The role of transnational corporations in Chile's transition: beyond dependency and bargaining

John M. Kline*

Experience in Chile demonstrates that transnational corporations (TNCs) can facilitate national economic restructuring. Responding to major public policy reforms, TNCs have provided capital, managerial know-how and global market access to sustain economic growth even through an uncertain transition to democracy. Chile's experience may assist other countries faced with similarly difficult transitions to open market economies in tandem with new democratic institutions. As more nations reject statist economic models, established academic theories built on dependency claims or bargaining-school dynamics need to be modified so as to reflect the evolving relationship between TNCs and host developing countries.

Extraordinary political and economic changes are reshaping global relations at the end of the twentieth century. Formerly communist nations and numerous developing countries are abandoning statist ideologies and seek to construct free and open market economies that will strengthen new democratic regimes. Transnational corporations possess considerable know-how and resources that can assist in these transitions (TCMD, 1992). However, after decades of turbulent relations, new guideposts are needed to shape a productive partnership between TNCs and host developing countries. The recent experience in Chile suggests useful lessons for both host Governments and TNCs on how foreign direct investment (FDI) can help meet the challenges faced in restructuring economies.[1]

* Deputy Director, Karl F. Landegger Program in International Business Diplomacy, School of Foreign Service, Georgetown University, Washington, D. C.

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Chile as a country case study

Chile offers a good historical benchmark for research on the relationship between TNCs and Governments of developing countries. Over the past 40 years, the nation has tried restrictive and facilitative FDI policies, with companion changes in its domestic economy. Initially following an import-substitution strategy, the Government's economic programme was built on a large role for State enterprises, attempts at regional integration and pressures to increase local ownership of foreign investments. The election of President Salvador Allende in 1970 shifted these policies even more sharply to the left.

Much of Chile's historical prominence in discussions on TNC issues stems from highly publicized events during the Allende era. Best remembered in the TNC literature is ITT's attempt to encourage a conspiracy to deny Allende the presidency (Senate Committee, 1973; Whelan, 1989). Also notable is the expropriation of numerous foreign properties, most importantly the huge copper mines owned by Kennecott and Anaconda. The former event symbolized developing countries' fears of powerful TNCs working in tandem with Governments of home countries. The latter expropriations placed Chile on transnational corporations' blacklists of dangerous investment sites, while sparking studies of political risk assessment and management techniques that drew on the two copper companies' contrasting fates (Moran, 1974).

President Allende's overthrow in a military coup opened a new era for Chile's domestic and foreign economic policy. Laying out a welcome mat for TNC investors constituted one part of a radical free market approach formulated by a group of young economists known as the "Chicago boys" for their years of studying the views of Milton Friedman at the University of Chicago. These market-directed policies were adjusted and refined over a decade that included a financial collapse and a deep recession during 1982-1983. During the early years, only a few TNCs risked re-entering Chile. In general, foreign investors did not flock to the country simply because a leftist regime was replaced by a rightist regime—even one that professed a free market philosophy. Most foreign investors waited for the right blend of economic opportunity and political reform that began in the mid-1980s.

Policy lessons for countries in transition

Inherent differences among countries make discussions of a general model suspect, but Chile's experience contains useful insights on how government policies affect FDI decisions and what impacts are likely to result from TNC operations. Among the key policy reforms that shaped Chile's successful investment climate, laying the basis for a working partnership with TNC investors, were: clear and stable FDI laws guaranteeing broad access and non-discriminatory national treatment; a pioneering debt-conversion programme that reduced interest payments, stimulated domestic business and returned Chile to voluntary lending markets; extensive privatization efforts that shifted economic initiative to private businesses while reducing government expenditures; an open-economy strategy that eliminated trade barriers and promoted non-traditional exports; and a return to democracy with a freely elected Government committed to maintaining stable growth policies, meeting pressing social needs and observing human rights.

