Transnational Corporations: The Governance of Foreign Investment

In the twenty-first century, transnational corporations (TNCs) have been the main engines underpinning the expansion of global capitalism. We constantly see them in our daily lives and in the news. Most major cities have stores owned by global retailers like McDonald's, Starbucks, Wal-Mart, and Ikea. Energy giants sell us gasoline and pollute the environment, as witnessed during the disastrous BP oil spill in the Gulf of
Mexico in 2010. Transnational banks and financial institutions like JPMorgan Chase and the Royal Bank of Scotland contributed to the global financial crisis. Manufacturing champions like Apple, Samsung, and Sony produce many of the electronic items we can no longer do without. But activists and some nation-states have begun to challenge powerful TNCs—and the liberal capitalist system itself. For example, the Occupy Wall Street (OWS) movement has focused popular attention on the inequality that invariably accompanies the spread of TNCs and lightly regulated capitalism. And fast-developing countries like China, Brazil, and India have created giant state-controlled companies that *The Economist* magazine claims represent a form of “state capitalism” and “the most formidable foe that liberal capitalism has faced so far.”

The durability and impact of these challenges are unclear at this time, but there is little doubt that TNCs will remain important actors in the global economy.

TNCs have always been controversial because their global reach makes them difficult for nation-states to regulate or control. Perceptions of TNCs have evolved as international political economy (IPE) has changed over the past fifty years. TNCs have been perceived as agents of capitalist imperialism, tools of U.S. hegemony, and actors engaged in “triangular diplomacy” with states and other TNCs. With the rise of the BRICs (Brazil, Russia, India, and China) as important economic powers and homes of fast-growing TNCs, new perceptions of TNCs may emerge.

This chapter looks at the contemporary patterns of TNC investment and answers a number of important questions: What exactly are TNCs? Where do they operate and why? How much power do they have? And to what extent can their activities and interactions with nation-states and workers be regulated by formal global regimes? Finally, we also consider how increased global competition and the severe economic crisis that began in 2007 might impact foreign direct investment (FDI) and the globalization juggernaut.

The main points this chapter makes are as follows: First, TNCs are critical actors in the international economy because they operate in markets that span national borders and often transfer badly needed resources and know-how to developing countries. Second, these corporations engage in FDI for a variety of reasons: to exploit a competitive advantage they have; to gain access to cheaper labor and natural resources; to circumvent trade barriers and mitigate the effects of currency instability; to be close to their customers; and to respond to the strategic moves of other TNCs. Third, FDI has grown dramatically over the last sixty years, fueled by technological changes facilitating international transportation and communication and the spread of economic liberalism across the globe.

Fourth, for much of the post-World War II period, the bulk of FDI flowed from rich, northern countries to other rich, northern countries. Today things are changing, as BRICs have become significant hosts of FDI—and foreign investors themselves. TNCs headquartered in BRICs and other developing countries may begin to have a substantial impact on economic competition and political relations among states. Fifth, many TNCs are powerful enough to engage in negotiations with states and can from time to time win such favorable concessions that structuralists see them as neocolonialist exploiters. Finally, new kinds of TNC are emerging, ones that are either more globally integrated with complex supply chains or owned by national governments.
WHAT ARE TNCs?

Before we begin, however, we must deal briefly with terminology. Businesses that compete in global markets have been given different names at different times and in different fields of study. Once they were called simply international businesses, to distinguish them from firms that operated in local or national markets. For many years, the term multinational corporation (MNCs) was applied to firms that operated in several different national markets. As global markets and production structures have emerged, the accepted term has become transnational corporations (TNCs). The prefix trans means to go beyond, and the markets where these businesses compete are regional—as in North America or the European Union (EU)—or global, thus transcending national markets.

You might not have encountered the term transnational corporation before, but you certainly are familiar with the businesses that wear that label, the items they produce and sell, and the markets where they function. It is estimated that there are about 103,000 TNCs in the world today with 892,000 foreign affiliates. Together they account for about one-quarter of global gross domestic product (GDP) and one-third of world exports. Table 17-1 displays a list of the twenty largest nonfinancial TNCs in 2011, as compiled by the United Nations Conference on Trade and Development.

