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CHAPTER 9

Multinational Corporations and Global Production

The largest **multinational corporations** (MNCs) are in many respects the main agents of globalization. They produce and distribute goods and services across national borders; plan their operations on a global scale; and spread ideas, tastes, and technology throughout the world. MNCs are normally considered to be firms that control productive assets in more than one country. MNC parent firms in *home* countries acquire foreign assets by investing in affiliate or subsidiary firms in *host* countries. This is **foreign direct investment (FDI)**, which involves management rights and control. **Portfolio investment**, by contrast, is investment without control; it involves the purchase of bonds, money market instruments, or stocks simply to realize a financial return. A new aspect of foreign investment is the emergence of *sovereign wealth funds*. As discussed in Chapter 6, SWFs are government investment vehicles that are managed separately from a country's official reserves. However, most SWFs have been invested in U.S. and European government bonds with ownership shares of less than 10 percent (only investment above the 10 percent level is classified as FDI). Because SWFs account for only 0.6 percent of total FDI flows, this chapter focuses on the role of MNCs in providing FDI. The growing presence of MNCs testifies to their role as agents of globalization. In 2008, 82,000 MNCs and their 810,000 foreign affiliates provided over $15 trillion in FDI stock. MNCs employed about 77 million people in 2008, and exports by foreign affiliates of MNCs account for about one-third of total world exports of goods and services. International production is also fairly concentrated. The world's 100 largest MNCs represent 0.13 percent of the total number of MNCs, but they account for about 9 percent of the foreign assets, 16 percent of the sales, and 11 percent of the employment of all MNCs.[1]

FDI has declined in some years (e.g., in 1982–1983 and 2000–2003), and global FDI inflows fell by about 14 percent from 2007 to 2008 due to the global financial crisis. MNCs can also decline. For example, no one would

have predicted that General Motors would have fallen to the level it did during the global financial crisis. One-third of the corporations in the Fortune 500 list of the largest U.S. corporations in 1980 were no longer on the list in 1990 because of decline, acquisition, or bankruptcy. Despite these reversals, FDI inflows have generally grown much faster than trade or income. From 1985 to 1999, the growth rates of global GDP, exports, and FDI inflows were 2.5, 5.6, and 17.7 percent, respectively.[2] The growing importance of MNCs has caused some analysts to argue that the critical problem in IPE today "is the tension between states and multinationals, not states and markets."[3] However, MNCs receive less attention because most IR scholars place emphasis on relations among governments. Limited amounts of reliable data also pose an obstacle to the study of MNCs. As private enterprises, MNCs are reluctant to provide information about themselves and adept at obscuring their activities. This problem is compounded by the fact that IOs regulate monetary, trade, and development activities but not foreign investment. Furthermore, MNCs evoke strong positive and negative reactions; in debates about MNCs it is common for "anecdote to replace data" and "the witty phrase to replace analysis."[4]

In this age of globalization, liberals often view MNCs and private banks as "the major weavers of the world economy."[5] Liberals also believe that FDI increases efficiency by stimulating innovation, competition, economic growth, and employment, and that MNCs provide countries with many advantages such as capital, technology, managerial skills, and marketing networks. Historical materialists also refer to the growing power of MNCs, but they see corporate managers as a transnational class that maintains and defends the capitalist system. They also view MNCs as predatory monopolists that overcharge for their goods and services, limit the flow of technology, create dependency relationships with LDC host countries, and impose downward pressures on labor and environmental standards. Realists are more inclined to downgrade the political importance of MNCs; they see the most powerful states as having considerable control over their MNCs, and MNCs as retaining close ties with their home governments.[6]

DEFINITIONS AND TERMINOLOGY

MNCs are usually defined as firms that control assets in at least two countries, but the Harvard Multinationals Project in the 1960s limited the MNC label to firms with subsidiaries in at least six countries.[7] Those who favor such restrictive definitions see the important investment issues as relating to the largest firms that establish a number of foreign affiliates as part of a global strategy; but restrictive definitions are problematic because they exclude enterprises on a rather arbitrary basis. This chapter adopts the more expansive definition of MNCs as firms that operate in two or more countries. An enterprise that does business in more than one country is not necessarily an MNC. To qualify, a firm must possess at least one FDI project in which it has a degree of management rights or control. A firm can undertake FDI in a host country in two forms: **greenfield investment**, or the creation of new facilities and productive assets by foreigners; and *mergers and acquisitions* (*M&As*), or the purchase of stocks in an existing firm with the purpose of participating in its management. In a cross-border merger, the assets and operations of two firms belonging to different countries are combined to establish a new legal entity. In an acquisition, a local firm becomes an affiliate or subsidiary of a foreign firm. During the past decade, most growth in international production has occurred through M&As rather than greenfield investment, and acquisitions are much more common than mergers.[8]

Although the definition of FDI may seem straightforward, there are disagreements over what constitutes "control." Until the 1960s, the U.S. Department of Commerce defined FDI as involving an equity capital stake of at least 25 percent. However, the department subsequently lowered this to 10 percent, and IOs such as the IMF and OECD use the 10 percent figure for statistical purposes. In most countries, a foreign company with 10 percent ownership has some control over management decisions and can select at least one member of the board of directors. The important point is that a shareholder can exercise some control without holding a majority of shares, especially when the ownership of a firm is widespread among many shareholders. Foreign affiliates may be minority-owned (10–50 percent of equity), majority-owned (more than 50 but less than 100 percent), or wholly owned (100 percent) subsidiaries.[9]

Differences exist not only over definitions but also over the use of the term *MNC*. The United Nations and a number of scholars prefer the term *transnational* to *multinational* because the ownership and control of most firms is not really multinational; a firm normally extends its operations from a single home country across national frontiers. Most MNCs are in fact *ethnocentric* or home country oriented, with directives flowing from the headquarters to the affiliates and much of the MNCs' R&D located in the home country. However, a small but growing number of MNCs are *geocentric* or *stateless;* they adopt a worldwide approach and are not closely tied to a single state. Strategic alliances among MNCs from different states further complicate the task of associating an MNC with a home government; they may take the form of production-sharing agreements, or collaborative research and networking arrangements. Finally, MNCs can sometimes gain entry into a foreign country only by agreeing to form *joint ventures* with local firms; joint ventures are increasingly common in LDCs and transition states. This text uses the term *MNC* simply to signify that a firm has ongoing managerial and productive activities in more than one country.[10]

WHY DO FIRMS BECOME MNCs?

John Dunning developed a seminal theory which explains that firms engage in FDI for reasons of ownership, location, and internalization, and the following discussion draws partly on his ideas.[11] To understand why firms become MNCs, we must distinguish between horizontal and vertical integration. A *horizontally integrated MNC* extends its operations abroad by producing the same product or product line in its foreign affiliates. Firms engage in

horizontal integration to defend or increase their market share. Although a firm's exports from the home country may initially meet the foreign demand for products and services, the firm may have to set up a subsidiary to compete with new local suppliers. The MNC can compete more effectively with local firms through its subsidiaries because they have lower transportation costs and become more aware of the market's special characteristics; and labor costs are lower if a DC firm produces directly in LDC markets. Firms also engage in horizontal integration because of foreign government policies. When a government's tariffs and NTBs limit exports from a firm's home country, it may establish foreign operations to get behind the trade barriers. For example, Honda began to produce automobiles in the United States when the U.S. government imposed voluntary export restraints on Japanese auto imports in the 1980s. National and subnational governments also provide investment incentives to encourage firms to locate production facilities in their territories.[12]

A *vertically integrated MNC* geographically separates the different stages of production, with the outputs of some affiliates serving as inputs to other affiliates. Firms engage in **vertical integration** to gain the benefits of comparative advantage in the production process. For example, an electronics firm can lower production costs by locating assembly operations in low-wage LDCs, chip production in an NIE such as Singapore, and high-end R&D operations in California. Vertically integrated MNCs can also gain control of uncertain transactions with different owners at various stages of the production process by *internalizing* them within the firm. Firms opt for *backward integration* when raw materials and other production inputs they require are not readily available or have high transaction costs. Examples of backward integration include steel firm investments in iron ore operations, oil company investments in the extraction of crude oil, and rubber manufacturer investments in natural rubber plantations. Backward integration also enables MNCs to gain control over the quality of inputs. For example, three vertically integrated MNCs accounted for 60 percent of the banana export trade during the 1980s, because bananas are highly perishable and require specific handling and ripening conditions. MNCs also engage in *forward vertical integration* to reduce uncertainty and transaction costs, and to ensure the quality of goods and services that reach the consumer.[13] Another reason firms engage in vertical integration is to limit competition. When a small number of MNCs control the raw materials for an industry, they can impose stiff barriers to the entry of new rival firms. MNCs also engage in vertical integration to limit government scrutiny of their activities. For example, MNCs sometimes manipulate their **transfer prices** (the prices an MNC's affiliates charge for the *internal* sales of goods and services) without detection by governments. Transfer prices help an MNC efficiently manage its internal operations and monitor the performance of its affiliates; but they can also enable an MNC to shift its reported profits from high-tax to low-tax countries (and thus avoid paying some taxes) by raising or lowering the prices charged by each affiliate. In 1993 the U.S. Internal Revenue Service ruled that Nissan Motor Company used transfer prices to underreport its U.S. income, and Nissan had to pay the United States about $150 million.[14]

Firms that become MNCs must have the ability as well as incentive to make the transition. Innovations in communications, transportation, and technology have enabled firms to internationalize, and they are more successful if they can "think globally" and "act locally." On the one hand, large MNCs have advantages such as economies of scale, brand-name reputation, and access to global financing and inputs such as raw materials. On the other hand, MNCs operate in a world of states in which they must adhere to national laws and cater to the demands of local consumers.[15]

THE HISTORICAL DEVELOPMENT OF FDI

Although the rapid expansion of MNCs is a post–World War II phenomenon, some scholars trace the origin of MNCs to the transborder business operations of medieval banks in fifteenth-century Florence. During the sixteenth to eighteenth centuries, international trading companies such as the English, Dutch, and French East India Companies and the Hudson's Bay Company also coordinated cross-border business activities. In the nineteenth century, firms that are commonly considered to be MNCs were investing in a number of countries; thousands of these MNCs existed by the time of World War II.[16] A number of factors have affected the growth—and sometimes the contraction—of MNC activity:

- MNC activity increases when advances in communications, transportation, and technology facilitate MNC control over foreign operations.
- Rapid economic growth often stimulates MNC expansion, while depressed economic conditions have the opposite effect.
- MNC expansion depends on national and international rules and events. For example, the rules protecting private property encouraged FDI, whereas major wars had a depressing effect on FDI.
- Capital liberalization leads to increased FDI; capital and exchange controls discourage such activity.
- FDI often contracts in response to financial crises, but it may expand in response to trade protectionism because MNCs shift production abroad to circumvent the trade barriers.[17]

The following discussion focuses on three periods: pre–World War II, the mid-1940s to mid-1980s, and the mid-1980s to the present.

