of announcement when the talks are not yet concluded."⁹⁴ Jack Kay, president of the CDMA and vice-president of Apotex, declared that this was the result of the

⁹² Michael Crawford, "Strong Medicine," in *Canadian Business*, June 1992, p. 43.

⁹³ Spurgeon, p. 1432.

⁹⁴ Spurgeon, p. 1430.

pharmaceutical multinationals “pulling the wool over the eyes of Canadian regulators.” It was claimed that the pharmaceutical drug companies had found new ways to increase their profits and competitiveness - ways that effectively bypassed the monitoring capabilities of the PMPRB. Some companies were claiming drug patents for compounds that had only been altered by size, shape, or colour. Consequently, the generics would be hindered from producing substitutes.⁹⁵ As well, they argued that Canadians were being shortchanged about the R&D levels. It was claimed that about 60% of what the brand-name drug-makers were claiming as tax deductible research actually had nothing to do with discovering new drugs. The truly innovative research was still done offshore at the head offices of the multinationals.⁹⁶

The generic manufacturers were also upset that they were not consulted.

Although Wilson had publicly stated that he had consulted them before his announcement, Leluk denied having any input.

We had a meeting prior to Christmas, but the GATT document was not available to us at the time. A copy was later sent to us. We only had that document for a short period and we spent a lot of time and a lot of effort was put in with lawyers and with our board in getting a response prepared. The very day it was sent in was the day the announcement was made.⁹⁷

However, what further enraged the generics was the fact that the abolition of compulsory licensing, if passed in the House, would be retro-active to December 20,

⁹⁵ Donald Campbell, “GATT threatens cash cow, Tories fear,” in *Winnipeg Free Press*, 14 January 1992.

⁹⁶ Crawford, p. 42.

⁹⁷ Spurgeon, p. 1430.

1991. This upset them for two reasons. Firstly, a few generic companies had already made commitments to expand their operations based on the licensing of newly-expired patented drugs.⁹⁸ Thus, with the announcement, plans would have to be shelved or scrapped, depending on the outcome of the soon-to-come Parliamentary proceedings on the changes. The second reason was perhaps best expressed by Leluk.

Why would any government disallow companies the right to apply for compulsory licenses prior to any agreement being signed [GATT]. There may not be an agreement signed until April, or maybe not at all. We think it's totally unfair.⁹⁹

Like with C-22, the generic companies were not alone in opposing the changes. Provincial health ministers, with the exception of Quebec, warned that it would cost the provinces millions of dollars in increased drug prices. Again, senior, consumer, and anti-poverty groups were distressed over the announced changes. Kevin Doucette, of the Consumers Association of Canada, declared:

It's going to have an impact of relatively large proportions on consumers. We're not going to take this lying down.¹⁰⁰

This was the battle cry of the many that opposed the proposed changes to patent protection. Therefore, the two camps that had formed in 1986 were solidified and ready

⁹⁸ Barry Sherman, of Apotex, was one of them. He had hoped to create a \$1 billion industry in Winnipeg. But this, he stated, would unravel if Canada's drug patent laws were changed. If the GATT package was approved, Apotex would still proceed with the \$17 million research project. But, the chemical manufacturing and export development phase of the plan--which he estimated would create \$1 billion in sales within two decades--would have to be shelved as they would not have the resources anticipated from licensing. See Donald Campbell, "GATT threatens cash cow, Tories fear," in *Winnipeg Free Press*, 14 January 1992.

⁹⁹ Spurgeon, p. 1430.

¹⁰⁰ Spurgeon, p. 1432.

to begin another heated debate over patent protection in Canada. It was certain that, over the next few months, the contending positions would be brought forth by intensive lobbying.

C-91 in Parliament

On June 23, 1992, the proposal to extend full patent protection, retro-active to December 20, 1991, was introduced into the House of Commons as Bill C-91. As expected, the rival groups pulled out all their familiar artillery - newspaper ads, television commercials, tough talk, and the best lobbyists money could buy. The ensuing battle in Parliament would come to be seen as a mirror of the battle that took place during 1986 and 1987 over C-22. However, this time, there would not be as much opposition from Liberal members of Parliament, which not only benefitted the pharmaceutical multinationals, but was also carefully orchestrated by their lobbying campaigns. Hence, although the anti-C-91 supporters would put up a good fight, from the beginning, it appeared that the deck was stacked in favour of the pharmaceutical multinationals.

Some opposition politicians, notably Ron MacDonald (Liberal MP-Halifax) and Jim Karpoff (NDP MP-Surrey), became vocal opponents of the bill, but most of the Liberals remained quiet because they did not want to offend voters in the Montreal area, where many of the multinationals made their headquarters in Canada. Nor did they want to "turn off the companies' tap" at their fundraising parties and dinners, for the

pharmaceutical companies bought tickets.¹⁰¹ And even the Liberal leader, Jean Chretien, was relatively quiet on the subject and asked MacDonald to tone down his criticisms.¹⁰² However, MacDonald did not abide by the request, which put him in a position to be a prime target for PMAC's efforts.

Both Karpoff and MacDonald complained that they were bombarded by telephone calls and faxes from university officials and others in their home provinces who had been promised PMAC research money if the bill passed through Parliament. In essence, it was suggested that their strong opposition to the legislation could jeopardize opportunities back home. Jim Karpoff stated that the threats/incentives about the bill were "not thinly veiled," and that the lobbying efforts of PMAC have been "very upfront and heavy handed."¹⁰³ MacDonald also claimed that Quebec Liberal and Conservative MPs have been told on PMAC's behalf that "if you're opposed to this, you're obviously against jobs in Quebec."¹⁰⁴ Obviously, PMAC's strategy of using jobs and investments to lure MPs into their corner appeared to be working, especially those from Quebec and Ontario. Yet, Karpoff and MacDonald would continue their opposition to the bill in the House, on behalf of all those opposed, even though it was realized that the bill would eventually become a done deal.

¹⁰¹ Stevie Cameron, in *Globe and Mail*, 30 November 1992.

¹⁰² Ibid.

¹⁰³ Ian Austen, in *The Montreal Gazette*, 5 December 1992.

¹⁰⁴ Austen, in *Globe and Mail*, 5 December 1992.

C-91, like C-22, was viewed by its opponents as another 'giveaway' to the U.S. and its pharmaceutical multinationals as a part of the GATT and NAFTA negotiations. Again, patent protection was a priority of both the Reagan and Bush administrations in the U.S., and this legislation was linked to another emotional debate surrounding free trade.¹⁰⁵ As well, many believed that the proposed amendments to the Patent Act were the result of intense lobbying by the U.S. and European multinationals, which sought a larger share of the Canadian market and felt threatened by competition from Canada's fast-growing generics. Karpoff expressed this view. He stated that, although the Canadian government articulated that the changes were required for participation in GATT and NAFTA, it became increasingly clear that:

this whole process was being directed from outside of Canada by the American drug companies, the big multinationals... The real push for this [C-91] is from the American Pharmaceutical Manufacturers Association. Gerald Mossinghoff, the president of the PMA, said that their goal was to get rid of compulsory licensing in Canada. As well, Edgar Davis, the former vice-president of Eli Lilly, stated that "putting the patent provisions in GATT and the North American accord was a master stroke - a master stroke."¹⁰⁶

As well, the arguments of the CDMA, and its member generic companies, were well-voiced in the House. Ron MacDonald questioned PMAC members' contributions in Canada and the rationale for the legislation using a report released from the

¹⁰⁵ Jim Karpoff summarized this point in the House of Commons on 7 December 1992. He read a letter aloud that was written by the U.S. PMA to a U.S. trade negotiator, Carla Hill. The letter, dated 26 February 1992, clearly stated the goals of PMA. "The NAFTA must require Canada to dismantle its discriminatory compulsory licensing regime for pharmaceutical products and to suspend the granting of licenses from December 20, 1991, forward." In Canada, *House of Commons Debates*, 34th Parliament, Vol. XI (1992), p. 14730.