### TABLE 17-1

<table>
<thead>
<tr>
<th>Rank</th>
<th>TNC</th>
<th>Headquarters Country</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>General Electric</td>
<td>United States</td>
<td>Electrical and electronic equipment</td>
</tr>
<tr>
<td>2.</td>
<td>Royal Dutch Shell</td>
<td>Netherlands/United Kingdom</td>
<td>Petroleum</td>
</tr>
<tr>
<td>3.</td>
<td>BP</td>
<td>United Kingdom</td>
<td>Petroleum</td>
</tr>
<tr>
<td>4.</td>
<td>Exxon Mobil Corporation</td>
<td>United States</td>
<td>Petroleum</td>
</tr>
<tr>
<td>5.</td>
<td>Toyota Motor Corporation</td>
<td>Japan</td>
<td>Motor vehicles</td>
</tr>
<tr>
<td>6.</td>
<td>Total SA</td>
<td>France</td>
<td>Petroleum</td>
</tr>
<tr>
<td>7.</td>
<td>GDF Suez</td>
<td>France</td>
<td>Electricity, gas, and water</td>
</tr>
<tr>
<td>8.</td>
<td>Vodafone Group</td>
<td>United Kingdom</td>
<td>Telecommunications</td>
</tr>
<tr>
<td>9.</td>
<td>Enel SpA</td>
<td>Italy</td>
<td>Electricity, gas, and water</td>
</tr>
<tr>
<td>10.</td>
<td>Telefonica SA</td>
<td>Spain</td>
<td>Telecommunications</td>
</tr>
<tr>
<td>11.</td>
<td>Chevron Corporation</td>
<td>United States</td>
<td>Petroleum</td>
</tr>
<tr>
<td>12.</td>
<td>E.ON AG</td>
<td>Germany</td>
<td>Electricity, gas, and water</td>
</tr>
<tr>
<td>13.</td>
<td>Eni SpA</td>
<td>Italy</td>
<td>Petroleum</td>
</tr>
<tr>
<td>14.</td>
<td>ArcelorMittal</td>
<td>Luxembourg</td>
<td>Metal</td>
</tr>
<tr>
<td>15.</td>
<td>Nestlé SA</td>
<td>Switzerland</td>
<td>Food, beverages, and tobacco</td>
</tr>
<tr>
<td>16.</td>
<td>Volkswagen Group</td>
<td>Germany</td>
<td>Motor vehicles</td>
</tr>
<tr>
<td>17.</td>
<td>Siemens AG</td>
<td>Germany</td>
<td>Electrical and electronic equipment</td>
</tr>
<tr>
<td>18.</td>
<td>Anheuser-Busch InBev NV</td>
<td>Belgium</td>
<td>Food, beverages, and tobacco</td>
</tr>
<tr>
<td>19.</td>
<td>Honda Motor Co Ltd</td>
<td>Japan</td>
<td>Motor vehicles</td>
</tr>
<tr>
<td>20.</td>
<td>Deutsche Telekom AG</td>
<td>Germany</td>
<td>Telecommunications</td>
</tr>
</tbody>
</table>

TNCs in Perspective

TNCs have existed for hundreds of years; some of the earliest ones were state-chartered organizations such as the East India Company, which was granted a monopoly on trade with the East Indies by Queen Elizabeth I in 1600. These firms neatly combined visions of a business empire with the imperial territorial ambitions of the home state. TNCs today typically are private business firms that compete in regional and global markets. They are distinguished by the foreign investment that they undertake as part and parcel of their operations. Because TNCs operate in markets that span national borders, they necessarily invest in production, research, distribution, and marketing facilities abroad; often transferring technology in the process.

It is tempting but dangerous to generalize about what the 103,000 TNCs are and how they behave, beyond saying, as we have here, that they are creatures of transnational markets that have command of valuable FDI resources. A certain stereotyped image of TNCs has been formed in the press and elsewhere, however; and it is important to take a close look at it. Stereotypes are usually distortions based on a few exceptional cases, and this is true of TNCs as well. Here are some "facts" commonly associated with TNCs:

- They are gigantic business organizations that dominate production, investment, sales, and employment worldwide.
- They exploit the cheap labor and natural resources of less developed countries (LDCs).
- They are the most powerful actors in the world today, dwarfing all but a few states.