The Pre–World War II Period

According to earlier studies, *portfolio* investment accounted for most of the long-term capital flows during the nineteenth and early twentieth centuries. However, as economists refined their definitions, they upgraded their estimate of foreign *direct* investment flows. Indeed, some studies indicate that FDI accounted for up to 45 percent of British foreign investment in 1913 and 1914.[18] As the first country to industrialize, Britain was the main force behind the growth of FDI during the nineteenth century. Although there were no

government guarantees or international institutions to provide safeguards, investments were fairly secure for several reasons: Economic risk was lower under the pre–World War I gold standard because currencies were convertible and exchange rates were fairly stable; political risk was lower because a large share of European investment was in colonial territories operating under home country rules; there were no major restrictions on capital flows; and wars during this period were limited in scope. The nineteenth century was also a period of rapid advances in rail and sea transport and communications, which facilitated the expansion of FDI. Although FDI continued to increase in the twentieth century, there was an investment downturn after World War I because of global economic and political instability. For example, a number of countries began to impose restrictions on inward FDI, the Soviet Union nationalized foreign property, and the gold exchange standard was suspended. FDI contracted further during the Great Depression and World War II, and MNCs accounted for a smaller share of world economic activity in 1949 than in 1929. It was not until after World War II that the vigorous growth of MNCs and FDI would resume.[19]

The Mid-1940s to Mid-1980s

The United States overtook Britain as the leading source of FDI after World War II. As Table 9.1 shows, U.S. firms accounted for 47.1 percent of outward FDI stock in 1960, compared with Britain's 18.3 percent. FDI rapidly expanded under U.S. leadership because the North experienced a sustained period of economic growth from 1950 to 1973; there were major improvements in international transportation and communications; and most DCs relaxed their controls over FDI after their currencies became convertible. (A notable exception was Japan, which continued to restrict foreign investment flows.) Since the late 1960s, the U.S. share of outward FDI has declined steadily, partly because of Japan and Germany's rapid economic growth as they recovered from the war. Thus, Table 9.1 shows that the U.S. share of total outward FDI stock fell from 47.1 percent in 1960 to 32.3 percent in 1985, whereas Japan's share rose from 0.7 to 6.0 percent, and West Germany's share rose from 1.2 to 8.1 percent. Table 9.1 also shows that DCs were the source of most FDI flows: 99 percent in 1960 and 90 percent in 1985. However, MNCs based in the South increased their share of outward FDI stock from only 1 percent in 1960 to 10 percent in 1985. Most of this FDI came from more prosperous LDCs in Asia and Latin America and from OPEC states. The five largest LDC sources of outward FDI stock in 1985 were Brazil, South Africa, Argentina, Singapore, and Hong Kong.[20]

Table 9.2 shows that the DCs were the largest recipients as well as providers of FDI, accounting for 58.6 percent of inward FDI stock in 1985. Whereas the U.S. share of outward FDI stock was declining, its share of inward FDI stock increased from 12 percent in 1980 to 19 percent in 1985. Japan was the only DC that maintained an extremely low share of inward FDI stock, at 0.5 percent in 1985, because of its governmental, societal, and cultural barriers to investment flows. Although the South had received over

TABLE 9.1

Outward FDI Stock (U.S. $ Billions)

	1960		1975		1985		1990		2000		2008	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
United States	31.9	47.1	124.2	44.0	238.4	32.3	430.5	24.1	1316.2	21.7	3162.0	19.5
Japan	0.5	0.7	15.9	5.7	44.0	6.0	201.4	11.3	278.4	4.6	680.3	4.2
Germany[a]	0.8	1.2	18.4	6.5	59.9	8.1	151.6	8.5	541.9	8.9	1450.9	9.0
Britain	12.4	18.3	37.0	13.1	100.3	13.6	229.3	12.8	897.8	14.8	1510.6	9.3
France	4.1	6.1	10.6	3.8	37.8	5.1	112.4	6.3	445.1	7.3	1397.0	8.6
Italy	1.1	1.6	2.0	3.3	16.6	2.2	60.2	3.4	180.3	3.0	517.1	3.2
Canada	2.5	3.7	3.5	10.4	43.1	5.8	84.8	4.7	237.6	3.9	520.4	3.2
Total G7[b]	53.3	78.7	219.8	77.9	540.1	73.1	1270.2	71.1	3897.3	64.2	9238.3	57.0
Total DCs[c]	67.0	99.0	275.4	97.7	664.9	90.0	1640.4	91.9	5186.2	85.4	13,623.6	84.1
World Total	67.7		282.0		738.8		1785.6		6069.9		16,205.7	

[a] The 1960 to 1985 data are for West Germany.
[b] G7 = Group of Seven
[c] DCs = developed countries

Source: Centre on Transnational Corporations, *Transnational Corporations in World Development: Trends and Prospects* (New York: UN, 1988), Table 1.2, p. 24 (1960 and 1975 data); UNCTAD, *World Investment Report 2004* (New York: UN, 2004), Annex Table B.4, p. 382 (1985 data); UNCTAD, *World Investment Report 2009* (New York: UN, 2009), Annex Table B.2, pp. 251–254 (1990, 2000, and 2008 data).

TABLE 9.2

Inward FDI Stock (U.S. $ Billions)

	1980		1985		1990		2000		2008	
	Value	%	Value	%	Value	%	Value	%	Value	%
DCs[a]	390.7	56.4	569.7	58.6	1412.6	72.7	3960.3	68.8	10,212.9	68.5
United States	83.0	12.0	184.6	19.0	394.9	20.3	1256.9	21.8	2278.9	15.3
Japan	3.3	0.4	4.7	0.5	9.8	0.5	50.3	0.9	203.4	1.4
Germany[c]	36.6	5.2	36.9	3.8	111.2	5.7	271.6	4.7	700.5	4.7
Britain	63.0	9.1	64.0	6.6	203.9	10.5	438.6	7.6	982.9	6.6
France	25.9	3.7	36.7	3.8	97.8	5.0	259.8	4.5	991.4	6.6
Italy	8.9	1.3	19.0	2.9	60.0	3.1	121.2	2.1	343.2	2.3
Canada	54.2	7.8	64.7	6.7	112.8	5.8	212.7	3.7	412.3	2.8
LDCs[b]	302.0	43.6	402.5	41.4	529.6	27.3	1736.2	30.2	4276.0	28.7
Africa	32.0	4.6	33.8	3.5	60.6	3.1	154.2	2.7	510.5	3.4
Asia and Oceania	218.3	31.5	287.3	30.0	358.4	18.5	1079.4	18.7	2583.9	17.3
Latin America and Caribbean	50.4	7.3	80.1	8.2	110.5	5.7	502.5	8.7	1181.6	7.9
World Total	692.7		972.2		1942.2		5757.4		14,909.3	

[a]DCs = developed countries

[b]LDCs = less developed countries

[c]1980 and 1985 data are for West Germany

Source: UNCTAD, *World Investment Report 2004* (New York: UN, 2004), Annex Table B.3, pp.376–380 (1980 and 1985 data); UNCTAD, *World Investment Report 2009* (New York: UN, 2009), Annex Table B.2, pp.251–254 (1990, 2000, and 2008 data).

60 percent of total FDI before World War II, this figure fell after the war because of LDC demands for more control over their natural resources in the 1970s, the LDC foreign debt crisis in the 1980s, a gradual shift in FDI from primary products to manufacturing, and an increase in technology-related investment in the North. Among the LDCs, the most prosperous and resource-rich states received the most FDI. Thus, Table 9.2 shows that the share of FDI stock directed to Africa, which has many of the LLDCs, declined from 4.6 percent in 1980 to only 3.5 percent in 1985. Asian and Latin American LDCs, by contrast, received 30 and 8.2 percent of total inward FDI stock in 1985. The five largest LDC recipients of inward FDI stock in 1985 were Hong Kong, Brazil, Indonesia, Saudi Arabia, and Mexico. The Central and Eastern European socialist states and the Soviet Union received almost no FDI from 1975 to 1985.[21] Thus, DCs were directing most FDI in the mid-1980s to each other, and many LDCs were marginalized.

The 1980s to the Present

As discussed, FDI flows have declined in some years such as 1982–1983, 2001–2003, and 2008. However, FDI flows since the 1980s have *on average* increased faster than at any time since the nineteenth century. Table 9.3 shows that inward and outward FDI stock as a share of the GDPs of DCs increased from 4.9 and 6.2 percent in 1980 to 24.7 and 33 percent in 2008. A number of factors account for the rapid growth of FDI. First, the reemergence of orthodox liberalism with deregulation, privatization, and an end to restrictions on capital flows gave MNCs more freedom to expand their activities. Second, the breakup of the Soviet bloc opened up large new areas for FDI as the transition economies instituted market reforms, and China also became a major FDI recipient. A third factor was the problems with international trade. The protracted Uruguay and Doha Round negotiations, combined with the use of NTBs, caused many MNCs to extend their activities abroad to circumvent trade barriers. Finally, significant advances in information and transportation technologies enabled MNCs to extend their global network.[22]

An important feature of FDI is the degree to which it has been concentrated in the "Triad"—the United States, the EU, and Japan. From 1985 to 2002, the triad accounted for about 80 percent of the world's outward FDI stock and for 50–60 percent of the inward FDI stock. U.S. firms have shown a strong preference for investing in Europe, intra-European investment has accelerated, and Japan and Western European countries have invested heavily in the United States. Clusters of non-Triad states also have strong FDI links with each Triad member. Table 9.4 shows that the nine largest host countries for FDI from 1985 to 1995 were also included among the largest home countries for FDI (those with the superscript *a*) and that all but one of these nine (China) is an advanced industrial state. The only important home country for FDI that is not also an important host country is Japan. Although Japan has eased some of its formal impediments to inward FDI, a number of informal

TABLE 9.3

Share of Inward and Outward FDI Stock as a Percent of GDP[a]

	1980	1985	1990	1995	2000	2008
DCs[b]						
Inward	4.9	6.2	8.2	8.9	16.1	24.7
Outward	6.2	7.3	9.6	11.3	21.1	33.0
United States						
Inward	3.0	4.4	6.9	7.3	12.9	16.0
Outward	7.8	5.7	7.5	9.5	13.5	22.2
Japan						
Inward	0.3	0.3	0.3	0.6	1.1	4.1
Outward	1.8	3.2	6.6	4.5	6.0	13.9
Germany						
Inward	3.9	5.1	7.1	7.8	14.3	19.2
Outward	4.6	8.4	8.8	10.5	28.5	39.8
Britain						
Inward	11.8	14.1	20.6	17.6	30.4	36.9
Outward	15.0	22.0	23.2	26.9	62.3	56.7
France						
Inward	3.8	6.9	7.1	12.3	19.5	34.7
Outward	3.6	7.1	9.1	13.2	33.5	48.9
Italy						
Inward	2.0	4.5	5.3	5.8	11.0	14.9
Outward	1.6	3.9	5.2	8.8	16.4	22.5
Canada						
Inward	20.4	18.4	19.6	21.1	29.3	27.5
Outward	8.9	12.3	14.7	20.3	32.8	34.7

[a]GDP = gross domestic product

[b]DCs = developed countries

Source: UNCTAD, *World Investment Report 2003* (New York: UN, 2003), Annex Table B.6, pp.278–279 (1980 to 1995 data); UNCTAD, *World Investment Report 2009* (New York: UN, 2009), Annex Table B.3, pp.255–266 (2000 and 2008 data).

barriers remain. As Table 9.2 shows, Japan accounted for only 1.4 percent of inward FDI stock in 2008—well below the shares for other G7 countries.[23]

Despite the continued predominance of the DCs, there have been some notable changes in outward FDI since the 1980s. First, the United States lost its dominant position as a source of FDI. As Table 9.1 shows, the U.S. share of outward FDI stock fell from 44 percent in 1975 to 19.5 percent in 2008. Second, there were erratic changes in Japan's share of FDI outflows. As Table 9.1 also shows, Japan's share of outward FDI rose dramatically from 6 percent in 1985 to 11.3 percent in 1990. A strong Japanese yen as a result of the 1985 Plaza accord, combined with trade barriers on Japanese goods such

TABLE 9.4

Leading Host Economies for FDI (Cumulative Inflows, 1985–1995)

Rank	Country	FDI (U.S.$ Billions)
1	United States[a]	477.5
2	United Kingdom[a]	199.6
3	France[a]	138.0
4	China[a]	130.2
5	Spain[a]	90.9
6	Belgium–Luxembourg[a]	72.4
7	Netherlands[a]	68.1
8	Australia[a]	62.6
9	Canada[a]	60.9
10	Mexico	44.1
11	Singapore[a]	40.8
12	Sweden[a]	37.7
13	Italy[a]	36.3
14	Malaysia	30.7
15	Germany[a]	25.9
16	Switzerland[a]	25.2
17	Argentina	23.5
18	Brazil	20.3
19	Hong Kong[a]	17.9
20	Denmark[a]	15.7

[a]Economies that are also among the 20 leading home economies for FDI.