¹⁰⁶ Speech on 8 December 1992, in Canada, *House of Commons Debates*, 34th Parliament, Vol. XII (1992), p.p. 14815-6.

Department of Consumer and Corporate Affairs. The report stated that:

there has been some improvement since 1988 in basic research, work to discover new drugs, but this has not been substantial. In 1990, it accounted for 26% of research spending, compared with 19% two years earlier. This still suggests that Canada is unlikely to become a centre for basic drug research.¹⁰⁷

Another report also confirmed the expected increase in drug costs. *The New York Times* published a report in November of 1992 that concluded that the change in patent legislation would cost Canada about \$508 million annually, a 12% increase on spending on drugs.¹⁰⁸ As well, shortly thereafter, Ralph Nader, a well-known American consumer activist, illuminated another reason, and negative impact, of the change in legislation. He remarked that the powerful U.S. pharmaceutical and hospital lobby wanted to eradicate the Canadian Medicare and drug systems because these were being proposed as models for reform in the United States.¹⁰⁹

Lastly, Brian Mulroney also became the target of criticism. Not only was the bill a 'giveaway' to the U.S. and its powerful pharmaceutical companies, but he was also charged for pushing the legislation through so as to repay the multinationals for all the financial support they had given him in the past election campaigns.¹¹⁰ Indeed, even Jean Chretien broke his passive, silent stance to denigrate Mulroney for this.

¹⁰⁷ As read aloud by Ron MacDonald, MP-Halifax/Dartmouth, September 17, 1992. In Canada, *House of Commons Debates*, Vol X (1992), p. 13265.

¹⁰⁸ Excerpt from *New York Times* report published November 16, 1992. Cited in "Report says drug patent law will cost Canadians billions," in *Globe and Mail*, 17 November 1992.

¹⁰⁹ "Nader reviles drug law," in *Winnipeg Free Press*, 3 December 1992.

¹¹⁰ "1 billion increase in drug laws under patent law rejected," in *Vancouver Sun*, 24 November 1992.

When will this government make it a priority to look after the weakest members of our society - the poor, the sick, the elderly - instead of siding with the multinationals who contribute to the coffers of the Conservative party?¹¹¹

Ergo, although it was understood that, with a sizeable Conservative majority, the bill would eventually become law, the opposition certainly put forth strong arguments and put up a good fight to challenge the extension of patent protection.

However, the federal ministers and the Conservative caucus of Parliament also argued forcefully, but for the passage of the bill. It became clear that the federal government, under P.M. Brian Mulroney, had identified pharmaceuticals as a strategic industry for Canada and hoped that the legislation would be a good start in building an integrated industry.¹¹² The need for full patent protection in Canada was best expressed by Pierre Blais, Minister of Consumer and Corporate Affairs, to the House on the 17th of September, 1992.

This legislation will help create jobs, attract new investment in research and development and provide new export opportunities for our many manufacturers of patented drugs. It is also a guarantee that Canadians can continue to buy patented drugs at a price that is, and will be remain, reasonable.

As far as economic benefits are concerned, Bill C-91 is another step in the government's program to modernize and rationalize Canadian patent legislation. In a global economy that draws its strength from Canadian and international know-how, ideas and innovation are essential to be able to compete on international markets.

Any nation that wants to maintain a high standard of living must remain at the forefront of scientific development and technology. To maintain its status as the country with the best quality of life in the world, according to the UN, Canada must have patent legislation that will reward innovative research and medical discoveries, and attract investment, as these will enhance the quality of life for Canadians.

This legislation will help bring the Canadian patent system more in line with the

¹¹¹ Canada, *House of Commons Debates*, Vol XIV (1 April 1993), p. 17934.

¹¹² Spurgeon, p. 1430.

systems of our main trading partners. In a global economy, businesses will prefer to invest in countries that offer the best possible environment for their investments. Without effective patent legislation, Canada will not be able to attract investments in manufacturing, research and development that create specialized, well-paid jobs in rapid growth industries.¹¹³

The federal government pointed to the announcements of the pharmaceutical multinationals to increase their R&D and investment in plants in Canada, after extended patent protection became part of the Canadian agenda, as illustrations of the potential of this extension for Canada.¹¹⁴ Thus, the federal government stated that these new investments, and the R&D and jobs that accompanied it, was something that would benefit all Canadians and increase Canada's competitiveness in the world economy.

The government also countered the arguments of those opposed to the patent legislation. The assertion that C-91 would destroy the home-grown generic industry was all but dismissed, as it was pointed out that all indicators showed that the industry was profitable and growing, despite the changes brought forth by C-22. Yes, the government did acknowledge that drug costs would rise, but that the PMPRB would be strengthened to be more effective in keeping drug prices reasonable. It was also insisted that the extra costs would be outweighed by the positive investments by the pharmaceutical

¹¹³Excerpt from a speech made to House of Commons, 17 September 1992, by Pierre Blais, introducing the second reading of the Bill. In Canada, *House of Commons Debates*, 3rd Session, 34th Parliament, Vol. XI (1992), p. 13258-9.

¹¹⁴Refer to Note 90; and speech made by Jim Edwards, Parliamentary Secretary to the Minister of Consumer and Corporate Affairs, February 10, 1992, in *House of Commons Debates*, Vol. IX, p. 6617-8; and speech made by Michael Wilson, November 16, 1992, in *House of Commons Debates*, Vol. XI, p. 13418 for references to the amount and type of investment pledged and by which pharmaceutical multinationals following the patent extension announcement.

multinationals, and that this was a small price to pay for keeping Canada in the league of scientific research.¹¹⁵

On December 10, 1992, the battle over C-91 was all but over. It had been successfully passed in the House (118-91) and, although it was expected to pass through the Senate, it was believed that it would not meet the pre-Christmas deadline.¹¹⁶ However, after the Christmas break, the Senate passed the bill. In February of 1993, C-91, the bill to amend the Patent Act, became law. This was the victory that the pharmaceutical multinationals had wanted, and lobbied for almost a decade. This was also the biggest defeat that the Canadian generic companies, provincial health programs, and consumers would suffer. The pharmaceutical multinationals finally attained their goal - to scrap compulsory licensing. Thus, the longest, most-lobbied, and one of Canada's most fiercest debates was finally laid to rest.

The Demise of Compulsory Licensing: An Analysis

In February of 1993, C-91, the bill to amend the Patent Act, was enshrined in law, and retroactive to December 20, 1991. C-91 effectively prohibits patent infringement of brand drugs by generic producers for the twenty year life of a patent.

¹¹⁵ Arlene Billinkoff, "Canada swims against current on drug issue," in *Winnipeg Free Press*, 24 November 1992.