Let us look at these stereotypes to see how well they explain the actual pattern of TNC activities today.

How Large Are TNCs?

Some TNCs are very large, but in general, TNCs come in different sizes and compete in markets of different scales. For example, the U.S.-based company General Electric, the largest TNC in the UNCTAD rankings for 2011, owned $503 billion in foreign assets. By comparison, the firm ranked 20th, Deutsche Telekom AG of Germany, had foreign assets of just $102 billion. The 100th ranked TNC, British aircraft maker BAE Systems plc, had foreign assets of $30 billion. If we were to continue down the list, we would come to some very small firms indeed. These businesses might be TNCs, and they might even be quite large compared to the typical firm competing in a local market, but they are of an altogether different scale from the "giants."

When we talk about giant TNCs, then, we are really talking about the largest 200 or so firms, not about TNCs generally. These business organizations are very large, as has been said before, because they often make huge investments and compete in global markets for goods and services such as electronics and electrical...
equipment (including computers), oil and gas, telecommunications, motor vehicles and parts, food and beverages, and pharmaceuticals.

There are several ways to measure the relative size of TNCs, and it is useful to look at several of them to get a better perspective on the competitive landscape. UNCTAD lists TNCs according to the value of their foreign assets, a good approach because it stresses the effects of FDI. But large firms that do not invest abroad and therefore do not own foreign assets would not appear on this list at all. The Financial Times, the distinctive pink-toned British newspaper, publishes a Global 500 listing based on the total value of company shares on world stock markets. Firms need not be TNCs to appear on this list, since rankings are based on share value, not FDI, but in practice many of them are TNCs. The financial crisis caused a 42 percent drop in the market value of these 500 companies from $26.8 trillion in 2008 to $15.6 trillion in 2009, but by 2012 total market capitalization had recovered to $25.3 trillion. Table 17-2 lists the top fifteen firms from the Financial Times list for 2012; while in 2009 Apple was 33rd in the Global 500 listing with a market value of $93.6 billion, in 2012 it had leapt to first place with a value of $559 billion, largely due to the spectacular popularity of its iPhones and iPads. In 2003 there were no Chinese companies in the Financial Times' top fifteen, but by 2012 there were four (including two banks)—a clear indication of China's rising power and ability to weather the financial crisis relatively well. The list is dominated by three types of TNCs: those in banking, energy, and electronics/communications sectors. It is notable that the only non-U.S., non-Chinese TNCs in the top fifteen are Royal Dutch Shell and Nestlé.

**TABLE 17-2**

Largest Global Companies by Market Value, 2012

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Market Value (billions of dollars)</th>
<th>Total Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Apple</td>
<td>United States</td>
<td>559</td>
<td>63,000</td>
</tr>
<tr>
<td>2. Exxon Mobil</td>
<td>United States</td>
<td>409</td>
<td>82,000</td>
</tr>
<tr>
<td>3. PetroChina</td>
<td>China</td>
<td>279</td>
<td>553,000</td>
</tr>
<tr>
<td>4. Microsoft</td>
<td>United States</td>
<td>271</td>
<td>90,000</td>
</tr>
<tr>
<td>5. IBM</td>
<td>United States</td>
<td>242</td>
<td>433,000</td>
</tr>
<tr>
<td>6. Industrial &amp; Commercial Bank of China</td>
<td>China</td>
<td>236</td>
<td>409,000</td>
</tr>
<tr>
<td>7. Royal Dutch Shell</td>
<td>United Kingdom</td>
<td>222</td>
<td>90,000</td>
</tr>
<tr>
<td>8. China Mobile</td>
<td>Hong Kong</td>
<td>221</td>
<td>175,000</td>
</tr>
<tr>
<td>9. General Electric</td>
<td>United States</td>
<td>212</td>
<td>301,000</td>
</tr>
<tr>
<td>10. Chevron</td>
<td>United States</td>
<td>212</td>
<td>61,000</td>
</tr>
<tr>
<td>11. Wal-Mart Stores</td>
<td>United States</td>
<td>208</td>
<td>2,200,000</td>
</tr>
<tr>
<td>12. Nestlé</td>
<td>Switzerland</td>
<td>207</td>
<td>328,000</td>
</tr>
<tr>
<td>13. Berkshire Hathaway</td>
<td>United States</td>
<td>201</td>
<td>271,000</td>
</tr>
<tr>
<td>14. China Construction Bank</td>
<td>China</td>
<td>193</td>
<td>329,000</td>
</tr>
<tr>
<td>15. AT&amp;T</td>
<td>United States</td>
<td>185</td>
<td>256,000</td>
</tr>
</tbody>
</table>