Source: World Trade Organization Annual Report 1996, vol. 1, *Trade and Foreign Direct Investment*, p. 47, Table 4.1.
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as voluntary export restraints, forced Japanese firms to invest and produce more abroad.[24] However, Table 9.1 also shows that Japan's share of outward FDI fell back to 4.2 percent in 2008. Persistent economic recession and the financial problems of major Japanese banks (see Chapter 11) led to changes in the corporate strategies of many Japanese MNCs, which found it difficult to expand abroad.[25] Table 9.3 shows that Japan's outward FDI stock accounted for only 13.9 percent of its GDP in 2008, the lowest share of any G7 country. Third, as Table 9.1 shows, the DC share of outward FDI stock fell from 91.9 percent in 1990 to 84.1 percent in 2008. LDCs increased their share of outward FDI stock, and East Asian economies have been the most active investors. South Korea, Singapore, Taiwan, and China (including Hong Kong) accounted for more than two-thirds of FDI outflows from the LDCs in 2004.[26]

There have also been some notable changes in inward FDI since 1980. First, Table 9.2 shows that the U.S. share of inward FDI stock steadily

increased from 12 percent in 1980 to 21.8 percent in 2000. However, the U.S. share declined to 15.3 percent in 2008; this is concerning because inward FDI has become important for the future of U.S. prosperity. Although the U.S. share of inward FDI has fluctuated since 2000, economists attribute the general downward trend to several factors: The U.S. dollar was overvalued, and this elevated the cost of producing in the United States; some other countries gave more incentives to MNCs to engage in offshore production; U.S. corporate taxes were higher than taxes in some other locations; and MNCs were concerned about U.S. economic prospects. Second, Canada was the only G7 country whose share of inward FDI stock fell in all of the years listed in Table 9.2; overall, the Canadian share fell from 7.8 percent in 1980 to 2.8 percent in 2008. The U.S. share of Canada's inward FDI has declined from about 80 percent in 1980 to 60 percent today, and this decrease is linked to the creation of CUSFTA and NAFTA. Before free trade, U.S. MNCs often located inside Canada to avoid paying tariffs; but under NAFTA, a U.S. firm can produce in the United States (or Mexico) and freely export to Canada. Canada has not attracted more FDI from sources other than the United States for a variety of reasons related to productivity, labor costs, taxes, and the increase in value of the Canadian dollar. Third, the DC share of inward FDI stock has declined, and the LDC share has increased (to a limited extent) in recent years. Table 9.2 shows that the DC share of inward FDI fell from 72.7 percent in 1990 to 68.5 percent in 2008, whereas the LDC share rose from 27.3 percent to 28.7 percent during the same period. As Table 9.4 shows, a small group of rapidly growing LDCs, including China, Mexico, Singapore, Malaysia, Argentina, Brazil, and Hong Kong, were among the 20 leading host economies for FDI between 1985 and 1995. China and India are major candidates for inward FDI because they offer MNCs a huge supply of cheap labor, their workforces are becoming more educated and technologically skilled, and, in terms of numbers, they are the two largest consumer markets in the world. However, China attracts much more FDI than India. Whereas China has moved quickly to adopt economic initiatives and reforms, India has delayed in removing regulatory practices that MNCs consider burdensome. However, India is attracting more FDI in some areas such as outsourcing contracts that provide business services for MNCs. In 2008, China's FDI inflows surged to a historic high of $108 billion, and it became the third-largest FDI recipient in the world after the United States and France. Although India ranked 10 places behind, it was narrowing the gap with China.[27] In contrast to the more prosperous LDCs, most Sub-Saharan African LDCs have been marginalized. Table 9.2 shows that Africa accounted for only 3.4 percent of inward FDI stock in 2008, compared with 17.3 percent for Asia and 7.9 percent for Latin America. Fourth, FDI has become a significant part of the privatization process in transition economies in Eastern Europe and the FSU.[28]

The following sections examine the effects of MNCs on home and host states. Most of the discussion of host state–MNC relations is devoted to the LDCs, and much of the discussion of home state–MNC relations focuses on the advanced industrial states.

MNC–HOST COUNTRY RELATIONS: DETERMINANTS AND EFFECTS OF FDI

We earlier discussed the reasons firms decide to become MNCs, but it is also important to examine why firms direct FDI to one host state rather than another. For example, analysts disagree as to whether MNCs are more likely to invest in LDCs with democratic or authoritarian governments. Some authors assume that democratic LDCs attract more FDI, because democratic institutions impose constraints on governments that decrease political risks and preserve MNCs' private property rights. Other authors assume that authoritarian LDCs attract more FDI, because autocratic leaders can repress labor unions, drive down wages, and shield MNCs from popular pressures for environmental controls. The results of empirical studies to determine which of these views is correct have been inconclusive. For example, one study found that "regime type . . . seems to have little impact on foreign investors"; a second study found that "empirically the results prove rather conclusive—democracies attract more FDI"; and a third study found that "in fifteen Latin American countries for the period of 1981 to 1996 . . . abuse of civil liberties and political rights . . . had a positive and statistically significant effect on inflows of U.S. FDI."[29] A major problem is that authors use different measures of democracy; whereas some focus on the holding of elections, others emphasize the rights of workers and peasants, freedom of the press, or economic rights and privileges. Thus, more research is needed to determine which types of countries attract FDI. Scholars also have different views of the *effects* of FDI on host states. Orthodox liberals see MNCs as contributing to LDC development by providing external capital, new technologies, and modern ideas that replace traditional social values. They assert that states have different factor endowments and that foreign investment goes to areas where it is most needed or in shortest supply. Thus, inward FDI compensates for inadequate local savings, export earnings, and foreign aid; tax revenues from MNC profits supplement local taxes; and MNCs fill LDC needs for imported technology. Although liberals acknowledge that a strong MNC presence may initially result in more income inequality, they attribute this to the positive effect of MNCs on income growth in general. This inequality is a temporary price to be paid for economic success, and the market will bring about more convergence of incomes over the long term.[30]

The first major challenge to orthodox liberal views came from two economists, Stephen Hymer (a Marxist) and Charles Kindleberger (a liberal). They argued that FDI cannot simply be equated with the movement of capital from home to host countries, because MNCs often get financing for FDI by borrowing funds in the host countries. Although FDI supporters see free markets as promoting open competition, Hymer and Kindleberger noted that MNCs are oligopolistic; they lack certain advantages that local firms possess, but gain competitiveness by creating an oligopoly. For example, an MNC can raise barriers to the entry of other firms through its use of new technologies, economies of scale, and privileged access to global finance. Thus, Hymer wrote that "the industries in which there is much foreign investment tend to be

concentrated industries, while the industries in which there is little or no foreign investment tend to be unconcentrated."[31] Drawing on Hymer's ideas, dependency theorists argue that MNCs appropriate local capital rather than bringing in new capital, prevent local firms from participating in the most dynamic sectors of the economy, increase income inequalities in the host country, and use capital-intensive technologies that contribute to unemployment. They also see MNCs as undermining host countries by co-opting local elites, imposing political and economic pressure (often with the help of MNC home countries), and altering consumer tastes and habits. Although Latin American and East Asian NIEs are industrializing, MNCs prevent these states from achieving genuine autonomous development; for example, one study claims that MNCs in Brazil keep "the innovative side of their businesses as close to home as possible" and ensure that "the industrialization of the periphery will remain partial."[32]

A number of studies indicate that MNC effects on host states are neither as positive nor as negative as neoliberal and dependency theorists maintain, and that a host state's options vary under different circumstances. For example, one factor affecting a host state's options is the amount of competition among investors; a host state has greater leverage if it has more investors to choose from. Although states have become more dependent on investment, the diversity of investment sources has also increased because U.S. MNCs have become less dominant and there are more European, Japanese, and Southern MNCs. Raymond Vernon's **obsolescing bargain model** (OBM) is another factor that can cause a host state's relations with MNCs to change over time. A host state has a weak bargaining position before an MNC invests in it because the MNC can pursue other options and the host state must provide incentives to attract the initial investment. The MNC's bargaining power stems from its sophisticated technology, brand-name identification, access to capital, product diversity, and ability to promote exports. After the investment is made, however, the host state has more bargaining leverage because the MNC commits itself to immobile resources. The host state can treat these resources as a "hostage," and it gains bargaining, technological, and managerial skills through spin-offs from the foreign investment. Thus, the host state may be able to renegotiate the original bargain and gain more favorable terms from the MNC.[33]

Three factors—fixed investments, new technologies, and brand identification—help determine whether an industry will be subject to the OBM. In regard to the first factor, the OBM is more likely to apply to projects that require large fixed investments. Although such projects initially give foreign investors considerable leverage, later the fixed investments can become hostage to the host state. MNCs with smaller fixed investments can more easily withdraw from the host state. A second factor is the type of technology used; MNCs using sophisticated technologies that are unavailable to the host state may be less vulnerable to aggressive host state policies at a later date. A third factor is the importance of product differentiation through advertising. When a firm's sales depend on brand identification and consumer loyalty, it is in a stronger position vis-à-vis the host state.[34] MNCs can employ various strategies to offset the risks of the OBM. For example, they can decrease their vulnerability to host state pressures by vertical integration and by establishing alliances with the local private sector in joint ventures. When an MNC becomes more firmly established in a host state, it can gain political and economic support by creating linkages with local suppliers, distributors, and consumers. State-to-state interactions can also affect MNC–host state relations, and one analyst argues that first-tier bargaining between the host and home states can give MNCs more influence in second-tier bargaining with host states.[35] For example, DC home states have induced LDC host states to liberalize their policies toward FDI through bilateral investment agreements (discussed later in this chapter) and conditions attached to IMF and World Bank structural adjustment loans.

Foreign investment in the oil industry provides a prime example of how the OBM is more applicable in some periods than in others. There was strong evidence for the OBM in the 1970s and early 1980s when international oil companies lost control of agreements they had with LDCs, and oil produced for the international market was gradually brought under state control. From the mid-1980s, however, the international oil companies began to regain their leverage over LDC oil producers as oil prices declined; the oil companies found alternative investment options; and British prime minister Thatcher and U.S. president Reagan called for economic liberalization, privatization, and deregulation. Expropriation and nationalization in the natural resource industries declined sharply in the 1980s and 1990s, and a number of scholars concluded that the OBM had "outlived its usefulness."[36] In the current decade, however, there has been a resurgence of resource nationalism as rising oil prices have given oil-exporting LDCs increased bargaining power, and the OBM has regained some of its importance in explaining MNC–host state relations. In sum, theoretical models such as the OBM can have more relevance in some periods than in others.

