

Global Firms and National Governments

**Mini-Course Prepared for the Department of
Economics, University of Bergamo**

SYLLABUS

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Mini-Course Description & Objectives

The central objective of this mini-course is to acquaint students with one of the most significant and still growing phenomena present in the world economy, namely, the presence in it of international or global firms and the direct investments these firms make outside their “home” countries. In particular, the focus will be on national and sub-national public policies that directly or indirectly affect the flow of these investments.

The claims that, in a globalized world economy, the nationality of these firms is rapidly disappearing are highly exaggerated. Today, persons from different countries now reach senior management positions in most of these international firms. Partly for this reason, English has become the *lingua franca* in the world economy. Nevertheless, Toyota remains a Japanese firm; IBM remains an American firm; Siemens is German, Peugeot is French, and Fiat is quintessentially an Italian firm; and so on.

Whatever may be their nationality or country of origin, the international or global firms, and especially the top several hundred of them, exercise notable and still-growing political, as well as economic, influence and power. As a group, the foreign direct investments (FDI) made by international firms have grown at several times the annual increases in foreign trade. Furthermore, approximately one-half of foreign trade itself now takes place in the form of intra-company transactions among these same firms.

The most striking aspect of FDI is that about five hundred international or multinational firms now account for at least fifty per cent of the approximately 15 trillion dollars of the total book value of this form of capital.

Given these facts, it is no wonder that the largest and richest of these firms should weigh heavily in national and regional economic development. Given this condition, it is also no wonder that these same firms exercise considerable influence over the type economic and regulatory policies enacted by local, regional, national and even supra-national governmental authorities.

This “mini-course” will explore some aspects of the behavior of international firms that relate to these governmental authorities and the public policies they enact. The first four topics listed below relate to Professoressa Piantoni’s course in *Economics and the Management of International Firms*. The last three topics relate to Professoressa Falzoni’s course in *International Economics*. It goes without saying that all of these topics are related to each other.

Note: *There are readings listed under each of the topics. These are designed to make the lecture and classroom discussions clearer and more productive. Students should read as much of this material as possible, especially in advance of the specific date on which each of the lectures is scheduled.*

LECTURE I. Overview of Global Firms and Foreign Direct Investments

We will look, first, at the flow of foreign direct investments (FDI) around the world. We will examine where this critically important category of investment capital originates and to which areas and countries of the world it is directed. In this connection, we will examine several of the economic theories that purport to explain why firms internationalize, as opposed to exporting and/or distributing their products abroad.

The question of where FDI tends to be located is of considerable interest to national and sub-national governments. In the Third World, or developing countries, FDI represents notable proportions of annual increments in fixed capital formation and investments. In the advanced industrial countries, incoming FDI from abroad, as well as out-going FDI, have economic but also political and social consequences that often tax the ability of public policy makers.

Please pay careful attention to John Dunning's effort to encompass the theories of FDI in his so-called O (for organizational characteristics) L (for location advantages or attractions) and I (for strategic considerations that lead a firm to internalize certain transactions).

Readings.

Richard E. Caves, "The Multinational Enterprise as an Economic Organization," in Jeffrey R. Frieden et al. (eds.), *International Political Economy: Perspectives on Global Power and Wealth*, 5th Edition. (New York: Norton & Co., 2010, pp. 157-168.

John Dunning, *Global Capitalism at Bay?* (New York: Routledge, 2001), Ch. 7, "Globalization and the new geography of foreign direct investment," pp.222-241.

M. Panic, *Globalization and National Economic Welfare*. (New York: Palgrave-Macmillan, 2003), Ch. 6 "Transnational Corporations and the Nation-State," pp. 148-174.

LECTURE II. Global Firms and the Developing Countries

The advanced industrial countries continue to receive more than two-thirds of the net annual increments in foreign direct investments (FDI). Nevertheless, the so called less developed countries (LDCs) are of special interest to us, and not just because, for many reasons, FDI directed to those countries raises a number of problems not present in the

more industrialized world. In addition, FDI directed to these places have enormous longer-term economic as well as political and social implications for these latter countries, as India, China, Brazil and several other countries will now attest.