The foundation for Chile's FDI policy is Decree Law 600, adopted in 1974. The elements of this law considered most important by TNCs are the strong guarantees it provides as a contract signed with the Government of Chile; adherence to a broad national treatment standard; few restrictions on investment access; immediate profit remittance and relatively quick capital repatriation; effective access to foreign exchange; and the possibility to open offshore accounts for export earnings from major projects (over $50 million). A taxation-rate guarantee was also initially influential in light of historical controversies, but declined in importance as Chile's economic and political climate stabilized.[2] The Government decided to avoid both special investment incentives and the use of performance requirements, thereby promoting a market-directed allocation of investment resources.

Recognized as one of the most liberal FDI statutes in the developing world at the time of its adoption, Decree Law 600 was not sufficient on its own to attract foreign investors. The country still suffered from a negative image, facing continued political instability, as well as an uncertain economic outlook. Hence, only a trickle of new FDI (approximately $225 million) entered the country over the first four years. This total was actually several times smaller than the compensation paid out during these years by Chile's new Government to settle the expropriation claims of past foreign investors (Zabala, 1987).

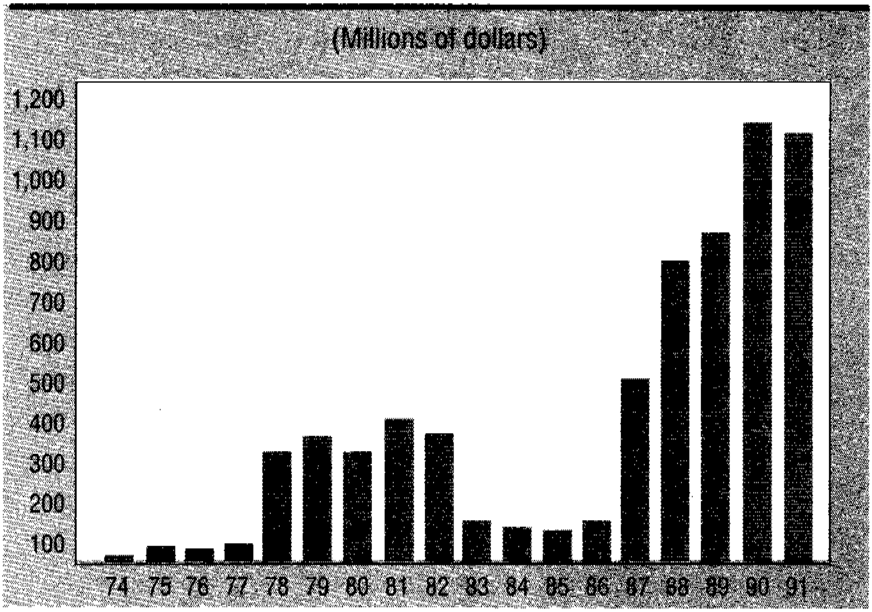
A jump in FDI began in 1978 and continued for five years at an average inflow of $375 million per year—an amount nearly two thirds higher than

[2] In early 1992, the Administration of President Aylwin proposed to reduce further the capital repatriation limitation from three years to one year, and to lower the taxation-rate guarantee from 49.5 per cent to 42 per cent.

the combined total of the initial four years (figure I). Two primary factors account for this change. First, the negotiation of several early Decree Law 600 contracts (most notably the one with St. Joe Minerals for the development of the El Indio gold mine) provided valuable "demonstration" cases of the successful refinement and implementation of Chile's new FDI policy. Second, Chile entered a period of high economic growth, fuelled largely by foreign credits and inexpensive imports. However, this was followed by a period of low growth, caused in part by inappropriate financial policies as well as the global recession and debt crisis. The inflow of new FDI dropped below $200 million annually during these years, sustained largely by the carry-through on major mining projects.