HOST COUNTRY POLICIES TOWARD MNCs

Host state policies toward MNCs vary widely, ranging from nationalizations to efforts to attract MNCs with concessions and incentives; and many states have an "attraction-aversion dilemma" vis-à-vis FDI. For example, governments may welcome FDI in some sectors while limiting or blocking it in others (e.g., in defense industries). States also may try to impose obligations such as performance requirements on MNCs to maximize the benefits of FDI. Some federal governments follow restrictive policies toward foreign investment, while their subnational governments (e.g., states or provinces) compete with one another to attract FDI. Although states seek the capital, technology, and organizational skills of MNCs, they may try to preserve large segments of the domestic market for local firms. The issue becomes even more complicated when a country's positive statements about FDI differ from the experiences of foreign investors.[37] The following sections discuss host state policies in the South and the North.

The South

Before World War I the South imposed very few restrictions on MNCs. Colonial territories were open to investment from the imperial powers, and independent Latin American LDCs generally accepted the liberal view that foreign investment would further their economic development. Russia's nationalization of its oil industry after the 1917 revolution had an impact on LDC attitudes, with some shifting to more nationalist policies during the interwar period. However, the South's adoption of restrictive policies was more notable after World War II. In extreme cases, communist regimes in China, North Korea, North Vietnam, and Cuba nationalized Western assets. In other cases, many newly independent states sought limits on FDI to preserve their national sovereignty. FDI often bred hostility because it involved foreign control over LDCs' natural resources and public utilities and was associated with the former colonial powers. However, LDCs had limited ability to pressure for a greater share of FDI benefits because they lacked experience in dealing with MNCs and had few sources of external finance. From 1946 to 1959, U.S. MNCs accounted for more than two-thirds of all new foreign-owned subsidiaries in the South.[38]

In the 1960s and 1970s, LDCs were more activist and had more leverage for several reasons. The growing number of non-U.S. MNCs gave the LDCs alternative sources of finance; FDI was often in natural resources, which were subject to the obsolescing bargain; OPEC's success in raising oil prices encouraged LDC activism vis-à-vis MNCs in general; dependency theorists encouraged the South to exert more pressure on MNCs; and LDCs increased their managerial, administrative, and technical abilities to regulate MNC behavior. Thus, nationalization of foreign firms became widespread in the petroleum and mining industries. LDCs also posed a major challenge to liberal economic views of FDI in the United Nations. In the 1950s and 1960s, the liberal approach to FDI emphasized national treatment, compensation to MNCs for any infringement of their privileges, and the right of MNCs to seek support from their home countries. By the late 1960s, LDCs instead pressured for agreements to restrict the rights of MNCs, permit discrimination in favor of national firms, and give host state institutions authority to resolve investment disputes. OPEC's success in raising oil prices in 1973 gave the LDCs more influence, and the UN General Assembly passed resolutions on FDI despite objections of the North such as the 1974 NIEO Declaration calling on host states to unilaterally apply rules to resident MNCs. However, these resolutions were largely symbolic, and the United Nations failed to reach an agreement on a comprehensive code of conduct for MNCs (discussed later in this chapter).[39]

By the late 1970s, the South shifted to a more conciliatory position for several reasons:

- The nationalization of large-scale petroleum and mining industries was largely completed.
- LDC experience with nationalizing natural resource industries was disappointing because of declining productivity, failure to introduce new technologies, and continued dependence on MNCs for marketing products.

- LDC militancy caused MNCs to shift some of their investments from the South to DCs with natural resources such as Australia, Canada, and the United States.
- The 1980s foreign debt crisis and world recession led to cutbacks in bank loans to LDCs, and the South's fear of exploitation by MNCs was replaced by concern that its inward FDI was declining.

Many LDCs therefore adopted more open policies toward MNCs during the 1980s; for example, Mexico liberalized its policies and supported the NAFTA provisions for freer foreign investment. The most significant change was in the policies of transition economies, especially China. Although China was largely closed to FDI from the 1950s to 1970s, it became more welcoming to FDI in the late 1970s and even granted foreign investors special treatment not available to domestic firms. Thus, China soon became the largest LDC host country for FDI.[40] Although LDCs adopted more welcoming policies, some governments imposed local content and export requirements on MNCs and pressured them to enter into joint ventures with local firms. The East Asian NIEs, for example, welcomed investment but attached a number of conditions to inward FDI. However, most LDCs and transition economies as well as DCs are currently seeking to attract FDI. Of the 1,035 changes in FDI laws of countries from 1991 to 1999, 974 were more favorable and only 61 were less favorable to FDI. Most new measures by LDCs and transition economies reduce restrictions on foreign entry and offer incentives such as lower taxes to promote investment in priority industries. FDI is the largest source of external finance for LDCs, and during financial crises they have found FDI to be more stable than other capital flows. Whereas investment ratings and short-term financial considerations influence access to bank lending and portfolio investment, FDI responds more to underlying economic fundamentals.[41] Despite the general LDC trend toward welcoming FDI, exceptions exist in certain sectors and geographic regions. For example, some Latin American countries nationalized strategic industries, especially extractive industries. In Venezuela, the national oil company Petróleos de Venezuela S.A. took over the operations of the gas company Exterran (the United States); in Bolivia, the government completed the nationalization of the oil and natural gas industry; and in Ecuador, increased taxes on windfall profits on oil have generated friction with some foreign companies.[42]

It is important to note that the poorest LDCs find it difficult to attract FDI even when they liberalize their investment policies. For example, most Sub-Saharan African LDCs adopted policies to encourage FDI, partly under pressure from IMF and World Bank structural-adjustment loans (see Chapter 11). However, low economic growth rates, civil conflicts, political crises, and high indebtedness levels have adversely affected their FDI inflows. As Table 9.2 shows, Africa's share of inward FDI stock was only 3.4 percent in 2008, compared with much higher shares for Asia and Latin America.

The North

MNC investments have on average focused more on natural resources and lower technology manufacturing in the South, and on higher technology production in the North. MNCs also loom larger in LDC than DC economies, and DCs are often major home as well as host countries for FDI; thus they are reluctant to restrict incoming FDI. Despite these differences, DC policies have also shifted over time.

The United States, Western Europe, and Canada imposed very few controls on foreign firms during the nineteenth century, largely because of liberal attitudes fostered by British hegemony. Western Europe followed more open policies than the United States toward FDI after World War I, but their positions reversed after World War II when the United States emerged as the global hegemon. Indeed, the Europeans adopted more restrictive policies in the 1960s largely because of concerns about the dominance of American MNCs. In his book *The American Challenge*, the French writer Jean-Jacques Servan-Schreiber attributed the success of U.S. MNCs to the dynamism of American society, and he called on Europe to reform its educational, industrial, and social policies, and focus on establishing its own MNCs.[43] In response, European governments promoted national champions in key industries by subsidizing research, encouraging mergers, and increasing procurement from national firms; and they demanded that foreign MNCs contribute to job creation and export promotion. France in particular screened inward FDI and rejected more FDI proposals than other European states. Canada also began a screening process in the 1970s because 50 percent of its manufacturing output and 70 percent of its oil production were foreign controlled. As Table 9.3 shows, inward FDI accounted for 20.4 percent of Canada's GDP in 1980, compared with only 11.8 percent for Britain, 3.8 percent for France, 3 percent for the United States, and 0.3 percent for Japan. In 1974 Canada created a Foreign Investment Review Agency (FIRA) to determine whether foreign takeovers were of "significant benefit" to the country, and in 1980 it developed a National Energy Program (NEP) to increase Canadian ownership in the oil and gas industry. These policies produced major tensions with the United States.[44] However, Japan had the most interventionist DC policy. Table 9.2 shows that Japan's inward FDI accounted for only 0.4 percent of total inward FDI stocks in 1980, compared with 12 percent for the United States and 9.1 percent for Britain. Japan's low level of inward FDI resulted partly from the difficulty Western MNCs had in adapting to its cultural and linguistic differences, but Japan's investment restrictions also played a critical role. Dating back to the sixteenth century, Japan's international economic controls resulted from fear of foreign intervention and pride in its distinct economy and society. During the 1930s, Japan developed policies to extract benefits from foreign investment, such as access to capital and technology, while avoiding the drawbacks of foreign control; and after World War II Japan continued to restrict FDI inflows.[45]

In contrast to the restrictions of the 1970s, most DCs began to seek FDI in the mid-1980s for several reasons. First, states viewed FDI restrictions as less legitimate because of the phasing out of global capital controls and the reemergence of orthodox liberalism. Second, states viewed FDI as a remedy for increased global competitiveness and unemployment. The average unemployment rate in OECD countries rose from 3.3 percent in 1973 to 8.6 percent in 1983, and governments placed considerable value on the jobs FDI could provide. DCs also began to view inward FDI as a means of enhancing their competitiveness, and they offered financial incentives and tax concessions to attract MNCs. A third factor in the policy shift was the change in the country composition of FDI. As other DCs joined the United States as important home countries for FDI, they favored fewer restrictions on MNCs. For example, the EC was ambivalent about a 1981 U.S. proposal that GATT should compile an inventory of host countries' trade-related investment measures; but after European MNCs increased their outward FDI, they favored greater discipline over host countries and supported the U.S. position in the GATT Uruguay Round.[46] Japan also felt pressure to ease its inward FDI restrictions as its outward investment increased. Although Japan had removed most legal obstacles to inward FDI by the 1980s, intangible barriers continue to limit the role of foreign firms. Foreign M&As are less common in Japan because shareholders with ties to the firms' management and members of *keiretsus* (groups with extensive cross-shareholdings) hold most of the stock of Japanese firms. For example, of the 584 M&As involving Japan in 1992, 165 were Japanese firms acquiring other Japanese firms, 165 were Japanese firms acquiring foreign firms, and only 32 were foreign firms acquiring Japanese firms. It is also difficult to develop new FDI projects because of the costs and complexities of doing business in Japan, exclusionary business practices of the *keiretsus,* and bureaucratic practices that discriminate against foreign firms. Japan is adopting policies to encourage more openness, and foreign takeovers of Japanese firms are increasing. However, Table 9.3 shows that inward FDI accounted for only 4.1 percent of Japan's GDP in 2008; this was well below the 24.7 percent figure on average for all DCs.[47]

A fourth reason for more open investment policies was the pressure imposed by the United States. Canada and Mexico as U.S. neighbors felt this pressure most strongly. For example, the Canadian Liberal government loosened the controls on inward FDI it had instituted through FIRA and the NEP because of U.S. protests and a U.S. challenge in GATT. The Progressive Conservative government elected in 1984 then rescinded the NEP and replaced FIRA with Investment Canada, which did more to encourage than to review inward FDI. Subsequently, the CUSFTA and NAFTA led to further liberalization of Canadian (and Mexican) foreign investment regulations. Canada's position on inward FDI was also changing because it was becoming a more important *source* of FDI. As Table 9.3 shows, in 2008 Canada's outward FDI stock accounted for a higher percentage of its GDP (34.7 percent) than its inward FDI stock (27.5 percent).[48]