¹¹⁶ Dennis Bueckert, "Senate delays drug patent bill," in *Montreal Gazette*, 11 December 1992.

This would give the pharmaceutical companies the same twenty year patent protection that all other manufacturers had for their invented products. In addition, the legislation also brought Canada into step with most other industrialized countries in the world that had this protection, and that supported the GATT proposal to have the norm set at this. It was firmly believed by the Mulroney government, and successfully argued by the pharmaceutical multinationals and the U.S., that without this kind of protection, Canada would be in a poor position to attract and hold firms engaged in advanced research and development. Without this, high-paying skilled jobs for the medical and scientific communities would not occur and Canada's international competitiveness would be retarded. C-91 offered to Canada - and particularly Montreal, the drug-making capital of Canada - the hope to maintain and attract a healthy and innovative pharmaceutical industry.

The case of the demise of compulsory licensing is rich with analytical possibilities. In fact, the successful influence of the pharmaceutical multinationals in receiving full patent protection in Canada, their desired outcome, could, most certainly, be attributed to structural power and their ability to effectively integrate themselves, and their goals, into the domestic structures. However, direct power, in the form of extensive lobbying, both in Canada and in the international realm (particularly through the United States) must also be considered to be an important factor in their success. Thus, it can be professed that structural power and domestic structures, inclusive of

direct power, were determinants of the outcome in the conflict over patent protection in Canada.

As one would recall, structural power was defined as the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises, and other actors must operate.¹¹⁷ Therefore, structural power is held if the possessor is able to change the range of choices open to others, without apparently putting pressure directly on them to take one decision or to make one choice rather than others.¹¹⁸ This power is indirect and, consequently, less visible, but no less potent. From an understanding of the events that led to the dismantling of compulsory licensing in Canada, it can certainly be asserted that the brand-name pharmaceutical multinationals held this power and that it was a contributing factor to the outcome in their favour.

With regards to the various aspects of the global pharmaceutical industry, structural power is easily understood. The industry is basically recession-proof, as disease and illness are, unfortunately, highly unlikely to disappear. And despite the recent grumblings within the industry about a decline in fortunes, there does not appear to be a significant down cycle occurring in terms of their profitability and nor with their research and development spending. In fact, the pharmaceutical industry is one of the

¹¹⁷ Susan Strange, *States and Markets* (London: Pinter Publishers, 1988), p. 24.

¹¹⁸ *Ibid.*, p. 31.

most profitable of industries. As was previously stated, in terms of foreign assets and in size of annual products, a substantial number of pharmaceutical firms are in the top-100 of transnational corporations worldwide.¹¹⁹ And although their profitability has fallen slightly, they are still above-average from a cross-analysis with other industries. In fact, in using the U.S. pharmaceutical multinationals to illustrate this profitability, in 1996, the top pharmaceutical multinationals based in the United States averaged a 21% profit, and their profits as a percentage of revenue averaged 16%.¹²⁰ And when one considers these factors, and the research and development nature of the industry (and the jobs associated with it), it comes as no surprise that states worldwide were, and still are, wooing the high-tech and high-rolling drugmakers. In fact, it is widely held that all industrialized, and even developing countries, are competing for pharmaceutical investment because the industry is non-polluting, recession-proof, profitable, and creates jobs oriented towards research and development and other high-tech responsibilities.¹²¹

Hence, it can be asserted that the pharmaceutical multinationals had structural power, in both the production and knowledge-based capacities, which directly related to the nature of the industry. Control over production is a structural power. It is manifested by those who are able to control the manner or mode of production of goods and services. The pharmaceutical multinationals were able to decide where to locate

¹¹⁹ *Supra* notes 3 and 4.

¹²⁰ "Top 500: America's Largest Corporations," in *Fortune*, 28 April 1997, pp. F-58-59.

¹²¹ Drew Pagan, "Drug firms go to court," in *Globe and Mail*, 9 December 1992.

facilities, what each facility would do, how they would operate, etc. This can also be seen as a negative power, as well, for the decision-makers of the corporation could also decide where not to locate manufacturing plants, or where not to conduct operations. As was outlined earlier, these global pharmaceutical firms had decided, in most cases, to conduct manufacturing operations in 'host' countries, where cheaper labour was a factor, and to conduct intensive R&D phases in their 'home' countries. Thus, states are aware that their domestic business climate could either entice, or deter, multinationals to locate there. As well, multinationals could also 'exit' a country in which they had set up operations. Thus, locational choices of production by multinationals can certainly impact on the decisions made by states, especially considering that states are aware of inter-state competition and the role of economic development in this. That is, states are in competition for this type of investment, and if they are chosen, or bypassed, this would affect their position. Clearly, the pharmaceutical multinationals were able to, indirectly, influence the decision of the Canadian government by virtue of their ability to decide whether to open facilities in Canada, decrease the operations of their facilities in Canada, or to close these facilities.

In 1987, with C-22, this government took its first step to begin to correct an outflow of economic activity in an industry which has traditionally had a strong scientific and manufacturing presence in Canada but which was on its way to leaving Canada for more welcome homes elsewhere in the world... C-91, the second and final step to full patent protection, was the antidote needed.¹²²

The Canadian government was well aware of this control, and it was obviously a factor

¹²² As stated by Ken James, Parliamentary Secretary to the Minister of Labour in the House of Commons. Cited in Canada, *House of Commons Debates*, 17 November 1992, pp. 13477, 13479.

in its decision to choose to extend patent protection rather than to retain compulsory licensing.

However, what perhaps was more of a factor in the Canadian government's decision was the fact that the brand-name pharmaceutical multinationals are part of an intensely knowledge-based, or high technology, industry. That is, the pharmaceutical multinationals held structural power in that they are able to disseminate this knowledge, or withhold it. In this respect, structural power can be exercised by those who possess knowledge and who can wholly, or partially limit, or decide, the terms of access to it.¹²³ Through this, the multinationals are able to decide in which territory, or state, they would conduct their highly knowledge-intensive phase of research and development for new drugs. Because knowledge, and high technology, are considered to be important elements of a nation's competitiveness, states are eager to entice pharmaceutical multinationals into their territory that would bring this with them. States, and in this instance, Canada, believe that this transfer of knowledge, or 'new' knowledge, is vital for their competitiveness and economic growth and, thus, do not want this withheld.

Although this was an 'indirect' source of power, the pharmaceutical multinationals, too, were well aware of its implications for the international competitiveness of a state. Kirk Schueler, the president of Marion Merill Dow, remarked that:

¹²³ Strange, p. 28.

The key aspect is one of international competitiveness. If Canada wants to have a world class level of research conducted here, and wants a strong industry, then it is only right, in return, that it provide world-class intellectual property protection.¹²⁴

Clearly, Canada was aware that the only way to lure the pharmaceutical multinationals to increase their R&D investment in Canada was to provide the favourable business climate that they required: full patent protection. As stated by Ken James, the Parliamentary Secretary to the Minister of Labour, this is what the government hoped to accomplish with C-91.