Chile's debt-conversion programme, an important element of its debt-management strategy, helped to reinstate and expand foreign investor interest. Formulated in 1985, Chapter XIX of the Central Bank's Foreign

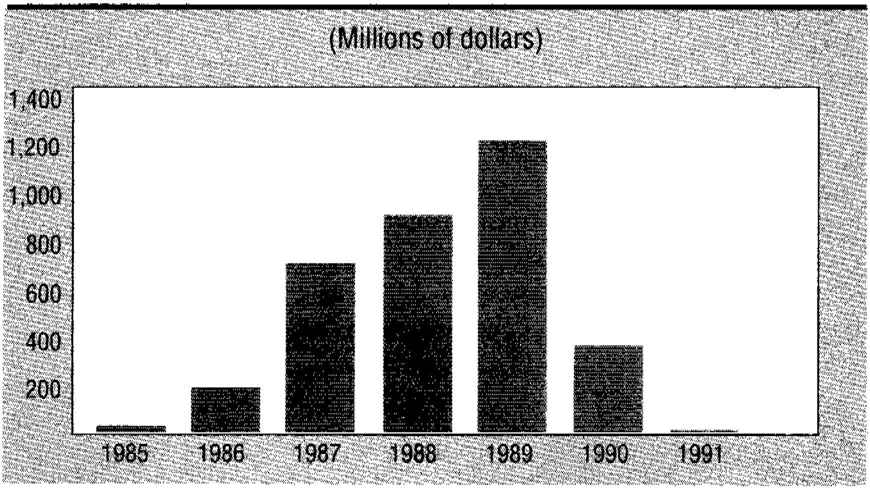
Figure I. Materialized foreign investment (Decree Law 600)



Sources: United States General Accounting Office, *Chilean Trade: Factors Affecting U.S. Trade and Investment* (Washington, D.C., June 1992), p. 9; Ricardo Zabala, *Inversion Extranjera Directa en Chile*: 1954–1986 (Santiago, Chile, Centro de Estudios Publicos, 1987), pp. 34–35.

Exchange Regulations provided the primary channel for foreign investors to convert external debt instruments into local-equity investments. In the first several years, total discounts averaged 30 to 40 per cent, with the Government claiming one third of the discount (Bergsman and Edisis, 1988). More than $3.5 billion was converted during 1985-1990, accounting for roughly one third of Chile's external debt reduction. The secondary market value rose to such a high level (90 cents on the dollar) for the relatively small amount of remaining restructurable debt that discounts essentially disappeared and Chapter XIX conversions virtually ceased in 1991 (figure II).

Figure II. Materialized Chapter XIX Investment



Sources: United States General Accounting Office, *Chilean Trade: Factors Affecting U.S. Trade and Investment* (Washington, D.C., June 1992), p. 11.

In addition to relieving the country's repayment burden, debt conversions stimulated domestic economic activity and drew in new non-bank foreign investors. Many key projects incorporated a major debt-conversion element in their total financing package, including large export-oriented forestry joint ventures, such as Celpac and Santa Fe. Continuing economic and political uncertainty, coupled with Chile's exclusion from traditional international financial markets, made debt conversion a necessary ingredient in meeting total project cost. Chapter XIX conversions actually exceeded investments under Decree Law 600 during 1986-1989. Most importantly, however, the latter funds jumped from $184 million in 1986, to a record $497 million the following year. That rise continued, topping $1 billion in 1990 and 1991, as the counterpart debt-conversion programme lost in importance. Research on individual foreign investments made during that period found that Chapter XIX conversions directly stimulated companion investments under Decree Law 600, which drew interest and competitive investments from other transnational corporations.

The results from Chile's debt-conversion programme were further enhanced by their connection with privatization efforts, helping to contain the inflationary potential of debt-to-equity swaps. Chile shifted hundreds of enterprises from public to private control, reducing the Government's share in national production from nearly 40 per cent in 1975 to approximately 25 per cent today (Normann, 1992). At present, only about 50 corporations remain in public hands, anchored by the huge national copper company (CODELCO), which was originally formed from expropriated foreign assets. This enterprise generates roughly one quarter of the Government's fiscal revenue. Although constitutionally protected from privatization, even this symbol of Chilean nationalism was opened to joint venture participation with private investors (foreign and domestic) by a new law in 1992, in order to exploit more mineral properties. CODELCO currently mines only 4 per cent of its holdings and lacks the requisite capital to undertake exploration, production and environmental protection improvements.