As the main advocate of open investment policies, it is ironic that the United States began to adopt some restrictive policies in the 1980s and 1990s. This policy shift resulted from the relative decline of its economic

hegemony and its increased role as a host country for FDI. Table 9.3 shows that inward FDI accounted for only 3 percent of U.S. GDP in 1980 and 4.4 percent in 1985. However, U.S. inward FDI rose to 6.9 percent of GDP in 1990 and to 16 percent by 2008. Some congressional leaders warned that foreign investors were acquiring U.S. high-technology firms and that the U.S. military was depending more on foreign-controlled suppliers. Thus, U.S. policies became more interventionist with a number of proposed and actual legislative changes. Most important was the Exon-Florio amendment to the 1988 Omnibus Trade and Competitiveness Act, which enables the president to block foreign mergers or acquisitions of U.S. firms that pose a possible danger to national security. The authority to implement Exon-Florio rests with an interagency Committee on Foreign Investment in the United States (CFIUS). The U.S. Congress did not pass some more extreme proposals, and the CFIUS and U.S. presidents have implemented the Exon-Florio amendment with considerable moderation. However, an administration could limit inward FDI if it chose to liberally interpret the national security clause in Exon-Florio. Despite the Exon-Florio amendment, the United States continues to support liberal foreign investment policies in international forums. For example, the United States was the main force behind the TRIMs negotiations in the GATT Uruguay Round and negotiations for a Multilateral Agreement on Investment in the OECD. The North in general supports liberalization, and most DC regulatory changes in recent years have been investment friendly.[49]

MNC–HOME COUNTRY RELATIONS

The number of major home countries for MNCs has always been small. Western Europe was the source of about 80 percent of FDI before World War I, and Britain accounted for the largest share. The United States, Britain, and the Netherlands accounted for 65–75 percent of outward FDI stock between World War I and 1980. Although the sources of FDI became more diverse after 1980, six DCs accounted for about 75 percent of the total in the early 1990s—the United States, Britain, Germany, France, Japan, and the Netherlands. Some LDCs and transition economies have become more important as sources of FDI, and the value of outward FDI stock from these countries reached $1.4 trillion in 2005.[50] Despite the increase in FDI from LDCs and transition economies, Table 9.1 shows that DCs still accounted for 84.1 percent of outward FDI stock in 2008. This discussion of FDI–home country relations therefore focuses mainly on the North.

The effects of FDI on a home country depend on the characteristics of both the home country and its MNCs. Whether policy makers focus on the characteristics of the state or the MNC, questions about the costs as well as benefits of FDI to home countries have increased in recent years. This section begins with a discussion of home country policies toward MNCs. It then examines two contentious questions in regard to home country–MNC relations: (1) What are the costs and benefits of FDI for labor groups in the home country? and (2) What is the relationship between the competitiveness of a home country and the competitiveness of its MNCs?

Home Country Policies Toward MNCs

Home countries normally view outward FDI as an indication of economic and political strength and as beneficial to their competitiveness. Thus, they usually give their MNCs favored treatment and try to protect them from hostile actions by foreigners, especially when the MNCs operate in strategic industries. However, governments sometimes associate outward FDI with a decrease in home country exports, a decline in the country's industrial base, and losses in domestic employment. In such circumstances, home countries may try to stem the flow of outward FDI. Some governments also view their MNCs as tools of foreign policy and may attempt to monitor, control, or restrain their outward FDI in the interests of the home economy.

The Pre–World War II Period During the nineteenth and early twentieth centuries, home countries supported their corporations and protected them vis-à-vis foreigners. For example, in the colonial period, European states sometimes intervened militarily to ensure that their companies developed and prospered. During the interwar years, European home countries provided subsidies and other assistance to support airlines, shipping firms, and oil companies that were closely tied to their strategic interests. In the 1930s, the Japanese army occupied Chinese plants and gave Japanese companies control over their management. The United States also was sometimes willing to support its companies' interests in Latin America with military force. However, governments at times took actions to limit outward FDI; for example, the Nazi government in Germany had to approve all new FDI, and it only rarely gave its approval. Although the U.S. government was concerned that outward FDI could transfer technology and employment to foreign countries, it adopted no policies to restrict FDI outflows before World War II.[51]

Early Postwar Period In the 1950s to 1970s, the United States as the hegemonic power both protected its MNCs and pressured them for political and economic reasons. For example, in 1962 the U.S. Congress passed the Hickenlooper Amendment, which threatened to withhold development assistance from LDCs that nationalized American MNC affiliates without providing adequate compensation. The United States also viewed its MNCs as tools of foreign policy. For example, the U.S. government used its Trading with the Enemy Act and Foreign Assets Control Legislation in the 1960s and 1970s to limit the trade of U.S. subsidiaries with China, Cuba, North Vietnam, and North Korea. Host governments for U.S. subsidiaries in Canada, Europe, and Latin America considered these policies an infringement of their sovereignty, and they often adopted laws to counter the U.S. legislation. The United States also tried to control corporate behavior in response to its growing

balance-of-payments deficits. In the 1960s, the government called on U.S. MNCs to limit capital outflows to their foreign affiliates; in the 1970s, the government created the Domestic International Sales Corporation (DISC) program, which provided tax incentives to encourage MNCs to export from the United States instead of from abroad.[52]

Although European governments recovering from World War II were concerned that outward FDI would adversely affect their balance of payments, they did little to either encourage or limit outward FDI in the 1950s and 1960s. Japan was the only major economy that systematically restricted outward FDI for about two decades after World War II. In its efforts to keep scarce capital at home for postwar reconstruction, Japan scrutinized FDI projects and approved only those that would increase exports, provide access to raw materials, and pose no threat to Japanese producers. Thus, Table 9.1 shows that Japan accounted for only 0.7 percent of outward FDI stock in 1960. Japan did not begin to liberalize its controls on outward FDI until the late 1960s, when its balance-of-trade surpluses were rapidly increasing.

The 1980s to the Present Although the United States eased its limits on economic transactions with communist countries as the Cold War declined, it sometimes acted in response to international events. In the early 1980s, for example, Western Europe and the Soviet Union agreed to construct a natural gas pipeline; Western European firms were to provide equipment for the pipeline's construction in return for future deliveries of Soviet natural gas. After Poland declared martial law in December 1981, the United States retaliated against the Soviet Union by imposing an embargo on materials produced by U.S. companies that were to be used in constructing the pipeline. The United States not only prohibited subsidiaries of U.S. MNCs from exporting equipment and technology to the Soviet Union but also ordered foreign companies not to export goods produced with technology acquired under licensing agreements with U.S. companies. The Reagan administration's opposition to the pipeline stemmed from concerns that Western Europe would become dependent on Soviet gas exports, and that these exports would provide the Soviet Union with hard currency to strengthen its economy. However, planning for the pipeline was already at an advanced stage, and Britain, France, West Germany, and Italy ordered their resident firms to ignore the U.S. restrictions and provide the goods and technology to the Soviet Union. A number of firms, such as Dresser-France (a U.S. subsidiary) and licensees of General Electric in Britain, Italy, and West Germany, complied with the European orders. Although the United States imposed penalties on these firms, the Europeans did not back down; eventually the U.S. sanctions were removed and the European sales proceeded.[53] Since the breakup of the Soviet Union, U.S. extraterritorial actions have been aimed mainly at Cuba. For example, the 1996 Helms–Burton Act penalizes *foreign* companies for doing business in Cuba if they use assets or property of U.S. MNCs (or individuals) that were nationalized after the 1959 Cuban Revolution; but foreign governments indicated that their companies would not abide by this legislation.[54]

Other home countries have been less inclined than the United States to take such blatant political actions to control MNC behavior. However, Japan and Western Europe have established close linkages with their MNCs to achieve common *economic* objectives, while the United States has maintained more of an arm's length relationship between business and government (the U.S. defense and oil industries are notable exceptions). Realists argue that the United States should counter the actions of Japan and Europe by developing an industrial policy to support U.S. MNCs, especially in high-technology areas; this would involve assessing competitive trends in high-technology industries and shifting federal R&D funds from military uses to dual-use and economic areas. The United States has pursued some limited industrial policy initiatives but not to the same extent as Japan and some European countries. In contrast to industrial policy measures, liberals support dependence on the market and on firms that are the lowest cost suppliers, regardless of their nationality.[55]

The Effects of MNCs on Labor Groups in Home Countries

A major controversy regarding the impact of MNCs on *home* countries relates to whether or not foreign production causes a loss of exports and jobs at home. The debate began in the 1970s when the American Federation of Labor–Congress of Industrial Organizations (AFL-CIO) reversed its liberal trade policy position and called for limits on imports and on FDI by American firms. In the early 1990s, U.S. labor groups opposed NAFTA because of concerns that MNCs would shift their operations to Mexico. The assumption of the AFL-CIO and other U.S. labor groups is that workers in the home country are likely to lose their jobs when a U.S. firm switches from exporting to serving foreign markets through subsidiaries. Other DCs have also been concerned about FDI and the loss of jobs. For example, a 1993 report to the French Senate argued that outward FDI was a major cause of unemployment among factory workers, Japanese policy makers warned that unemployment resulted from the relocation of plants to other Asian countries, and Germany was concerned about the employment effects of industries relocating in Eastern Europe.[56]

Liberals generally dismiss these concerns, arguing that U.S. FDI "tends in the aggregate to create rather than destroy U.S. job opportunities in high-wage, export-oriented industries."[57] Although outward FDI destroys some jobs in the home country, "it creates others, and the jobs thus gained tend to pay higher wages than the jobs lost."[58] Thus, liberals often present evidence that MNCs have a better record than domestic firms in job creation, worker salaries, export performance, and technological innovations in the home country. Liberals also reject the idea that home country workers suffer because MNCs transfer activities to LDC subsidiaries with lower wages and standards. For example, one liberal study argues that investment by U.S. firms in Mexico as a result of NAFTA "creates U.S. jobs, both in the short run, by boosting U.S. exports of capital goods, and in the long run, by establishing channels for the export of U.S. intermediate components, replacement parts, and associated goods and services."[59] Realists and historical

materialists by contrast emphasize the negative effects of outward FDI on employment stemming from export substitution and intrafirm imports. *Export substitution* occurs when production of a subsidiary in country B substitutes for exports from the parent firm in country A, or when exports from the subsidiary in B to a third country (C) substitute for goods and services that A formerly supplied to C. *Intrafirm imports* are goods and services that the home country imports from foreign affiliates of a parent firm. Realists argue that export substitution and intrafirm imports reduce production and employment in the home country, and historical materialists add that the mobility of capital and MNCs puts immobile workers at a disadvantage. The constant threat that MNCs will "outsource" jobs to subsidiaries in low-wage countries forces workers in the home country to accept lower salaries, health benefits, pensions, and job security. MNCs from this perspective benefit both by exploiting low-cost labor in LDC host countries and by reducing labor costs in DC home countries. Critical theorists reject the liberal view that workers in the home country will be compensated for the loss of manufacturing jobs with the growth of skilled service positions by arguing that MNCs are now even exporting more skilled positions to lower salary locations.[60]

Despite numerous studies on MNCs, it is difficult to find unequivocal evidence supporting one side or the other on this issue. A major problem confronting empirical researchers is that we cannot know whether a specific firm's exports would have been maintained if it had *not* established foreign subsidiaries. Firms that establish foreign affiliates are often more competitive, and workers in a less competitive firm may lose jobs whether at home or abroad. Creation of foreign production facilities can also be both job displacing and job creating for workers in the home country, depending on whether an MNC is able to expand and diversify its production facilities. With all the variables involved, it may be easier to determine the impact of FDI on specific jobs in specific firms than to provide a broader view of the impact on aggregate employment and exports. Finally, most analysts would agree that FDI in LDCs is more likely to adversely affect less skilled than more skilled workers in DC home countries. The "fairness" of this situation depends not only on our economic views but also on our political and social views. Thus, the controversy over the effects of FDI on workers in home countries shows no signs of abating.[61]