Rewarding discovery is an essential component of developing a strong economy in an age of increasing technological sophistication and international competition. Quite frankly, we as a government wanted the pharmaceutical innovators to remain in Canada to develop a technological and research base here, not elsewhere. We wanted them to concentrate their businesses here, to employ our science graduates, to invest implants and equipment on Canadian soil, to invest in research in Canadian universities and in Canadian hospitals and other research centres and export from Canada rather than import into Canada.¹²⁵

In addition, one also cannot dismiss normative dimensions of this structural power. As was expressed by Stephen Gill, the tenacity of normative structures can be illustrated how, in modern economies, consistently higher priority is given to economic growth and competitiveness relative to other goals.¹²⁶ This, inadvertently, awards multinational corporations, pharmaceutical multinationals as no exception, indirect power in influencing the range and choice of decisions to be made by states. It was quite obvious that ideology, one that espoused economic liberalism and multinationals as

¹²⁴ Rebecca Wigod, "Pill patent punch-up," in *Vancouver Sun*, 4 June 1992.

¹²⁵ An excerpt from a speech made by Ken James. In Canada, *House of Commons Debates*, 17 November 1992, p. 13478.

¹²⁶ Stephen Gill, "Global Hegemony and the Structural Power of Capital," in Gill, ed. *Gramsci, Historical Materialism and International Relations* (Cambridge: Cambridge University Press, 1993), p. 100.

'engines' of a nation's economic growth and competitiveness, shaped the Canadian government's actions.

The Canadian government sought to maintain a favourable business climate for the pharmaceutical multinationals, so as to accomplish the goals of furthering Canada's economic competitiveness, rather than maintain a system that would meet the needs of the Canadian public and provincial drug plans by providing more reasonably and lower priced prescription drugs. The system of compulsory licensing was a deterrent to this goal, as this was not a business climate that pharmaceutical companies wished to operate within. In fact:

A government seeking foreign capital [investments] and research and development to develop a drug industry within its own borders is clearly off to a bad start if it has adapted price controls, has introduced legislation designed to remove or weaken drug patent protection, has allowed legislative inquiries to create adverse publicity, or has tried to control the proliferation of brand names by favouring generic drugs or drawing up lists of drugs it will reimburse or permit to be prescribed within its social security system.¹²⁷

Therefore, Canada took steps, through C-22 and C-91, to rectify the domestic business climate that prevented pharmaceutical multinationals from deciding to invest and do more research and development which, in the eyes of the Canadian government, was crucial to its goal of economic competitiveness in a world that placed a high degree of importance on knowledge and technology to further this goal. That is, Canada championed the ideology that the competitiveness and prosperity of a nation, and its capacity to improve its standard of living in the global economy would be determined by

¹²⁷ Robert J. Ledogar, *Hungry for Profits: U.S. Food and Drug Multinationals in Latin America* (New York: IDOC, 1975), p. 53.

such factors as innovation and know-how. The pharmaceutical multinationals were key to the achievements of these objectives.

Ergo, it can be concluded that the pharmaceutical multinationals held various elements of structural power. Production, knowledge, and ideological bases of structural power certainly provided the brand-name drug-makers indirect influence in furthering their goals - to promote and consequently increase the levels of patent protection for their innovations. However, these elements of structural power, in themselves, do not provide an adequate explanation as to how the pharmaceutical multinationals were able to influence the Canadian government so as to have an outcome that was favourable to them. Certainly structural power can be considered a determinant of the outcome of a conflict between the multinational corporations and the state, but it is not the sole determinant. If it was, the pharmaceutical multinationals would not have bothered to integrate themselves into Canada's domestic structures, nor would they have bothered to directly lobby the government. Thus, a look at domestic structures as other determinants of outcome is warranted.

As one would recall, domestic structures encompass the organizational apparatus of the political and societal institutions, their routines, the decision-making rules and procedures, and other domestic entities or actors, such as business firms and trade

groups or associations.¹²⁸ Competitive pressures encourage multinational corporations to alter their behaviour or organize themselves in ways that allow them access into a state, or access to actors or structures of influence within a state. How they organize themselves within a state will differ depending on the state, as sources of influence vary. It can be asserted that the pharmaceutical multinationals were effective in the manner in which they organized themselves within the Canadian state, and this, consequently, was an important determinant of the favourable outcome. In fact, the successful formation of relationships with the 'right' people and groups in Canada was part of the overall strategy for the pharmaceutical multinationals, so as to increase the likelihood of gaining their objectives.

The pharmaceutical multinationals were able to effectively form functional linkages within the Canadian state. By definition, functional linkages are the connections or associations with other competitive, complimentary, or cooperative entities within the state, such as domestic firms, trade associations, financial institutions, suppliers, and the like.¹²⁹ Thus, building alliances, or relationships, with other domestic actors further integrates the multinational corporation into the state. The membership of many brand-name pharmaceutical manufacturers into the Pharmaceutical Manufacturers Association of Canada is an excellent example of this type of integration into domestic structures.

¹²⁸ Thomas Risse-Kappen, "Bringing Transnational Relations Back In: An Introduction," in Risse-Kappen, ed. *Bringing Transnational Relations Back In: Non-state Actors, Domestic Structures and International Institutions* (Cambridge: Cambridge University Press, 1995), p. 20.

¹²⁹ A. H. Meleka, "The changing role of multinational corporations," in *Management International Review*, Vol. 25 No. 4 (1988), p. 42.

PMAC was a well-regarded pharmaceutical industry group in Canada that was effective in voicing its concerns and needs, on behalf of its members, to the government and public. Indeed, the role of PMAC as an association has been regarded as “clearly one of a buffer or protector”. That is, PMAC could be considered to be “an apparatus for evading or resisting a state power that is attempting to intervene in the affairs of its members.”¹³⁰ PMAC played an important role in voicing the concerns of the multinational pharmaceutical corporations to the Canadian government and in convincing it that compulsory licensing was hurting the industry and also Canadian prospects for competitiveness. PMAC had the ‘right’ connections in Canada for the multinationals, including the in-house expertise and former connections of Judy Erola, its president and the former minister of Consumer and Corporate Affairs. Thus, pharmaceutical multinationals used PMAC as an important point of access in integrating themselves into the spheres of influence in Canada.

As well, pharmaceutical multinationals also built diffused linkages in Canada. Diffused linkages, as noted previously, are those linkages that are not associated with any formal organization, per se, but that are strengthened by the integration into the state’s political and professional milieux, by virtue of forging and fortifying relationships with political factions and intellectual elites.¹³¹ It was quite obvious that the

¹³⁰ As stated by W. Muller and C. Neuseuss, “The Welfare State Illusion and the Contradiction between Wage Labour and Capital,” in Holloway and Piccioto, eds. *State and Capital*, p. 37. Cited in W.D. Coleman, “The Capitalist Class and the State: Changing Roles of Business Interest Associations,” in *Studies in Political Economy*, No. 30 (September 1986), p. 145.