Foreign investors played a significant role in Chile's successful privatization campaign, especially during its second instalment after the set-backs caused by the recession of the early 1980s. A crucial example of this participation involves the privatization of the nation's pension system in 1981. At that time, Aetna was the only major foreign investor involved in new pension-fund management firms (AFPs), participating as a minority shareholder in AFP Santa Maria. The collapse of Chile's financial system led to the bankruptcy of Aetna's local partner along with many other large Chilean institutions, threatening the private pension system experiment. The Government was forced to intervene and to acquire control of the most important banks and many formerly privatized firms. In that way, the Government of General Pinochet temporarily controlled nearly as much of the economy as had the Government of President Allende.

As the Government struggled to restructure and reprivatize those assets, Aetna increased its stake in AFP Santa Maria, while Banker's Trust and American International Group invested in two other large AFPs. This injection of capital and financial managerial skills at a time of great economic uncertainty helped to reassure pensioners of the security and stability of those funds. Chile's private pension funds have gone on to become the most important source of private investment in the country, accumulating over $8 billion (more than a quarter of the gross domestic product) for long-term institutional investments. Foreign investors also played a central role in the successful privatization of other key State enterprises, including the national telephone system, the national airline, industrial plants and hydroelectric facilities.

A fourth element in Chile's reform package is a strong commitment to an open economy, including in the areas of trade and investment. Tariffs are now set uniformly at 11 per cent, having been recently lowered unilaterally from 15 per cent. Non-tariff barriers to trade are virtually non-existent. These policies help to prevent the abuse of strong market positions in the small domestic economy by maintaining both actual and potential import competition. Open economy policies also provide access to new technologies. Many advanced computer and telecommunications systems have become available in Chile earlier than in other Latin American markets. The advanced hardware enables Chilean enterprises to develop new software as well as biotechnology products that are competitive in world export markets.

The promotion of such non-traditional exports is a companion policy to the open economy strategy. Non-traditional exports have led the country's economic growth, spurred particularly by FDI in agro-business, fishing and forestry projects. These three sectors combined now account for around $3.5 billion annually or well over one third of the nation's export sales. By contrast, copper's traditionally dominant share of exports continues to decline, dipping below 40 per cent in 1991 (a 5 per cent drop from the previous year and down from a level of 80 per cent in 1973). Even in copper and other mining exports, increased sales come primarily from recent FDI. For example, the 11 per cent rise in Chile's 1991 copper production was due, primarily, to the opening of the large foreign-owned La Escondida facility (Corfo, December 1991 and March 1992).

A general lesson arising from Chile's open economy strategy is that FDI laws do not operate in isolation. In addition to investment-specific regulations, TNCs evaluate trade, monetary, technology and other policy components that affect their integrated business dealings. In addition to liberal FDI regulations, Chile evolved a coherent open economy theme for its external policies, allowing TNCs to draw on competitive advantages deriving from their global reach and organization. Similarly, the Government, abandoning its statist domestic role and embracing free market policies, helped to increase private business opportunities, correct public deficits and constrain chronic inflation—all important components of building an attractive investment climate.

Finally, Chile's return to democracy also made a difference. Many foreign investors who had avoided Chile during the military regime began to enter the country as democratic processes reemerged. This behaviour was particularly evident among TNCs influenced by political and societal attitudes in socialist-oriented European nations, including the earlier absence of supportive government programmes. Obviously, some TNCs did invest during the military junta's rule. Democracy's difference, therefore, lies in the absolute level of potential FDI and, more particularly, in the diversity and competition among possible investors.[3]

The democratic transition could have caused major concern among foreign investors. Some opposition parties strongly criticized the Government's openness to FDI, particularly privatization sales that involved debt-conversion financing. Nevertheless, TNC interest and activity remained strong and steady. The opposition coalition eventually coalesced around a position that endorsed maintaining stable economic policies and an open regime towards international trade and investment. Subsequently, continued TNC investment helped the new Government to sustain the economic growth begun under the military junta and to derive the resultant political benefits.