Competitiveness and Home Country–MNC Relations

Another contentious issue is whether a state's competitiveness is closely linked with the competitiveness of its MNCs, or whether MNCs have worldwide interests that differ from the interests of their home countries. Realists argue that a state's MNCs have a major impact on its competitiveness because its "standard of living in the long term depends on its ability to attain a high and rising level of productivity in the industries in which its firms compete."[62] For example, Canada has a good standard of living despite the high degree of foreign ownership in its manufacturing industry; but it can never have the highest standard because the best jobs and R&D are located in the home country.[63] Liberals by contrast often argue that MNCs seek profitable

opportunities around the world and "are becoming disconnected from their home nations."[64] They see U.S. competitiveness as depending more on U.S. workers' education and skills than on U.S. corporate ownership; if Americans have the requisite training, foreign MNCs will employ U.S. workers. Thus, U.S. senator Lamar Alexander asserted that the American auto industry was earlier defined as "the Big Three companies in Detroit. Now the definition is any company that makes a substantial number of cars and trucks in the U.S. and has a big payroll here, pays big taxes here and buys supplies here."[65] Some liberals go even further and assert that we are entering a "borderless world" in which a corporation's nationality no longer makes a difference.[66] An analyst's position on competitiveness affects their policy prescriptions. Whereas realists argue that governments should pursue industrial policies to promote their own MNCs in high-technology areas, interventionist liberals believe that governments should focus more on upgrading their workers' skills so that MNCs of any nationality will want to do business, invest, and pay taxes there.[67]

Interventionist liberals can point to China as a prime example of a country that has reaped enormous benefits from foreign MNCs because of its large population; its booming market; its low production costs; and its reasonably skilled, hard-working, and low-wage workers. China's surging exports have been "one of the great economic success stories in the modern era," and foreign MNCs have had a major role in this export success.[68] Whereas wholly and partially owned foreign subsidiaries accounted for less than 6 percent of China's exports in 1986, this figure climbed to about 55 percent in 2004. Foreign subsidiaries also accounted for 81 percent of China's exports of technology-intensive goods in 2000 and for more than 90 percent of China's exports of electronic circuits and mobile phones. Foreign MNCs have used China as an export platform, from which they can send goods to other parts of Asia and around the world.[69]

As liberals note, there is also some evidence that large MNCs are becoming more global in their operations and outlook and less closely tied to their home countries. For example, the sales of foreign affiliates of U.S. firms were four times greater than U.S. merchandise exports between 1988 and 1990; U.S. foreign affiliates accounted for 43 percent of their parent companies' total profits in 1990; and U.S. firms increased their foreign R&D spending by 33 percent, compared with an increase of only 6 percent in the United States from 1986 to 1988. National boundaries are also becoming blurred as some MNCs spread their head office functions and list their shares in stock exchanges in several countries. For example, Shell and Unilever have headquarters in Britain and the Netherlands, and Astra-Zeneca has its headquarters in one state and conducts most of its R&D in another state. Another example is Asea Brown Boveri, which was formed from a merger of Sweden's ASEA and Switzerland's Brown Boveri; moved its headquarters from Stockholm to Zurich; has Swiss, German, and Swedish managers; and does its business in English. The increase of cross-border M&As and cross-holding of shares are additional complications in defining an MNC's nationality, and integrated production systems make it difficult to determine a product's

origins. MNCs can insulate themselves from national policies and conditions by sourcing inputs, information, and personnel from around the world. For example, an automobile manufactured by Ford may be assembled in Britain with inputs from all over Europe, from designs produced in the United States, and from stages of processing in various locations. In this age of globalization, liberals argue that the highest priority should be "to provide competitive conditions for businesses in general in the country rather than only for the country's firms in particular."[70]

Despite the blurring of nationalities, realists note that *most* MNCs are home country oriented and that a state's competitiveness is linked with the competitiveness of its MNCs. R&D is a major factor promoting competitiveness, and MNCs tend to keep much of their R&D activity at home. In 1984, for example, the ratio of R&D to sales for industrial machinery and equipment firms in Canada was only 40 percent of the U.S. ratio, and much of this difference resulted from the high degree of foreign ownership in Canadian industry. Although U.S. MNCs are more willing than Japanese MNCs to invest in R&D abroad, even U.S. companies spent only 8.6 percent of their R&D funding in foreign countries in 1988.[71] One factor in a country's competitiveness is its ability to maintain a positive trade balance, and U.S. affiliates of Japanese firms are more likely than U.S. firms to import goods and services into the United States. R&D funding is also essential for developing new technologies, and the control of high-technology industries can affect a country's national security. Despite China's success as an export platform for foreign MNCs, "its reliance on stitching and welding together products that are imagined, invented and designed by others" means that it sometimes has to pay large amounts in licensing fees and patent royalties to foreigners. Much of Apple's iPhone is made in China, but only a small share of the profits from the sale of iPhones stays in China.[72]

Although a state's competitiveness is tied to the competitiveness of its firms, there are important national differences. For example, U.S. MNCs tend to favor their home country less than MNCs of Japan and Germany. Studies show that U.S. MNCs are more interested in the financial returns on investments, whereas Japanese MNCs emphasize market share; U.S. MNCs are more willing to invest in overseas R&D than Japanese MNCs; and German and Japanese MNCs put more emphasis than U.S. MNCs on exporting from the home country. Thus, Robert Reich's question as to whether "our MNCs" look after "our national interests" may be more relevant for U.S. MNCs than for Japanese and German MNCs.[73]

A REGIME FOR FDI: WHAT IS TO BE REGULATED?

Despite the global influence of MNCs, the principles, norms, and rules for foreign investment are more rudimentary than those for trade and monetary relations; and no IO has a role in a foreign investment regime comparable to the WTO's role in the global trade regime. Most government policies on MNCs are formulated at the national level, but the transnational nature of MNCs makes these policies inadequate. The main obstacle to forming a foreign investment regime is the lack of consensus on what should be regulated—the MNC, the host state, or the home state. The prominent role of private actors (MNCs and multinational banks) as sources of investment capital also makes international regulation a difficult and contentious issue. According to orthodox liberals, investment agreements should regulate host state behavior and provide maximum protection against nationalization, performance requirements, and other impediments to MNC operations in the global marketplace. Home countries should also be able to intervene on behalf of their MNCs to counter host country actions that inhibit investment flows. Realists and historical materialists, by contrast, view host country restrictions on foreign investment as perfectly legitimate. Realists argue that state intervention is necessary to ensure that FDI does not conflict with the national interest and national security, and historical materialists believe that investment agreements should regulate MNCs rather than host states.

The United States as the global hegemon provided much of the foreign investment regulation in the 1950s and 1960s. U.S. policy sought to protect FDI flows against host country actions such as nationalization and to ensure that MNC behavior did not conflict with the West's Cold War objectives. European states concluded **bilateral investment treaties (BITs)** in the 1960s to help protect their investments in LDCs (BITs are discussed later in this chapter). In the 1970s, attention shifted to developing international regulations for FDI, and some economists called for the creation of "a General Agreement for the International Corporation" like the GATT for trade.[74] Several events in the 1970s contributed to the view that this agreement should regulate the behavior of MNCs; for example, currency speculation by MNCs posed a threat to the Bretton Woods pegged exchange rates, and some DCs such as France and Canada began to screen foreign investment to limit the influence of U.S. MNCs.[75] In a widely quoted study, Raymond Vernon argued that "global corporations must be regulated to restore sovereignty to government" because the MNC is "not accountable to any public authority that matches it in geographical reach."[76] The South took the main initiative in the 1970s, pressuring for UN regulation of MNCs rather than host states. As a result, the United Nations set up a Commission on Transnational Corporations in 1974 with a mandate to develop a binding Code of Conduct for MNCs. To counter the UN emphasis on regulating only MNCs, the OECD's 1976 Declaration and Decisions on International Investment and Multinational Enterprises included guidelines for the behavior of both MNCs and host states.[77]

By the late 1970s, it was evident that the North would not agree to the South's demands for a UN Code of Conduct for MNCs, and several factors contributed to a shift back to emphasis on controlling the behavior of host states. For example, the South's share of inward FDI was declining because of the 1980s foreign debt crisis, concerns about LDC political and economic stability, and the emphasis on high-technology investment in the North.

Thus, LDCs followed less interventionist policies toward MNCs as their needs for capital increased, and the North was able to begin forging a consensus that host state (not MNC) behavior should be regulated. Before examining the multilateral efforts to regulate foreign investment, the next section provides some background on BITs.

BILATERAL INVESTMENT TREATIES

Bilateral treaties to protect and promote foreign investment have a long history. In the eighteenth century, the United States, Japan, and some Western European states concluded bilateral treaties that dealt with investment as well as trade, maritime, and consular relations. When the GATT-based multilateral trade regime was formed, countries began to conclude separate BITs. The first BIT was ratified in 1959, and most of the earlier treaties were between DCs and LDCs. With the breakup of the Soviet bloc, many Eastern European countries signed BITs with DCs and LDCs, and the number of BITs between LDCs increased as more LDCs became home countries for FDI. BITs are the most widely used international agreement for protecting FDI and MNCs. Most BITs call on host states to provide national treatment to MNC subsidiaries, which ensures that they are treated at least as favorably as domestic firms. Other provisions include the right of MNCs to repatriate profits, and the right to "fair" compensation in cases of expropriation. The treaties also prohibit host country performance requirements committing MNCs to export goods produced in the host country or to purchase goods and services locally, and they have dispute resolution procedures that MNCs can use to seek compensation in cases of hostile host country actions. Although some more recent BITs refer to the host country's right to regulate FDI, BITs continue to give priority to the rights of MNCs.[78]

The South tends to view BITs with the North as one-sided because they impose obligations on the host state to protect foreign investment without any corresponding obligations on the home country or the MNC. However, many LDCs have agreed to sign BITs because they assume this is necessary to attract foreign investment. Even in the 1970s, when LDCs called for a New International Economic Order, they participated in BITs for pragmatic reasons to attract FDI. The 1980s foreign debt crisis resulted in a sharp reduction in commercial bank loans, and LDC debtors became more dependent on foreign investment for development finance (see Chapter 11). Thus, the total number of BITs increased from 167 in the late 1970s to 385 in 1989. As DC foreign aid declined during the 1990s, the number increased even more rapidly to 2,676 BITs in 2008.[79] However, several studies find "little evidence that BITs have stimulated additional investment" to signatory LDC states.[80] LDCs with weak domestic institutions are not likely to gain from signing BITs, because BITs act as a complement rather than as a substitute for domestic laws protecting private property. Thus, many countries in Sub-Saharan Africa have difficulties in attracting FDI even when they sign BITs.

From the North's perspective, BITs provide a "second best solution in the absence of a universal investment agreement."[81] Other than some regional agreements such as NAFTA, BITs continue to be the best means to regulate the treatment of foreign investors by LDC host countries. It is important to note that the South's approach to BITs has become less uniform as the number of BITs *between LDCs* has continued to grow. About 26 percent of all BITs today are South–South treaties. The rapid increase in the number of BITs of all types presents a major problem because it is resulting in "a wide range of non-uniform and inconsistent arrangements that could become increasingly inefficient, complex, and non-transparent."[82] The following sections focus on efforts to establish more uniform regulations in the United Nations, the EU, NAFTA, the GATT/ WTO, and the OECD.