¹³¹ Meleka, p. 43.

multinationals had effectively managed to forge these relationships, by themselves or through PMAC. Usually the promise of money, in financing R&D or political campaigns, is a useful tool in building these relationships. A good example of this relationship with the political milieu was that, at the opening of Merck's new facility in suburban Montreal, Canada's prime minister and several cabinet ministers were in attendance. In fact, it was previously remarked by John Duncan, a government analyst, that "anytime you get 4500 people out to one of your events, plus the prime minister and several cabinet ministers, this shows something. These people really know what they're doing."¹³²

In addition, not only did PMAC and its individual members build relationships with the federal political milieu, but also the provincial. This, too, can be seen as an example of multinationals shaping their strategies and themselves to work within the distinct character of each state's domestic structures - as federalism in Canada, especially in the policy realm of health care, warranted such. As was shown through the events leading up to the demolition of compulsory licensing, the pharmaceutical multinationals build their support by promises of increased investments and R&D into the provinces, particularly Ontario and Quebec. Obviously this strategy could be attributed to the fact that Ontario and Quebec, by virtue of seats in the House of Commons, were politically important. But, as one would recall, Quebec was the location of the majority of these firms' subsidiaries. This, in conjunction with the fact

¹³² Refer to Note 78.

that Quebec was expressing disenchantment with the federalist structure of Canada, provided an incredible strategic prospect. The pharmaceutical multinationals, by promising greater investment and R&D in the province, were effectively able to convince Quebec politicians, particularly officials in its ministry of health, to become supporters for the extension of patent protection. This put added pressure on the federal government, as national unity was a significant concern at that time, and gave the multinationals greater influence in shaping its range of choices and, ultimately, its decision. Thus, the pharmaceutical multinationals illustrated their capabilities in forging these diffused linkages with important political elites.

As well, the brand-name pharmaceuticals also built relationships with the academic and professional milieux in Canada. By promising research money and a 'helping hand' in medical research facilities and universities, PMAC and its members were able to garner greater support for their cause. In fact, brand-name drug firms were shelling out millions for research programs at Canadian universities and teaching hospitals and striking alliances with home-grown research-based firms that needed capital infusion to continue.¹³³ These alliances, or arrangements, brought more support for their objectives to increase patent protection in Canada. As one would recall, university administrators and representatives from small Canadian research firms were vocal supporters of the changes to patent protection (both times), and raised their voices to the government and public through letters and public statements that these changes

¹³³ Gherson, p. 144.

were needed for their establishments.¹³⁴ Without these changes, they argued, pharmaceutical multinationals would cease to spend funds for their research, and this would inadvertently affect them and Canada's competitiveness. Therefore, diffused linkages in Canada were also an important method of the pharmaceutical multinationals to integrate themselves into Canadian structures - ones that would award their views and concerns more influence.

In addition, the direct influence of the pharmaceutical companies should also be considered to be an important factor, or determinant, of the favourable outcome. As was mentioned earlier, PMAC, and the individual companies, had hired a large number of lobbyists and strategists to promote their cause to Canadian legislators. Not only were these firms well-regarded and proven to be top lobbyists in the country, but the top management of these firms had important political connections - especially to the Canadian Prime Minister, Brian Mulroney. Therefore, these factors gave the lobbyists much influence, especially in terms of access to the primary legislators in Canada and in the potency and credibility of their arguments. In fact, one of the brand-name drug-makers' fiercest opponents, Barry Sherman, president of the Canadian generic firm Apotex, commented on the political might of their lobbyists.

We [the generic firms] save money for health care. We create jobs, too. But there's a whole system of barriers to entry maintained by the Ministry. The lobbyists for the multinationals get to these people. They spend enormous amounts of money. They have all the right connections.¹³⁵

¹³⁴ Austen, in *Montreal Gazette*, 5 December 1992.

¹³⁵ A. Kingston, "Drugstore Cowboy," in *Report on Business Magazine*, September 1996, p. 81.

Indeed, the multinationals did spend large sums of money, estimated at over \$100 million, on these lobby firms, and also on print and TV advertisements, to convince the government and the publics that they were positive forces in Canada, and that the generics were costing Canadians a lot more than what they were saving on drugs - fewer jobs, less original research, and no investment in plants.¹³⁶

It is also important to note that the direct power that was exerted, in the form of lobbying and political 'financing', was shaped by the domestic structures of Canada and the United States. That is, in states where lobbying efforts matter, these will occur. In the instance of the Union Carbide in Bhopal, the use of lobbying efforts to influence the Indian government were not important in India's domestic structure and, thus, they were not used. However, in this particular case, as with the Toshiba case, domestic structures presented opportunities for lobbying to occur, and to be influential. Thus, it can be stated that, although direct power is an important determinant of the outcome, it must also be viewed as being determined by the particular domestic structures in which the multinational wishes to infiltrate.

Having come thus far, it has been ascertained that elements of structural power had, indirectly, awarded the brand-name pharmaceutical multinationals a great deal of influence in shaping the outcome to its liking. This, in conjunction with their ability to

¹³⁶ Crawford, in *Canadian Business*, June 1992, p. 40.

integrate themselves successfully into Canadian domestic structures, including lobbying strategies, the multinationals were able to successfully exert influence, both directly and indirectly, on the Canadian government to make its decision in their favour. However, how can one explain the difference in influence between the multinationals and the generic companies? The Canadian generic companies held the same factors of influence, in that they, too, had the ability to provide Canadians jobs and a boost to the economy. They also used Canada's domestic structures and also exerted direct power in the form of lobbying. In fact, the generic companies had an additional linkage in the domestic structure--one that could be termed a normative linkage. The generics had effectively persuaded much of the Canadian public, and officials of social institutions, that their goal - to retain compulsory licensing- was also a goal that they, too, should promote. They argued that, by supporting extended patent protection for pharmaceutical multinationals, they were supporting the increase of drug costs and the unaffordability of provincial health plans. Thus, through a quick comparison of the two rival parties in the debates, the pharmaceutical multinationals and the Canadian generic firms, it appears that, in terms of domestic structures (and lobbying efforts), they were both on equal footing (or close) in their attempts to influence the government's decision. However, this obviously conveys the importance of structural power, especially knowledge-based and international in nature, as an effective determinant of the outcome in the favour of the multinationals, as this was not held by the generics. Nonetheless, aside from structural power and domestic structures, in this particular instance, one must also be compelled to

consider another possible factor, or determinant, of the outcome in favour of the multinationals.

As was stated in the introduction of this chapter, the paradigms that concluded that the 'strength' of a state, or role of a state in the international system, was an important determinant, or predictor, of the outcome of a conflict between it and a multinational corporation. However, this may, possibly, explain why the pharmaceutical multinationals, based in 'powerful' countries, were able to defeat the Canadian generic firms on their own turf. That is, the role of the U.S., and to a lesser extent, the European states, must be examined.

The United States is, one of the most (if not the most) powerful states in the international system. When one combines this with the fact that it is also Canada's largest trading partner and an economic behemoth, it is understandable that Canada, a 'lesser' power in comparison to the U.S., pays consideration to its viewpoints. It was illustrated that the United States had a great deal of power in the free trade negotiations (Canada-U.S. FTA, GATT, and NAFTA). They were able to successfully place intellectual property rights on the agenda at these talks. And from their position as an important trade partner (access to its market was crucial) and from its forcefulness on this issue, the U.S. was able to influence many countries into accepting provisions on intellectual property in the final agreements. Although there was no binding agreement reached on intellectual property rights in the Canada-U.S. Free Trade Agreement, GATT

and NAFTA did contain provisions relating to intellectual property rights, which included full patent protection for pharmaceuticals. Thus, this could be construed as a confirmation that the 'strength' of a nation is important. However, what is important to examine, before such a simplistic assessment is made, is the role of multinationals in the United States and their success in placing this on the agenda of the administration, so as it would be covered during the negotiations.