Transnational corporations did not instigate Chile's return to democracy, but their demonstrated confidence in the country and its people facilitated the democratic transition. Materialized FDI grew during 1989 and 1990 as elections were held and the military administration stepped aside (but not too far away) as Chile inaugurated its first democratic Government in nearly 17 years. Foreign investors supplied nearly one third of the investment needed to maintain national growth. They actually provided the Government of President Aylwin with a steadier source of productive investment than domestic enterprises, many of which delayed new spending while taxation and labour-reform proposals were debated. Foreign investors' interest continues unabated, with new authorizations setting a record of $3.4 billion in 1991, and reaching nearly $2 billion for just the first half of 1992.

[3] Opinions differ on whether Chile's successful economic restructuring depended on the military junta's dictatorial powers. The author's personal opinion is that the fundamental disruption of entrenched economic, political and social patterns during the 1970s was probably a necessary precondition for the wholesale reorientation in policies and attitudes; the repression and longevity of military rule were not.

This success story, nevertheless, contains a sobering reminder about the limitations, as well as the opportunities, associated with potential FDI during economic and political transitions. The full picture of Chile's restructuring process reveals the slow and cautious response of most TNCs to the adoption of radically new FDI policies. Some firms respond quickly, taking the risk and seeking a comparable reward. More generally, TNCs exhibit a cautious attitude that places a premium on a host country's successful negotiation and implementation of early "demonstration" cases. During that period, host Governments must refine initial regulations to meet legitimate investor concerns without sacrificing overall policy stability. Consistent, effective and honest administration of business regulations is also essential to the establishment of an attractive investment climate.

Foreign direct investment thus does not provide a quick-fix solution for countries facing the long and painful task of restructuring their economies. A lagged response must be expected from most potential investors. Policy reforms may not yield significant aggregate business results for at least several years (and perhaps much longer), depending on conditions both within the country and in the world economy. A key lesson from Chile, however, is that even countries suffering from a highly negative image can overcome this obstacle and build a mutually beneficial working partnership with TNCs.

Beyond dependency and bargaining

The recent, more productive partnership forged between TNCs and Chile does not correspond to basic assumptions in prominent academic theories, developed largely during the 1960s and 1970s to explain relations between TNCs and Governments of developing countries. The hypothesis advanced in the present article is that Chile's experience may signal changes that require a reassessment of these theoretical assumptions and applications. To illustrate this notion, the evolved TNC-Government partnership found in Chile can be measured against the contrasting poles of dependency theory and "bargaining-school" concepts, taking note of some recent efforts to integrate the two approaches.

Dependency theories (e.g., Sunkel, 1972; Cardoso and Faletto, 1979) find little support in contemporary Chile. The TNC behemoths of Kennecott, Anaconda and ITT no longer dominate the economy. Especially during the 1980s, both the number and diversity of TNCs operating in Chile increased markedly, aided in part by improved diplomatic relationships with home countries as a result of the return of democratic processes. Although the United States remains the major home country, many nations are represented among recent foreign investors, including Australia, Canada, Finland, France, Japan, the Netherlands, New Zealand, the Republic of Korea, Saudi Arabia, Spain and Sweden.

Competition is vigorous, maintained partly by the country's open trade policies, leading firms to transfer new competitive technologies to Chile before they are available elsewhere in the region. In contrast to dependency predictions, TNC operations also provided critical support for the attainment of national goals in Chile's economic restructuring process. Foreign capital supplied between one quarter and one third of the investment needed to sustain a 5 per cent growth rate, a target the country consistently exceeded after the recession of the early 1980s. This led in 1991 to a per capita income 16 per cent above the 1980 level. That growth also enabled the Government to nearly double its expenditure in the areas of social programmes on health, housing and education to around $1 billion a year.