Microsoft, the fourth most valuable firm in the Financial Times' Global 500, competes in a global market and is a technology leader, but it does not in fact engage in a great deal of foreign investment, so it does not even appear among the top 100 firms in the UNCTAD rankings. Microsoft forms partnerships with foreign firms and sells to foreign customers: This is a fundamentally different strategy from FDI.

Wal-Mart Stores is a big firm (number 11 by market value) and also a major foreign investor (number 34 on the UNCTAD list), but it is perhaps most noteworthy because of its large global workforce, estimated at about 2.2 million workers in 2011. Many TNCs, however, do not employ as many workers as one might suppose given their economic size. They are more important for the technology they can supply (Microsoft) or the FDI they can provide (Exxon Mobil) than for the absolute number of jobs they can create.

In conclusion, the largest TNCs are very large indeed, but not all TNCs are large businesses. Many of the world's largest businesses do not engage in substantial amounts of FDI and do not, therefore, rank among the leading TNCs. The key aspect of TNCs to keep in mind is not their size, which varies, but their ability to provide FDI.

The Recent Rise of TNCs

TNCs have become more pervasive in recent years. According to UNCTAD, the total amount of inward FDI flows increased dramatically from an annual average of about $225 billion worldwide in the period 1990–1995 to nearly $1.9 trillion in 2007. Because of the global financial crisis, inward FDI flows dipped to $1.2 trillion in 2009, but they rebounded to $1.5 trillion in 2011. This rise in TNC investments reflects the growth of regional and global markets. UNCTAD identifies three forces driving this transnational market growth: policy liberalization, technological change, and increasing competition.

More and more countries have sought to attract FDI inflows to create jobs and encourage economic development. Since the early 1980s, many LDC governments have adopted the “Washington Consensus” policies, which facilitate open trade and free capital mobility. These policies create an environment more conducive to TNC investments. Countries that enter the main regional economic groups—NAFTA and the European Union—adopt especially liberal trade and investment rules. China’s entry into the World Trade Organization (WTO) in 2001 accelerated its inward FDI flows. Countries such as India and Japan that have been slow to abandon mercantilist policies are disadvantaged in the competition for FDI, though that seems to be changing with India. FDI is still controversial, but virtually all nations now actively seek it to advance their economic agendas.

Technological change has also accelerated FDI by reducing transportation and communication costs. Taken together, technological change and policy liberalization have expanded the domain of transnational markets relative to markets that are mainly domestic. This means that firms face greater competition than ever before, which further accelerates the FDI process. Unlike the first TNCs, which benefited from monopoly power, most TNCs today are driven to invest abroad by the competitive environment found in transnational markets,
the policy liberalization that encourages that competition, and the technological changes that make foreign investment more efficient.

The Patterns of TNC Operations

For many years there was a widespread perception that most TNCs were North-based businesses that shifted production to the less developed South to take advantage of cheap labor and natural resources. But the facts did not support this perception. For much of the post-World War II period, most TNC investment was North-North rather than North-South. FDI mainly originated in rich countries in the industrialized North (the United States, Europe, and Japan) and flowed predominantly to Europe and the United States. Consider that in 1990 developed countries originated 95 percent of all outward FDI and were hosts to 83 percent of all inward FDI. These were the regions that had the largest, most technologically advanced and competitive corporations. They also had the richest markets and most skilled labor forces. The high wages of their workers were matched by their high productivity.