UNITED NATIONS

As discussed, concerns were raised about MNC effects on the national sovereignty of host states in the 1960s and 1970s. A high-profile case involving the International Telephone and Telegraph Corporation (ITT) and Chile brought the issue of regulating MNCs to UN attention. ITT was concerned that Salvador Allende, the Marxist candidate in Chile's 1970 presidential election, would nationalize its Chilean affiliate without compensation. As a result, ITT tried to prevent Allende's election and have him removed from power after he was elected, and also tried to involve the U.S. Central Intelligence Agency and U.S. Information Agency in its activities. When ITT's actions became public in 1972 through published documents of a syndicated columnist, a U.S. Senate subcommittee investigated the case and released a report on *The International Telephone and Telegraph Company and Chile,* and the UN secretary general appointed a Group of Eminent Persons to examine the impact of MNCs.[83] In 1974 the UN group's report condemned "subversive political intervention" by MNCs such as ITT in Chile, and called for the development of a code of conduct for governments and MNCs.[84] The United Nations then established a *Commission on Transnational Corporations* to develop a comprehensive information system on MNC activities and a code of conduct, and a *UN Center on Transnational Corporations* (*UNCTC*) to serve as its secretariat. An intergovernmental working group began preparing a draft code of conduct and submitted its report to the commission in 1982, but a long period of negotiations followed because of fundamental disagreements among UN members. For example, there was no consensus on whether the code should be a set of voluntary guidelines or have the force of law. Most LDCs and socialist states supported the draft code because it sought to prevent MNC tax evasion, restrictive business practices, and transfer pricing. The DCs as leading home states for MNCs, by contrast, argued that the draft code did not deal with host state treatment of MNCs. After years of sporadic negotiations, the United Nations abandoned its efforts to form a consensus on a code of conduct for MNCs in 1992; the UNCTC was dissolved in 1993 and replaced by a less proactive Division on Transnational Corporations and Investment under UNCTAD auspices.[85]

UNCTAD has developed expertise on foreign investment issues, and its annual *World Investment Reports* and *Trade and Development Reports* are highly regarded. However, UN efforts since 1993 have been limited to promoting *voluntary* standards of behavior for MNCs. At the 1999 World Economic Forum in Davos, UN secretary-general Kofi Annan invited MNCs to join a UN-led partnership mission called the **Global Compact**. The compact comprises 10 principles on human rights, labor standards, the environment, and anticorruption that are designed to promote responsible global capitalism. The compact has continued to gain support, and hundreds of companies and organizations ranging from business, labor, and civil society groups to cities and even stock exchanges have signed on to it. Unlike a regulatory code of conduct, the compact is voluntary and depends on a self-reporting system. Critics argue that MNCs may endorse the compact to gain publicity, but that they are often slow in implementing the 10 principles. The UN's Global Compact Office has responded by generating a "grey list" with names of companies that signed on but did not report on what they were doing to comply with the compact's terms. However, the efficacy of this "moral suasion" approach is uncertain, and only "time will tell whether these changes will influence corporate conduct in the long term."[86]

REGIONAL APPROACHES: THE EU AND NAFTA

Regional agreements often include investment as well as trade provisions, partly because of the failure of multilateral institutions to develop a strong foreign investment regime; this section focuses on two important examples: the EU and NAFTA. As a common market, the EU provides for the free movement of capital and protection of FDI among the member states. Thus, the European Commission has legal authority to monitor and regulate MNC activities to ensure that there is a "level playing field." The EU has also been concerned that European MNCs are not large enough to compete with American and Japanese MNCs, and its policy toward MNCs is therefore "two-edged, encouraging multinational activity in a transnational European market, while seeking to remedy the concerns caused by this activity by specific binding measures of containment."[87] In view of the high level of EU integration, NAFTA's method of dealing with FDI is more likely than the EU's to serve as a model for future efforts to develop a multilateral foreign investment regime.

The investment provisions in NAFTA Chapter 11 have created considerable controversy regarding the regulation of FDI. In one respect, the Chapter 11 investment provisions were unique because they marked the first time that a regional FTA "provided a full set of legal rights and protections to foreign direct investors (from other member countries)."[88] In another respect, the Chapter 11 provisions were not really new, because they "carry forward on a trilateral basis all of the key provisions of U.S. bilateral investment treaties."[89] For example, NAFTA commits its three members to provide MFN and national treatment to foreign investors; to ban all new export performance, local content, and technology transfer requirements; and to phase out most existing performance requirements within 10 years. NAFTA also commits governments to compensate investors in cases of expropriation, which it defines in very broad terms. Most liberal economists believe that "open investment policies should be the norm," with limited exceptions for issues such as national security.[90] Liberals applaud NAFTA for its significant advances in freeing investment flows but criticize the sectoral exceptions that prevent NAFTA from completely liberalizing North American investment.[91] For example, the United States excludes its maritime industry, Canada exempts its cultural industries, and Mexico excludes its energy and rail sectors. Realists and critical theorists, by contrast, view the NAFTA investment provisions as threatening national sovereignty and the ability of environmental and labor groups to protect their interests. In the view of critical theorists, the NAFTA rules increase capital mobility and give the capitalist class greater leverage vis-à-vis labor. MNCs can transfer their operations from the United States and Canada to Mexico to benefit from lower labor costs and environmental standards, contributing to a competitive "race to the bottom."[92] Realists argue that NAFTA's limits on the use of performance requirements prevent host countries from gaining positive spinoffs from foreign investment. By preventing these measures, NAFTA makes it difficult for host countries to channel foreign investment to further their national objectives.[93]

The most controversial aspect of NAFTA Chapter 11 is its investment dispute resolution provisions, which permit private investors to obtain relief directly from governments for alleged NAFTA violations. Chapter 11 stipulates that a private investor from a NAFTA state can compel one of the other two NAFTA governments to participate in binding arbitration to determine whether the investor has incurred financial losses because of the government's alleged breach of its obligations. Whereas BITs have included this type of investor–state arbitration for many years, in the WTO only governments have "standing" in dispute settlement cases, and investors must be represented by governments in settling their claims. Liberals have praised these procedures for "distancing investment disputes from the political arena. An investor who feels that it has suffered damage . . . by a NAFTA country can pursue its claim without having to involve its government." Realists by contrast see the procedures as providing "a vehicle for investors to harass governments whose policies they dislike."[94] By giving MNCs legal standing in investment disputes with governments, the NAFTA provisions pose a direct threat to national sovereignty. Environmentalists strongly criticize the fact that many Chapter 11 investor complaints have challenged governments' antipollution and public health policies. Many early supporters of Chapter 11 assumed that it would prevent the Mexican government from over-regulating the activities of U.S. and Canadian business. However, U.S. and Canadian government actions are being challenged in a growing number of investment disputes, which are sometimes highly controversial. Thus, all three NAFTA governments have expressed concerns about Chapter 11, and they want to ensure that the protection of investors' rights "does not threaten the ability of governments to regulate in the public interest."[95]

THE GATT/WTO TO THE OECD AND BACK TO THE WTO

The WTO is a natural institution to deal with FDI because of the close relationship between foreign investment and trade. However, FDI is the "neglected twin" of trade because it has been less subject to multilateral regulation.[96] The proposed ITO of the 1940s contained some controversial FDI-related topics, and this was a major factor in the U.S. rejection of the Havana Charter. As a result, GATT did not deal with investment until the TRIMs was negotiated in the Uruguay Round and incorporated into the WTO (see Chapter 7). Although the TRIMs is an important beginning in recognizing the relationship between trade and investment, it is largely symbolic because many LDCs are reluctant to accept limits on their investment policies. TRIMs does not impose major new restraints on government actions vis-à-vis FDI; it only bans certain investment-related measures that are inconsistent with GATT/WTO provisions. The GATS and the TRIPs also contain some investment provisions, but the WTO does not provide a comprehensive body of rules for FDI; they are not designed specifically with investment in mind and are scattered throughout the agreement.[97]

Instead of conducting investment negotiations in the WTO, the DCs began negotiations in the OECD in 1995. The OECD seemed to be a natural venue for developing a *Multilateral Agreement on Investment* (*MAI*) because OECD countries account for such a large share of FDI inflows and outflows. The OECD also had long-term experience with investment issues: In 1961 it adopted two codes to liberalize capital flows, in 1976 it issued a Declaration on International Investment and Multinational Enterprises, and its definitions and ideas had a major influence on the BITs.[98] The United States wanted a comprehensive and binding MAI, and it was frustrated that LDCs had opposed even the limited TRIMs agreement in the GATT negotiations. Most OECD members are capital exporters, and the United States therefore wanted the OECD to be the venue for the MAI negotiations. However, the EU Commission preferred the WTO as a venue because it wanted the agreement to bind non-OECD countries, which were a growing destination for FDI. Canada also favored the WTO as a venue because NAFTA already dealt with its most important investment relationship (the United States), and it wanted an MAI to benefit Canadian MNCs in the South. Despite these differences, the MAI negotiations began in the OECD for several reasons: Many LDCs in the WTO opposed negotiations on investment issues; and some EU members wanted to negotiate for themselves in the OECD rather than having the EU Commission negotiate for them in the WTO. (The EU Commission represents the EU members in the WTO, but EU members represent themselves in the OECD.) To allay concerns about the exclusivity of the MAI negotiations, the OECD indicated that nonmember states would be consulted.[99]

The OECD negotiations addressed three major issues: protection for foreign investors, liberalization of investment, and dispute settlement procedures. The investment protection talks focused on compensation for expropriation of property, freedom of investors to transfer profits and dividends out of host countries, and fair and equitable treatment for foreign

investors. The investment liberalization talks focused on host country obligations to limit performance requirements and provide MFN and national treatment to foreign investors. The dispute settlement talks focused on procedures investors as well as states could take to submit complaints for binding international arbitration. Although BITs and NAFTA already dealt with many of these issues, the MAI would be multilateral and more comprehensive than previous agreements. Despite early progress in the talks, the negotiating group requested a one-year extension of its mandate in May 1997 because of significant national differences. For example, France and Canada wanted to exempt culture from the agreement to protect their arts and media sectors; the EU and Canada resented the U.S. Helms–Burton law that could be used to sanction foreign companies for investing in Cuba, Iran, and Libya; and OECD members disagreed as to whether environmental and labor measures should be included. These differences gave outside critics such as civil society groups and LDCs the opportunity to organize opposition to an agreement. Although LDCs had become more open to foreign investment after the 1982 foreign debt crisis, they resented being excluded from the OECD negotiations and feared that an MAI would limit host government policies. Indeed, most OECD members seemed "to agree that an MAI should not impose any obligations on firms but that it should be binding on governments."[100] This position resulted from the North's opposition to the South's efforts to develop a UN code of conduct for MNCs and from growing neoliberal support for free foreign investment and capital flows. In the South's view, by contrast, the 1990s Asian financial crisis demonstrated the need for regulation of foreign investment and capital flows (see Chapter 11).[101]

A coalition of NGOs launched the most effective opposition to an MAI, arguing that it would threaten human rights, labor and environmental standards, and LDC development. They predicted that an MAI would result in a race to the bottom among countries willing to lower their labor and environmental standards to attract foreign investment. A crucial turning point occurred when Ralph Nader and his consumer advocacy group acquired a draft copy of the MAI and put it on the Internet. Using a variety of websites, NGOs mobilized a strong opposition composed of human rights, consumer advocacy, and labor and environmental groups. Gramscian theorists would argue that the NGOs organized a counterhegemony, which used the Internet "with incredible effectiveness to derail a planned . . . pact designed to increase globalization."[102] Problems also mounted within the OECD when France forced a suspension of the OECD negotiations in 1998 because of its concerns about culture and the threat to national sovereignty. The failure of the MAI negotiations shows that the OECD is better suited to providing advice and analysis and concluding nonbinding accords than it is to negotiating binding agreements on sensitive issues.