Transnational corporations also helped to build the nation's continuing trade surplus, contributing to non-traditional export expansion, as well as increased overseas sales from new private mining operations. The value of national exports has doubled since the mid-1980s, reaching 30 to 35 per cent of GDP and yielding a substantial annual trade surplus, well over $1 billion. Transnational corporation quality control programmes, transportation and services infrastructure, and overseas marketing expertise all proved valuable in meeting Chile's trade expansion and diversification goals.

National economic growth and the increasing diversity among TNCs also bring enhanced opportunities for Chilean firms, many of which have arranged cooperative ventures with foreign TNCs. Some of these ventures extend into the TNCs' home markets and third-country locations, providing local firms with valuable overseas experience and direct market information. In a particularly interesting development contrary to dependency theory, an increasing number of Chilean firms, including several computer technology enterprises initially developed from TNC-related business activities, are now becoming TNCs themselves.

For example, Sonda (computers and data processing), CMPC (forestry products) and state-owned ENAP (oil and natural gas) have recently invested in neighbouring economies, with a view to expand sales and gain resources to complement their strong positions at home. Chilean FDI in Argentina, a country that recently embarked on a similar economic restructuring strategy, jumped from $53 million in 1990 to $253 million in 1991. A mixed public/private partnership between Chilean copper firms (CODELCO and MADECO) has joint manufacturing ventures with firms in Europe and China. Even the unique quasi-public Fundacion Chile, which initiates technology transfer projects to stimulate national development, also participates in ventures abroad. These enterprises all look to enhance their experience, technology and market knowledge in ways available only through direct participation in business activities in other countries.

In terms of political issues, dependency writers are concerned about TNC interference in host country processes, often allied with conservative national business interests to preserve the local *status quo*, or to promote the interests of home country Governments. In Chile, contemporary TNC activities are helping to broaden the base of economic power that had rested primarily with traditional family-owned industrial groups. Foreign financial investors aided the development of the stock exchange as an attractive source of business funding, with associated requirements for greater public disclosure and accountability. The possibility of negotiating joint venture partnerships or sales and service arrangements with new foreign investors also assists smaller Chilean firms to become better established, sometimes expanding their operations into new lines of business.

The appearance of a TNC-home Government alliance arose on only a single recent policy issue. A patent reform controversy pitted pharmaceutical TNCs against the local industry. Recalling dependency arguments and charging an affront to national sovereignty, domestic interests protested excessive pressure by the Government of the United States on behalf of its pharmaceutical TNCs (although enterprises from other industrialized countries were also active in the debate). The Government of the United States did indeed press the Government of Chile to extend effective patent protection to pharmaceuticals, placing the issue high on its agenda of bilateral issues, in line with other United States bilateral and multilateral initiatives that sought stronger protection for intellectual property rights. In the end, however, the pharmaceutical TNCs were isolated in their support of United States retaliatory measures against Chile which did not take place. Other TNCs represented in the local Chilean-American Chamber of Commerce opposed retaliation that would harm the bilateral relationship. The Chamber of Commerce even opposed holding hostage the return of Chile's eligibility for Generalized Scheme of Preferences tariff benefits in order to attain the pharmaceutical TNCs' goals in revising the country's patent law. Although this policy controversy began during the military Government's rule, legal reforms were not adopted by decree. Discussions continued for several years and were resolved only after the transition to democracy. Hence, Chile's revised patent law was approved after a full airing of views through open and vigorous debate in the renewed democratic legislature, which is hardly a typical scenario for dependency theories.

Bargaining-school approaches (e.g., Vernon, 1971; Fagre and Wells, 1982; Grieco, 1982) also have little application to contemporary Chile, primarily because the concept is founded on an assumption of negotiations and renegotiations between a statist host country Government and a centrally directed TNC. Following its free market reforms and extensive privatization actions, Chile no longer fits the traditional statist model. In terms of FDI policy, the Government does not engage in project-specific bargaining, except at the margin of a standard investment contract.