These long-established patterns are rapidly changing. FDI outflows from rich, developed countries dropped from 95 percent in 1990 to 81 percent of overall outflows in 2011 as firms from developing countries entered global markets and acquired foreign business assets. Five TNCs on UNCTAD’s top 100 list are headquartered in newly industrialized countries: Hutchison Whampoa and CITIC Group (diversified businesses in China); Vale (a Brazilian mining company); Petronas (a state-owned Malaysian petroleum producer); and Cemex (a Mexican cement producer). The change is even more dramatic when we notice that inflows of FDI to developed countries dropped from 83 percent in 1990 to only 47 percent of overall inflows in 2011. Emerging economies in Asia, Latin America, and the Caribbean have become attractive locations for TNC operations. China and Hong Kong, for example, received almost half as much FDI in 2011 ($207 billion) as did the whole of the European Union ($421 billion). India and Russia, which still have domestic regulatory regimes that are perceived to be biased against foreign investment, have had a steady and significant inflow of FDI since 2007.

Other developing countries like Brazil and Mexico also attracted large amounts of FDI ($67 billion and $20 billion in 2011, respectively), but the whole of sub-Saharan Africa saw an inflow of only $35 billion in 2011, with few nations attracting FDI of more than a few hundred million dollars. Excluding FDI in natural resources extraction, Africa is essentially ignored by TNCs because these countries do not have large markets and significant skilled labor, or because political and social instability makes them an undesirable investment target.

Despite recent changes, a great deal of FDI is still regionally based, flowing out of countries in the EU into other EU countries and out of countries in NAFTA and into other NAFTA countries. This makes sense because TNCs tend to evolve and expand to compete in particular markets. While markets for some commodities are truly global, especially petroleum and some primary products, much recent market growth has been regional, driven by EU and NAFTA expansion. The European Union and NAFTA combined accounted for over 33 percent of all
inward FDI in 2011. The United States, Japan, the United Kingdom, and Germany remain the biggest investors in the world today.

Most "global" businesses are not really global at all, it seems, but instead channel investment to particular regional markets, leaving out large parts of the world, especially in Africa. But as we have seen, the North–North pattern is changing, with developing economies in Asia and Latin America becoming important hosts and homes for FDI. A survey of 3,000 TNCs by UNCTAD in 2011 found that China, the United States, India, Indonesia, Brazil, and Australia—in that order—were seen as the most attractive locations for future FDI.

What Determines Where TNCs Invest?

The stereotype that TNCs invest only where labor and natural resources are cheap is clearly not a good general explanation of TNC behavior, although it does apply to some specific situations. As noted above, a great deal of FDI goes from rich, high-wage countries such as Germany to other rich, high-wage countries such as the United States. And, in any case, the theory that TNCs go where labor is cheap is at best an incomplete theory because it does not tell us why TNCs invest in a specific low-wage country like China instead of another low-wage country like Kenya. The question of why TNCs invest where they do is thus a very interesting one. Since there are thousands of TNCs in the world, it is unlikely that a single theory can explain all of their behavior. Here are several explanations that attempt to account for different aspects of TNC behavior.

Product Cycle Theory

Why do TNCs invest abroad, especially in other high-wage countries, when they face so many obvious disadvantages in doing so? A U.S. company setting up operations in France, for example, must deal with different laws and regulations, different labor practices and union restrictions, a different language and culture, and a variety of other difficulties. It would seem that a French firm that is already equipped with "local knowledge" would have a distinct competitive advantage. Why wouldn't a U.S. company simply reach an agreement to have a French firm produce and sell products under license?

TNCs do not make much sense in highly competitive markets with standardized products and technology, where everyone has equal access to resources and decisions are made on the basis of cost or price alone. In markets like these, the disadvantages of operating abroad would doom any foreign firm. TNCs make sense, however, if they possess some particular knowledge or advantage that compensates for other disadvantages. Raymond Vernon's product cycle theory provides one explanation for TNC investment behavior.