Clearly, this calls for one to also consider how the U.S.-based pharmaceutical multinationals were able to have such an impact in persuading the U.S. to become vocal supporters of its goals in the trade negotiations. It is quite obvious that the U.S.-based pharmaceutical multinationals knew that they stood a greater chance of having Canada dismantle its system of compulsory licensing if the U.S., the more powerful state and a vital market for Canada, if the United States became an ally. Throughout the chapter, there are a number of indications that the multinationals were pressuring Canada with the knowledge that this would have an impact on the lesser developed countries to alter their patent policies. Therefore, it can be illustrated that structural power, in an international sense, was an important element. However, the same production and knowledge-based structural power was also important in allowing them great influence in the U.S. administration so that they would promote these goals on an international level. As well, it can also be illustrated that, along with structural power, their infiltration into the domestic structures of the United States were also a cause of this influence.

As one would recall, the pharmaceutical industry was well-ensconced in the domestic structures of the U.S., including its decision-making structures. Both Reagan and Bush had strong ties to the companies, as Reagan used one of the industry's top executives as a trade advisor and Bush was, himself, a former director for Eli Lilly. As well, the companies were well integrated into both the functional and diffused linkages in society - with a vast network of business affiliations and alliances, membership in key associations (such as the Business Roundtable and the PMA) and coalitions, political alliances, cooperative ventures with university research centres, and the like. As well, it was also noted that the U.S. was well-accustomed to consulting various industry and trade groups before entering into bilateral and multilateral forums. Thus, the pharmaceutical multinationals were well-positioned to exert their influence on the U.S. administration so that it would fiercely promote their goals in the bilateral and multilateral trade negotiations.

From this, one might be tempted to conclude that a multinational corporation is as influential as the state it chooses to employ for strategic influence towards another state in which there is a need for this kind of influence in order to achieve its goals. However, this type of analysis does not take into account that, if this strategy is employed, then the conflict is altered from being one that is between a multinational and a state to one that is inter-state, which requires a different basis for analysis. Thus, although multinationals may employ other states to enter into its battle in its corner, this may, or may not occur, and would greatly depend on: 1) whether the multinational was

unable to achieve its outcome with a respective state through structural power and its domestic structures and 2) whether the multinational had the ability to influence its 'supporter' state to act on its behalf through its structural power and integration into its domestic structures.

In conclusion, as in the previous cases of the Bhopal tragedy and the Toshiba incident, an examination of the successful outcome of the pharmaceutical multinationals in Canada illuminates that elements of structural power and domestic structures are potent as determinants of the influence of multinational corporations. Ergo, it can be asserted that structural power and domestic structures can provide potent explanations as to the outcome of MNC-state conflict.

**Conclusions: The Multinational Corporation
and its Sources of Power**

Power, as one would recall, can be measured by the influence over outcomes.¹ That is, power is usually defined as the ability to get what is wanted, or to produce a desired change. The main purpose of this thesis has been to examine the relationship of the multinational corporation with the state so as to establish a basis for analyzing and understanding the sources of the power of the multinational corporation in this conjunction. The three case studies illustrate that multinational corporations can, certainly, hold a great deal of power in their interactions with the state. However, as is exhorted by Susan Strange, it is not enough to ask who has power, but rather what is the source of that power.² Consequently, this precipitates one to question the source of the power of the multinational in its relations with the state. Hence, it has been concluded that structural power and domestic structures are important determinants of its ability to influence outcomes in its favour.

Prevailing Approaches Revisited

The presence of multinational corporations as actors in national and international economies is well-established. But despite more than twenty years of controversy about their presence, role, and actions, there still exists a poor understanding of their power.

¹ Susan Strange, "Politics and Production," in Strange, ed. *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996), p. 53.

² Susan Strange, *States and Markets* (London: Pinter Publishers, 1988), p. 23.

As was discussed in the introductory chapter, conventional approaches to the multinational corporation have been inadequate in addressing or explaining the power of the multinational in its interactions, or conflicts, with the state.³ Much of the debate centred around multinational corporations has been a normative one, particularly in establishing whether multinationals are beneficial or harmful to states. These approaches study the impact of multinationals on the interests of states, but convey very little with regards to how multinationals are able to influence the state. Nor do they offer any explanation as to why some multinationals are more influential than others. Vernon's model of obsolescing bargaining, the most widely-accepted paradigm of multinational-host state relations in International Political Economy, explains the development of this relationship over time as a function of the goals, resources, and constraints of each. Although this model has its merits, it, too, fails as it does not have explanatory capacity for corporations engaged in industries in which the bargain may not obsolesce, such as in advanced technology, and nor does it take into consideration advantages that may be gained through the usage of idiosyncratic domestic structures.

As well, through a dissection of the case studies at hand, several key assumptions regarding the power of a multinational during a conflict with the state have also been debunked. Firstly, it was mentioned earlier that variations in the influence of a multinational might be explained by the degree of importance of the issue-area to the

³ Refer to sub-section "Prevailing Approaches to the Multinational Corporation" in the Introductory chapter for a more detailed explanation of the conventional approaches and of their failures.

state in question. That is, insight may be gained by utilizing the importance of the issue-area, or the magnitude of the issue in conflict, to the state in question. For instance, in conflicts arising from issues held to be in the traditional realm of 'high' politics, such as military and state security matters, one would assume that it would be unlikely that the multinational would have a great degree of influence in shaping an outcome to its preference. However, as the Toshiba case suggests, an analysis based solely on the importance of an issue-area to a state is clearly insufficient. As well, the Bhopal accident also calls this assumption into question. Although environmental and health and safety issues have not, conventionally, been treated as issues of top priority, or high politics, by states, the magnitude of the tragedy suggests that a state would be in a dominant, or winning position, and would be able to effectively punish the offending multinational corporation. Yet this, too, did not occur. What is discernible, however, is the extreme difficulty in accurately assessing the degree of influence, or success, that a multinational corporation will have by exclusively examining issue-areas. Certainly, studying the issue-area may be of assistance in understanding an outcome and should, therefore, not be dismissed entirely. However, it would be nearly impossible to generalize about the influence of a multinational corporation just by examining the specifics of the issue-area and by ignoring other more potentially explicative conditions, such as the particularities of the domestic structures of the state in question and the international structural changes that have occurred.⁴

⁴ Thomas Risse-Kappen, "Structures of Governance and Transnational Relations," in Risse-Kappen, ed. *Bringing Transnational Relations Back In: Non-state Actors, Domestic Structures, and International Institutions* (Cambridge: Cambridge University Press, 1995), p. 307.

As well, to analyze a multinational's potential power solely by its resources is also too simplistic. As the case studies have shown us, the possession of resources, such as economic wealth, that could give potential power is not enough to determine the multinational corporation's impact on the domestic policies of the state. If the assumption that possession of resources is an effective determinant of outcome, then clearly Union Carbide and the United States would have prevailed in their respective conflicts, and the struggle between the pharmaceutical multinationals and the Canadian state would have resulted in a draw. Yet, the pharmaceutical MNCs successfully obtained their chosen outcome, the United States did not prevail over the wishes of Toshiba, and Union Carbide, although it emerged relatively unscathed from the battle, did not directly deploy its resources. Therefore, it can be stated that the exclusive use of this analytical basis does not posit an accurate result for it has been illustrated that the control of these resources of power does not automatically translate into power. However, the possession of these resources can play a role in the manner in which power can be exercised. It is how multinationals translate these resources into power that should be studied. Ergo, it can be stated that structural power and domestic structures are important factors of this translation.