In this lecture, we will review, in broad strokes, the policies that LDCs have enacted regarding FDI, the changes in these policies enacted over time, and the causes that brought about the changes themselves. It is necessary to draw sharp distinctions between less-developed countries that have made huge economic gains and, in the process, developed global corporations of their own. South Korea was one of the first countries to move in that direction. Now the economic press and journals are full with commentaries about the BRICs, i.e., Brazil, Russia, India and China. This phenomenon, among other effects, is certain to change, perhaps radically, the world's political and military as well as economic configurations.

Readings:

David Fieldhouse, "A New Imperial System? The Role of the Multinational Corporations Reconsidered," in Jeffrey R. Frieden and D. A. Lane (eds.), *International Political Economy*, 4th Edition. (New York: St. Martins Press, 1995), pp. 165-178.

Shah M. Tarzi, "Third World Governments and Multinational Corporations: Dynamics of Host's Bargaining Powers," in Jeffrey Frieden et al, *op. cit.*, Ch, 10, pp. 169-179.

Louis T. Wells, Jr., "Multinationals and the Developing Countries," in Thomas H. Brewer, S. Young and S. E. Guisinger (eds.), *The New Economic Analysis of Multinationals*. (Cheltenham, U.K, Northampton, Mass.: 2003), pp.106-121.

LECTURE III. Policy Changes and FDI Flows: Some Examples

The empirical evidence is overwhelming that changes in national policies toward the multinational or global firms bring about sharp changes in FDI flows. This cause-and-effect is neither automatic nor is it an iron-clad rule. Nevertheless both China and India are very good examples of the effect of such changes. The article by Long, below, is an interesting review of China's policies.

On a much broader scale, the introduction of new devices in the international economy, such as bilateral treaties on investment, are also associated with changes in the flow of FDI. The article by Elkins et al., below, is one example of this new trend in international economic and trade relations that impinge on the flow and treatment of FDI.

Policy changes that increase the flow of FDI to a less developed country can also backfire, particularly if there are political changes that permit one or more ideological group to capitalize on allegations that fraud or corruption may have accompanied a major

agreement between governments and a multinational corporation. One interesting case study of this type is included in these readings..

Readings

Guogang Long, "China's Policies on FDI: Review and Evaluation," in T. N. Moran, E. N. Graham and M. Blomstrom, (eds.), *Does Foreign Direct Investment Promote Development?* (Washington, D.C." Institute for International Economics, 2005), pp.

Zachery Elkins, A.T. Guzman & B. A. Simmons, "Competing for Capital: The Diffusion of Bilateral Investment Treaties," in Jeffrey Frieden, et al., *op.cit.*, Ch. 11, pp. 180-199.

Paul Lejoy and Frederik Pretorius, *Politics, Institutions and Project Finance: The Dabhol Power Project*. (University of Hong Kong: Asia Case Research Centre, 2007. 13 pages.

LECTURE IV. Problems of Corporate Behavior at Home and Abroad

Corporations, including the most famous multinational firms, will sometimes misbehave, at home as well as abroad. Less developed countries have a long list of complaints regarding this subject. Advanced industrial countries, particularly in recent years, have had to confront major problems regarding some of their own prominent firms. Much attention is now being paid subjects like corporate ethics and corporate governance. At the same time, corporations themselves are once again rushing to enact and publicize their "codes of conduct" or statements about corporate social responsibility. What does it all mean?

Readings

Charles Handy, "What's a Business For?" *Harvard Business Review*, Vol. 80 (December 2002), pp. 49, 70-74.

Frederick Bird, "Dilemmas of Development: Managing Socially Responsible International Business in Developing Areas," in F. Bird, R. Rauflette & J. Smucker (eds.), *International Business and the Dilemmas Development*. (New York: Palgrave, 2004), pp. 11-35.