Even before the MAI talks collapsed, the EU and Japan tried to revive the investment issue at the WTO's first Ministerial meeting in 1996 when they pressured for negotiation of the so-called Singapore issues: trade facilitation, competition policy, government procurement, and investment. However, the

South was adamantly opposed to negotiating these issues, and the impasse was eventually resolved by the decision that only one of the Singapore issues (trade facilitation) would be negotiated in the Doha Round. Any current work the WTO does on investment will therefore be separate from the multilateral trade negotiations.[103] A major obstacle to WTO negotiations is the wide North–South divergence of views on whether an MAI should regulate the behavior of MNCs, host states, or home states. With the failure of the WTO to regulate foreign investment, the OECD has again moved in to fill the gap. The OECD has, of course, avoided trying to revive the contentious MAI talks and has instead focused on its traditional activities of identifying investment barriers so that peer pressure can be exerted on states. In 2006, the OECD released a comprehensive *Policy Framework for Investment*, identifying policies that states can adopt to attract foreign investment.[104] Despite the OECD's continuing efforts to liberalize investment, governments have not established a multilateral foreign investment regime with effective regulations and procedures. As a result, private actors are having a greater role in regard to FDI issues.

PRIVATE ACTORS

In view of the lack of multilateral mechanisms to regulate MNCs, private actors have become involved with promoting corporate social responsibility (CSR). NGOs representing consumer, environmental, religious, and other groups have pressured MNCs to engage in socially responsible behavior, and MNCs have engaged in a degree of voluntary self-regulation. This section discusses the role of NGOs and civil society groups, and the "considering IPE theory and practice" section that follows examines the CSR concept from different theoretical perspectives.

As discussed in Chapter 2, NGOs and civil society groups may be conformist, reformist, or rejectionist.[105] Conformists largely endorse MNC behavior and do not favor restrictions on their activities, reformists believe that MNCs can and should be reformed with some regulation, and rejectionists believe that MNCs are not reformable. NGO reformists want to promote responsible MNC behavior without engaging in ideological confrontation. For example, reformist environmental strategies include ecoconsumerism or NGO campaigns to purchase products from ecologically minded firms, partnerships between NGOs and business firms to make production methods more environmentally responsible, and codes of conduct that call on MNCs to voluntarily engage in socially conscious behavior.[106] Rejectionist NGOs seek to expose and punish irresponsible corporate behavior and are less willing to engage in dialogue. Their strategies include consumer boycotts to publicly expose and punish environmental abuses, monitors to track and disseminate information about MNCs' destructive activities, and counterinformation to refute MNC claims. Some rejectionists aim to develop a counterhegemony to "confront the hegemonic formation of globalization," which includes MNCs.[107] Some NGOs employ reformist and

rejectionist strategies simultaneously. For example, Greenpeace worked with companies to develop ozone-friendly refrigerators at the same time as it was encouraging consumers to boycott Shell Oil Company over its alleged involvement with state suppression in Nigeria. In efforts to avoid negative NGO campaigns and government regulations, many MNCs have been developing their own regulatory frameworks and collaborating with reformist NGOs. Instead of binding commitments at the international level, business firms and associations have supported voluntary agreements as an alternative. Thus, the International Chamber of Commerce endorsed 16 principles on the environment known as the *Business Charter on Sustainable Development* before the 1992 UN Conference on Environment and Development in Rio de Janeiro, Brazil.

The question arises as to how effective NGOs have been in altering MNC behavior. MNCs have different levels of vulnerability to NGO strategies. For example, oil companies are less vulnerable to NGO pressure because governments depend on MNCs' access to oil technology, expertise, and distribution networks. NGOs also have limited monitoring capabilities; although they direct their campaigns and protests at certain high-profile companies, they permit other companies to be free riders. Overall, MNCs have not changed significantly as a result of NGO activities, and NGO pressure does not substitute for adequate multilateral regulation.

Considering IPE Theory and Practice

As discussed, liberals, realists, and historical materialists have widely divergent views regarding MNCs. Liberals view MNCs as positive agents of change that contribute to efficiency and stimulate innovation, economic growth, and employment. Realists believe that host states should be able to impose performance requirements and other regulations on MNCs to promote industrial development and protect the national interest. Historical materialists argue that MNCs overcharge for their goods and services, create dependency relationships with LDC host states, and pose a threat to labor groups and the environment in home as well as host states. In this section, we discuss competing theoretical views of corporate social responsibility, a concept to which many MNCs are now directing some attention.

CSR evokes a wide divergence of views, both within and between the IPE theoretical perspectives. Three common definitions of CSR are

- the responsibility of a corporation to "operate ethically and in accordance with its legal obligations and to strive to minimize any adverse effects of its operations and activities on the environment, society and human health"
- "actions that appear to further some social good, beyond the interests of the firm and that which is required by law"
- "the contribution that a company makes in society through its core business activities, its social investment and philanthropy programs, and its engagement in public policy."[108]

The first definition describes CSR as operating ethically but also in accordance with the law, the second emphasizes the fact that CSR goes *beyond* obeying the law, and the third does not even mention the law. CSR can mean different things to researchers and practitioners, and to companies, NGOs, consumers, and governments; it may include such activities as corporate governance, philanthropy, environmental management, labor rights, community development, and animal rights. Some orthodox liberals have rejected CSR as irrelevant to MNCs and their basic objectives. For example, Milton Friedman has asserted that there is "one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it . . . engages in open and free competition, without deception or fraud."[109] However, orthodox liberals today find it more difficult to dismiss CSR than Friedman did in 1962 when he wrote this passage, because many private and public groups now support CSR. Thus, many neoliberals (including MNC and industry representatives) now give credence to CSR, but they believe it should be voluntary rather than regulated; regulation would stifle innovation and national competitiveness. Regulation is also unnecessary because MNCs are aware that there are financial benefits in being socially responsible. Peer pressure alone will cause MNCs to develop CSR policies and collectively increase standards.[110]

At the other extreme from neoliberals are critical theorists who view CSR as a contradiction in terms, because the MNC "remains . . . a legally designated 'person' designed to valorize self-interest and invalidate moral concern." The corporate ideal from this perspective "compels executives to prioritize the interests of their companies and shareholders above all others and forbids them from being socially responsible—at least genuinely so."[111] These critical theorists basically agree with neoliberals such as Friedman that CSR has little or no relevance for MNCs, but unlike the neoliberals they view this in highly negative terms. Whereas some critical theorists reject the idea that MNCs can be socially responsible, others argue that CSR can only have meaning if it is subject to mandatory regulation; a voluntary approach would not lead to responsible corporate behavior. For example, one NGO has argued that "the image of multinational companies working hard to make the world a better place is often just that—an image. . . . What's needed are new laws to make businesses responsible for protecting human rights and the environment."[112]

In between the more extreme orthodox liberal and critical views are a wide range of interventionist liberals who see CSR as a viable concept that can depend on a combination of government regulation and voluntary involvement. For example, Jagdish Bhagwati argues that "in the main, voluntary codes must characterize what corporations should do . . . and mandatory codes must address what they should not do."[113] MNC self-regulation can supplement but not substitute for government regulation. However, government regulation cannot resolve all CSR issues because the law has many gray areas. MNCs should therefore be expected to follow the spirit as well as the letter of the law. When legal standards are unclear or difficult to enforce, corporate culture or pressure from consumer groups and NGOs may also be important. According to interventionist liberals, MNCs will have the motivation to engage in CSR for various reasons. For example, companies often view CSR as part of good financial management, because unethical firms tend to be unsustainable in the long term; and CSR can both contribute to society and increase the profitability of participating firms. Some interventionist liberals use the term "strategic CSR" to refer to "good works that are also good for business."[114]

In sum, there is a wide divergence of theoretical views on CSR as there are on other aspects of MNCs. It is difficult to build a good body of empirical research in this area because of the private nature of MNCs, and because many researchers have strongly held views. As one analyst states, "one of the very few generalizations that accurately characterize FDI and MNCs is that their benefits have been exaggerated by advocates and their harm has been exaggerated by critics."[115] The next chapter addresses another subject on which there is a diversity of strongly held views: international development.

QUESTIONS

1. How and why do liberals, realists, and historical materialists differ in their views of what should be regulated in a foreign investment regime?
2. Do liberals, realists, and historical materialists believe that the nationality of an MNC makes a difference? Do you think that the competitiveness of a country is closely tied with the competitiveness of its MNCs?
3. Why does a business firm choose to become horizontally integrated? Why does a firm choose to become vertically integrated?
4. In what ways have the major host and home countries for FDI changed over time? Have there been changes in the position of the South vis-à-vis the North in FDI? Is it possible to generalize about "the South"?
5. What are some of the major effects of MNCs on home and host states? Do you think that the effects have on the average been more positive or negative?
6. What is the role of BITs, NAFTA, the United Nations, the WTO, and the OECD in regulating FDI? Why was the decision made to negotiate an MAI in the OECD, and was this a wise decision?
7. What is the obsolescing bargaining model? Does the OBM have more validity in some areas and periods of time than in others?
8. Have NGOs had an impact on the behavior of MNCs? What is CSR, and what are the competing theoretical views regarding the value of the concept?

KEY TERMS

bilateral investment treaties 275
corporate social responsibility 283
foreign direct investment 249
Global Compact 278
greenfield investment 250
horizontal integration 252
multinational corporations 249
obsolescing bargain model 262
portfolio investment 249
transfer prices 252
vertical integration 252

FURTHER READING

Important general studies of MNCs include Geoffrey Jones, *Multinationals and Global Capitalism: From the Nineteenth to the Twenty-first Century* (New York: Oxford University Press, 2005); Stephen D. Cohen, *Multinational Corporations and Foreign Direct Investment: Avoiding Simplicity, Embracing Complexity* (New York: Oxford University Press, 2007); and Nathan M. Jensen, *Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment* (Princeton, NJ: Princeton University Press, 2006).

A useful book on theories of the MNC is Mats Forsgren, *Theories of the Multinational Firm: A Multidimensional Creature in the Global Economy* (Northampton, MA: Edward Elgar, 2008). Studies that discuss MNCs in positive terms are Edward M. Graham, *Fighting the Wrong Enemy—Antiglobal Activists and Multinational Enterprises* (Washington, DC: Institute for International Economics, 2000); and Jagdish Bhagwati, *In Defense of Globalization* (New York: Oxford University Press, 2004), Chapter 12. Strong critiques of MNCs include Joel Bakan, *The Corporation: The Pathological Pursuit of Profit and Power* (New York: Penguin, 2004); and James Petras and Henry Veltmeyer, *Multinationals on Trial: Foreign Investment Matters* (Burlington, VT: Ashgate, 2007). A realist study arguing that an MNC's nationality makes a difference is Paul N. Doremus, William W. Keller, Louis W. Pauly, and Simon Reich, *The Myth of the Global Corporation* (Princeton, NJ: Princeton University Press, 1998). On CSR see Jennifer A. Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (New York: Cambridge University Press, 2006); and Josep M. Lozano, Laura Albareda, and Tamyko Ysa, *Government and Corporate Social Responsibility: Public Policies beyond Regulation and Voluntary Compliance* (New York: Palgrave Macmillan, 2008).

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