In terms of structural power, resources held by the multinational, such as production capabilities, economic wealth, and knowledge (including technology), are indirectly used to garner influence with states. It is the multinational's mobility and ability to control these on an international scale that awards them indirect power, or

influence, with states. It is not the mere fact that they possess these resources which states desire in their economic goals, but rather what they are able to do with these resources is what endows multinationals with this indirect form of influence.

As well, domestic structures should also be included in this analysis. These power resources can also be used to strengthen their associations, or links, with various domestic structures of a particular state, such as through channelling money into research programs at universities or by corporate philanthropy practices. Again, the variance in how these resources are used is shaped by the idiosyncrasies of domestic structures.

However, when one discusses the 'power' resources of a multinational and how they are used as tools for influence, most often reference is made to examples of direct power. The resources of power can certainly be employed, and be needed, by a multinational corporation which seeks to influence a state. In fact, in the use of direct power, the economic wealth of a multinational can be an important aid, as lobbying, bribing, and public relations campaigns (just to name a few examples of direct power) are quite expensive strategic activities. In both the Toshiba and pharmaceutical cases, it was evident that direct power was exercised by the multinationals so as to influence the outcomes in their favour. However, using 'power' resources in a direct exercise of power must also be considered in the context of domestic structures. That is, as stated above, domestic structures shape whether or not direct power by a multinational will be

used. In states where these activities, such as lobbying and bribing, are the norm or are considered to be important factors in influencing a state, they will be used by the multinational.

In sum, there is no denying that the resources of a multinational are important elements of its potential power, but it is not just the possession of these resources that garners influence. Rather, an examination of how these resources are used by multinationals to gain influence with a particular state would be a more appropriate measure. From this, it is apparent that structural power and domestic structures filter or shape how these resources will be used towards the goal of influencing a state, directly or indirectly, to produce an outcome favourable to the multinational.

However, aside from the evidence already presented, there are other grounds for including structures into analyses of the power of multinationals in their relations with the state.⁵ Firstly, as was stated in the introduction, realists regard the state as the dominant actor, both in the national and international realm. Consequently, it is deduced that the state always wins in these confrontations. However, states do not always win. Just the same, multinational corporations do not always win. In all three cases, it certainly was not guaranteed that the multinational would win and, in fact, they did not

⁵ I am indebted to Professor Tony Porter for presenting the following two points.

completely attain their desired outcomes.⁶ Thus, this strengthens the argument that structures are significant in shaping an outcome, for, as it was shown, it cannot be simply predicted by assessing relative capabilities or from assumptions of strength.

Secondly, another key realist assumption also falters in analysis. Realists argue that all states are rational unitary actors, and that because all states are essentially alike, domestic structures can be ignored as they do not have any impact in the construction of the national interest. However, the cases prove otherwise, as the character of states do vary (not all states are rational unitary actors!) and these idiosyncrasies are manifested in their respective domestic structures. The politically-constructed nature of the national interest in the pharmaceutical and Toshiba cases illustrate this point well, as does the fact that the Indian government and its judicial system were two different actors (structures) within the same state. Again, this posits that structures are of significance in analyses.

Ergo, although these approaches, and assumptions, in the study of multinational corporations certainly have their merits and cannot so easily be abandoned, it is apparent that their shortcomings stem from a neglect of incorporating structures into their analyses. Through a critique of these approaches, it is evident that structural power and domestic structures, including direct power, are important determinants of the influence

⁶ As one would recall, Union Carbide's ultimate goal was to be completely absolved of any liability, and thus of any financial obligation for the accident. Toshiba's preferred outcome was not to have any type of 'sanctions' imposed. As well, although it can be inferred that the pharmaceutical multinationals' attained their desired outcome - full patent protection for twenty years - they would have preferred to have this outcome without putting forth any promises of increased investment in Canada. Thus, all did not achieve their 'ultimate' outcomes.

that a multinational will have in its relations with a state. Therefore, it is now necessary to examine whether this hypothesis has a practical application in analysing instances of conflict that occur between a multinational corporation and a state.

The Case Studies

Three cases in which there has been a conflict between the multinational corporation(s) and a state have been thoroughly examined in my inquiry: Union Carbide Corporation and its tragic accident in Bhopal, India; the conflict in the United States arising from the sale of sensitive technologies to the Soviet Union by Toshiba Machine Company; and the quest of pharmaceutical multinationals to dismantle the Canadian system of compulsory licensing and extend patent protection .

In all three cases, structural power has proven to be important in determining a response from the state, one which favoured the multinational. As one would recall, structural power enables its possessor to change the range of choices available to others, without apparently putting pressure directly on them to take one decision or to make one choice rather than the others.⁷ As stated in the introduction, structural changes that have occurred in recent decades have been tremendously beneficial to multinational corporations. The technological and transportation advances, along with economic and capital liberalization efforts by states, have enabled a greater ease of mobility for

⁷ Strange, *States and Markets*, p. 31.

multinational corporations.⁸ Because of their ability to operate successfully within these changed structures and ideologies it appears that these multinationals are more able to, indirectly, shape the range of choices available to states, and thus, increase the likelihood of having the outcomes in their favour. Thus, the direct use of power by a multinational may not be necessary, for a favourable outcome may be achieved through other, indirect means.

In the case of Union Carbide and the tragic Bhopal accident, it is quite obvious that the normative dimensions of structural power allowed Union Carbide to operate in an environment that was conducive to its own goals, without the hassle or concern about the environment, or safety and health of its workers and the residents surrounding its Bhopal plant. This was manifested by allowing (or seducing) Union Carbide to expand its operations in India, and also in the way that Union Carbide was treated by the Indian government following the tragic accident. Union Carbide, responsible for the deaths and injuries of hundreds of thousands, was treated with 'kid gloves' by the Indian government: it did not appeal U.S. Judge Keenan's decision to have the case dismissed from U.S. jurisdiction; it quickly accepted the offer of settlement even though it appeared highly probable that Union Carbide would be held liable in the courts; and the Indian government did not seek extradition in the U.S. for the criminal charges that were

⁸ These changes are usually referred to as 'globalization', an all-encompassing term that attempts to acknowledge the structural changes that have occurred. See the sub-section "Structural Changes and Power Shifts" in the Introductory chapter for a more detailed explanation of 'globalization' and how this relates to the structural power of the multinational.

laid against some of Union Carbide's top executives. Clearly, the Indian state did not want to 'scare off' potential foreign corporate investors by acting belligerently towards Union Carbide. Thus, the maintenance of a favourable business climate, one that would attract foreign investment capital and technology, was important to the Indian government, much more so than aggressively pursuing justice for its dead and injured nationals. In this respect, the ideological aspect of structural power was clearly important in shaping an outcome that was favourable to Union Carbide.