LECTURE V. Effectiveness of FDI Policies and Controls: Theory and Practice

There exists an enormous literature regarding the relationship between governmental policies designed to entice or limit the in-coming flow of FDI, and in particular to regulate the multinational firms that are permitted to make investments in "host" countries. We will examine a couple of cases the shed light on this issue.

One dimension of the problem of control involves the extent to which a central government, in any type of political system, is actually able to exercise the degree of control that theories about such matters would lead one to imagine. For example, it is often claimed that authoritarian or highly centralized (i.e., monistic or parliamentary) political systems permit more effective controls than do democratic or less centralized (i.e., pluralistic or federal) systems. We will examine this matter as well.

Readings

Mike W. Peng, Controlling the Foreign Agent: How Governments Deal with Multinationals in a Transition Economy,” *Management International Review*. Vol.40 (2nd Quarter, 2000), pp. 141-163.

S. Athreye and S. Kapu, “Private Investment in India: Pain or Panacea,” *The World Economy*. Vol. 24 (March, 2001), pp. 399-425.

Jun Fu, *Institutions and Investments: Foreign Direct Investment in China During an Era of Reform*. (Ann Arbor: Univ. of Michigan Press, 2000), pp.63-91.

LECTURE VI. The Special Problem of Investment Incentives

We have examined why, beginning in the 1980s, earlier restrictive national policies regarding FDI were gradually (sometimes radically and drastically) liberalized. When this happened, countries began to compete with each other to attract more FDI. To this end, a wide range of incentives were and are still provided, as inducements designed to influence where, beyond their home-country borders, international firms will make investments.

About these “location” decisions made by international firms, there is a rich theoretical and empirical literature in economics that shows that these incentives actually have little or no influence on these decisions by the firm. This being the case, economists typically argues, the incentives provided by national or sub-national governments actually represent a waste of welfare. In addition, there is the continuing danger that, in their unchecked use of these incentives, countries risk becoming engaged in a “race to the bottom.”

The conclusion drawn by many students of this phenomenon, therefore, is not only that, in strict economic terms, these incentives schemes have a negative effect on the accumulation of welfare. In addition, they risk creating a “race to the bottom.” In any case, the arguments concludes, it is highly irrational, especially for developing countries, to use their limited resources in this wasteful manner.

Readings

T. L. Brewer & S. Young, "Investment Incentives and the International Agenda," *The World Economy*. Vol. 20 (March, 1997), pp. 175-198.

Sung Hoon Lim, "Foreign direct Investment and incentive: A strategic approach To the relationship between the objectives of foreign direct investment policy and their promotion," *International Business Review*, Vol. 14 (2005), pp. 61-76.

LECTURE VII. Evaluating the Impact of FDI in Developing Countries

Debates continue to rage over these two questions: 1. Are export-led, as opposed to import-substitution models of national economic development always the right policies for a less-developed country to adopt? 2. What are the effects of FDI on these same countries? In recent decades, advocates of the export-led model have won the day, and adopting that model is a condition for gaining membership in the World Trade Organization, as well as qualifying for various forms of international financial and economic assistance.

Even so, and especially in the midst of the current economic meltdown, there are increased pressures for more restrictive policies toward FDI, including in the advanced industrial countries.

In addition, where the less-developed countries are concerned, a nagging problem remains that of finding objective and persuasive empirical measures of the effects of FDI, including those not, strictly speaking, economic in nature.

Readings

Maria Carkovic and Ross Levine, "Does Foreign Direct Investment Accelerate Economic Growth?" T. H. Moran, E. M Graham, M. Blomstrom, *op. cit.*, Ch. 8, pp. 195-220.

Robert E. Lipsey and Frederik Sjöholm, "The Impact of FDI on Host Countries: Why Such Different Answers?" T.H. Moran, E.M. Graham, Blomstrom, *op. cit.*, Ch.2, pp. 23-43.