Early negotiations on the first several FDI projects, after the passage of Decree Law 600 in 1974, produced some bargaining on "demonstration cases", leading to a few refinements in the regulations. Subsequently, the investment-application process and approval procedure were standardized and made more transparent. Review by an interdepartmental foreign investment committee could, in theory, provide the mechanism for investment screening and bargaining; in practice the review has proven almost *pro forma*. Investors may raise particular problems with the committee and seek clarifications or modifications, but bargaining as envisaged in traditional theory does not occur. Investment rules and procedures are clearly specified in the law, including the identification of several special treatment provisions and the circumstances under which they may be invoked (in cases of large mining or export-oriented projects). The regulations have been implemented as written.

Chile's chosen policies leave the Government little to bargain with, even if it wanted to engage in project-specific dealings. The country does not offer special incentives to attract FDI and it places few restrictions or disincentives on investors. Thus, governmental authorities have little to offer that is not already generally available, or restrictions to remove, as part of a bargaining process.

By contrast, Chile's Chapter XIX debt-swap programme did display some bargaining characteristics, particularly during the last few years when the Government tightened the qualification criteria. Even then, however, Central Bank administrators did not exercize broad discretionary authority to alter project variables in line with the theorized bargaining process. Now, the programme's own success has effectively ended its utility as a channel for new FDI.

Bargaining theory, as applied to renegotiations, does not occur under Chile's procedures. Contracts signed under Decree Law 600 are guaranteed by the Government of Chile and have been fully respected. Renewed investment contracts are signed, and expanded or diversified investments by established TNCs are approved, through essentially the same application and review process used by a new investor. In a recent significant action, the Government reaffirmed national treatment guarantees for established foreign investors in the fishing industry. Despite emerging resource constraints and strong pressure from employment-intensive artisanal fleets, a revised law that establishes some limits on future FDI will not be allowed to violate already signed agreements.

Bargaining is most likely to occur in Chile between potential joint venture partners. In exceptional cases, TNCs may team up with one of the few remaining State agencies, such as ENAP, for special petroleum operating contracts or under the new law permitting joint ventures with CODELCO. By privatizing several hundred enterprises, however, Chile drastically reduced the number and scope of potential State partners. Joint venture bargaining, therefore, normally takes place between TNCs and local private firms, or with other TNCs, placing it outside traditional bargaining theory that presupposes TNCs and the host Government as the primary opposing actors. The utility of bargaining-school concepts may thus be limited in countries such as Chile, where privatization actions severely restrict direct State participation in the economy and where relatively liberal, standardized and transparent rules establish the effective conditions governing FDI.

Recent writings (e.g., Haggard, 1989) attempt to blend some aspects of dependency and bargaining theories, generally modifying the former to incorporate the latter's more dynamic and applied concepts. Unfortunately, combining the two approaches does little to alter their basic assumptions that limit applicability to developing countries which, like Chile, may reject statist policies and approaches in favour of a more internationally open and free market-directed economy. The Chilean example strikes out in a direction not directly comparable to most past research conditions from which prevailing theory was drawn. By examining individual firm behaviour in the context of this new development strategy, Chile's experience may be instructive on how economic and political transformations in other developing countries could shape TNC–host Government relations over the coming decade.

Partnerships for the 1990s?

Beginning earlier than most nations, Chile initiated its economic transition in the mid-1970s. The nation's eventual economic growth and its recent return to democracy offer a timely tale of public policy evolution. An important chapter in this story is Chile's struggle to forge a new relationship with TNCs. The country's outward-looking development strategy links its fortunes to the world economy and, with it, to FDI and TNC operations as vital components of this global outreach. Chile's success in building a mutually beneficial partnership can be instructive for other countries in Latin America, Central and Eastern Europe and elsewhere that confront similar challenges in their drive for democratization, privatization and sustained economic growth.

The Chilean experience may also be useful for refining FDI concepts and theories. The demise of statist economic policies and protected import-substitution strategies reduces the utility of current bargaining theories and older dependency notions. Now, the interplay between TNCs and Governments may occur more often, as it does in Chile, through essentially free market decisions taken within the framework of a liberal and outwardly open investment policy. If this change is upheld, both the theoretical and practical assumptions regarding relations between TNCs and developing country Governments will require re-examination. ■

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