In the Toshiba case, this ideological normative aspect was also an important factor in determining the outcome of the conflict. As one would recall, the United States administration was well aware of the fact that punitive measures imposed against Toshiba Corporation, the parent company of the offending subsidiary, would cause distress in the domestic economy. Economic interests, particularly that of the economic competitiveness of the U.S. and of the viability of its corporations, became a more important factor in the U.S. response than the violation of American, and Western, security. This was directly related to the fact that Toshiba Corporation held structural power in production and knowledge capacities. That is, Toshiba was able to control the manner and mode of its production and goods and, consequently, integrate themselves into the U.S. economic structure. With the imposition of sanctions, it was probable that Toshiba would close its operations in the United States. As well, the import penalties that were considered would also have had a dramatic impact on the numerous American companies that had supplier arrangements, joint ventures, and other business-related

arrangements with Toshiba. In addition, because Toshiba operated in the realm of high-technology and because of American defence projects in progress, knowledge-based structural power was also apparent, as this, too, was an important consideration incorporated into the decision not to impose comprehensive, lengthy sanctions against Toshiba. Overall, structural power was manifested in a variety of ways that enabled Toshiba to, indirectly, shape the outcome of the conflict in a manner that was favourable to its continuing operations.

As with the Union Carbide and Toshiba cases, the ideological, normative element of structural power was also an important force in awarding full patent protection to research-based pharmaceutical corporations in Canada. Again, this can be illustrated by the fact that consistently higher priority is given to economic goals, growth and competitiveness, relative to other goals and includes assumptions that an attractive business climate is necessary in order to lure foreign investment capital and technology for the achievement of these economic goals.⁹ This was certainly manifested in the Canadian government, as the extension of full patent protection, and the subsequent demise of compulsory licensing, was meant to create a favourable business climate for the pharmaceutical multinationals, so that they would be enticed into retaining their operations in Canada and into expanding their operations to include more research and development activities. Therefore, similar to Toshiba, the pharmaceutical multinational

⁹ Stephen Gill and David Law, "Global Hegemony and the Structural Power of Capital," in Gill, ed. *Gramsci, Historical Materialism, and International Relations* (Cambridge: Cambridge University Press, 1993), pp. 100-101.

corporations (primarily American-based) held structural power in not only a productive sense, but more importantly, in their control over knowledge - the ability to develop or acquire, and to grant or deny to others, the kind of knowledge that is respected and sought by others.¹⁰ In sum, these structural powers held by the pharmaceutical multinationals were certainly important in the deliberations of the Canadian government to dismantle the system of compulsory licensing and to extend the period of patent protection to twenty years. Thus, the structural power of the pharmaceutical multinationals, indirectly, enabled the final outcome to be shaped in a manner that was favourable to them.

However, as has been stated before, structural power alone is not enough to determine the influence that a multinational will have in an encounter with a state. That is, domestic structures, too, are important in shaping a multinational's entrance, operations, and responses, and will vary depending on the state in question. The greater the linkages, or associations, with the various domestic structures and actors, then the greater the chances would be of the successful influence of the multinational. It has been hypothesized that this has great potential to provide an explanation as to how non-state actors, such as multinational corporations, alter their behaviour and operations to 'fit in' and gain influence within a particular state. All three cases surmise the importance of using domestic structures as an important element of analyses involving a measure of the power, or influence, that a multinational will have within that particular state.

¹⁰ Strange, *States and Markets*, p. 30.

Union Carbide did not use its association, or entrenchment, in the domestic structures of the Indian state to exercise any influence or power over the proceedings of the Bhopal case. However, domestic structures cannot be dismissed as they were an important element of its strategy to invoke an auspicious outcome. As was shown, Union Carbide was very attuned to the differences in the domestic structures of the United States and India, particularly the legal and cultural differences, and was able to use them to its benefit. In the cases of Toshiba and the pharmaceutical multinationals, their ensconcement into the domestic structures of their respective states, and the role that this played in forming a favourable outcome for them, is more clear. The relationships, or associations, that were built with professional, corporate, and political persons and entities not only gained them important allies in their pursuits, but also enabled both Toshiba and the pharmaceutical multinationals to act in a manner that contributed to a greater chance of a successful outcome. Ergo, it can be concluded that domestic structures, through shaping the multinational's activities, and even its own structure, within a particular state are important in determining the degree of influence, or impact, that the multinational will have in shaping an outcome that is in its favour if, and when, a conflict arises.

Again, how a multinational shapes itself, and its activities, to gain important influence within a state very much depends upon the idiosyncrasies of that particular state, especially its domestic structures. As was stated previously, this, too, determines whether the exercise of direct power will be necessary, and how this will be done. In this

sense, direct power, as what is most commonly examined in deciphering the influence that a multinational will have on a particular state, is also shaped by the idiosyncratic domestic structures of a state. Therefore, in conjunction with structural power, an examination of domestic structures is clearly necessary in order to adequately assess a multinational corporation's power, or influence over an outcome, in a given conflict with a state.

Conclusion: Going Beyond Conventional Assessments of Power

Having come thus far, my hypothesis is that approaches to understanding the power of the multinational corporation in its relations with a state have been lax in explaining the multinational's power, and also in deciphering the variances in the power of multinational corporations. Clearly, from a critique of the conventional approaches and assumptions and from an examination of these three case studies, the importance, or necessity, of incorporating structures, both international and domestic, into an analysis of the power of multinational corporations has been illuminated.

These findings should, of course, be tested against a variety of cases of conflict in order to further assess their generality. However, for the purpose of evaluation, the case studies were selected not only for their individual value, but also for their comparative value - as they introduce variation in the issue-area and in the distribution of resources of the state relative to the multinational. As well, it should also be duly noted that the cases

were chosen without prejudice, in that they were not explicitly used to strengthen my hypothesis that structural power and domestic structures are important determinants of the power of the multinational in its relations with the state.

In fact, as was stated earlier, according to prevailing theories and assumptions about power, one would have expected, or predicted, the outcomes of the conflicts to be very different than their actual ends. One would have expected the U.S. to prevail over Toshiba, not only because the U.S. held vastly more resources of power than Toshiba but also because the issue was dealt with national security - a matter of utmost importance to states. Yet, this was not the outcome. In the case of the pharmaceutical multinationals versus the Canadian state, one would assume the outcome to be one 'too close to call', as a determination of resource-based power would be difficult and also because of the 'mid-importance' of the issue at hand. But the pharmaceutical multinationals successfully attained their goals of extending the duration of patent protection and the dismantling of compulsory licensing in Canada. As well, in the case study of Union Carbide and the Bhopal tragedy, the variation in resources would suggest that Union Carbide would have the upper hand. As well, with regards to the issue-area(s), the environment and health and safety, one would suspect that because these have been classified as areas of 'low' politics then Union Carbide would also have prevailed. However, because of the magnitude of the issue - the tragic death and injury to hundreds of thousands - then perhaps the Indian state would have been successful. Although Union Carbide did achieve a favourable outcome, it can be argued that it was

neither of the two that had as much of a bearing on the outcome as were other factors. Thus, from a thorough examination of the cases, it is clearly illustrated that the reason for the anomalies in the assumed outcome and the actual outcome stem from a failure to incorporate structural power and domestic structures into the analyses.

In sum, the case studies, both individually and collectively, illustrate that conventional approaches and assumptions of the power of multinationals in their relations with the state are clearly inadequate in understanding this power. Therefore, in order to understand, and assess, the power of a multinational corporation in its relations with a state, structural power and domestic structures must be examined, as it has been shown that these can prove to be effective determinants of the power of a multinational.

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