Vernon was particularly interested in TNCs that produce technologically sophisticated products and in the surprisingly common phenomenon of trade reversals, where the country that invents a product sometimes finds itself a few years later importing that same item from abroad. His three-stage product cycle theory explains how this can happen and how TNCs are created in the process.
In the first stage of the product cycle, a firm in a high-income country identifies a need that can be satisfied with a technologically sophisticated product. For example, the modern mobile phone satisfies the needs of people who want to remain in communication in many locations. The United States, Japan, and the EU members have the technology resources to address this sort of need and the income to pay for the products, which are often very expensive in the early stages. In the first stage, therefore, companies like Motorola (United States) or Nokia (Finland) invest millions of dollars in research, development, and manufacturing of products to satisfy a home-country need.

Once the product has been developed and a market created at home, it is possible to export to other countries where consumers or businesses may have similar incomes and living standards. In the second stage, therefore, mobile phones may be exported to other high-income areas of Asia, Europe, and North America. The firms become multinational or transnational in this stage, according to Vernon's theory, as they establish sales offices and some production or distribution facilities abroad. Some of the North-North FDI that was discussed earlier occurs in stage two. Finally, the technology becomes standardized to the point where the product may be produced more efficiently in a newly industrialized country such as Mexico or Malaysia. At this point production moves abroad and the TNC makes another foreign investment.

Note that technology and market factors are important elements of the product cycle explanation of TNC behavior. Products are invented and developed where technology is abundant and incomes are high. The market expands to other high-income countries once the product has been developed, and FDI follows as firms rush to compete in the bigger market. Finally, when the technology matures, production spreads around the globe via FDI flows.

**Appropriability Theory**

Developed by Richard Caves and others, appropriability theory helps explain why firms invest abroad rather than license production to a local firm or take on a local partner. The appropriability theory argues that some firms become TNCs because they have too much to lose if they enter into partnerships or licensing agreements with foreign companies, which might in fact appear more profitable in terms of a simple dollars-and-cents calculation. This is especially true if a firm has some specific “intangible assets” such as valuable trademarks or patents, new technologies, trade secrets (such as Coca-Cola's formula), or efficient management techniques.

The fear is that these advantages or technological innovations will be stolen, copied, or otherwise “appropriated” by the competition if a firm does not retain full control over them. If a firm gives up control of foreign production, distribution, or sales, it risks losing control of its key competitive advantage. For example, once the foreign partner or licensee learns how to manufacture and sell the product itself, it might go into competition with the originating firm.

The only way to be sure that the key competitive factors are protected (and not appropriated by foreign firms) is to keep full control of the process by sending FDI to foreign markets and creating wholly-owned subsidiaries. Rather than licensing agreements, TNCs engage in FDI, according to this theory, as a defensive measure.
TNCs AND UNDERDEVELOPMENT

Stephen Hymer, a political economist with a Marxist-structuralist perspective, was among the first to see that TNCs sometimes exist to protect and exploit unique advantages such as those just discussed. Hymer argued that the desire to retain monopoly power, exploit foreign markets, and earn excess profits caused TNCs to engage in patterns of FDI that do not foster economic development, but rather lead to the "development of underdevelopment" (see Chapter 4).

If executives in corporate headquarters fear that their company’s competitive assets will be appropriated or diluted, they will tend to keep control of them at home and be sure that strategic decisions are made by home-country, not host-country, executives. This creates what is called the branch factory syndrome, whereby critical technology and the most productive assets remain securely at headquarters while inferior technology and less productive assets are transferred abroad, to the branch factory. FDI that builds branch factories may transfer technology and create jobs, in this theory, but the technology will always be inferior and the jobs will never be as good as in the headquarters firm.

Hymer’s theory goes further than appropriability theory by linking TNC strategy to an international division of labor that privileges the industrial core and systematically prevents periphery countries from catching up. Hymer adopts a structuralist perspective on TNCs and FDI, conceptualizing the international economy as an arena of conflicting interests between actors with unequal power.

Politics and Protectionist Barriers

Political factors can also be important in TNC strategies. TNCs depend on open international markets. They need to be able to invest abroad, of course, but they also depend on the ability to import and export. Trade barriers make their internal operations less efficient and disadvantage them compared with protected domestic firms. This explains in part why so much FDI is regionally based, such as FDI within the EU or within NAFTA. The lower trade and investment barriers within the regional blocs encourage intra-bloc FDI compared with other patterns of FDI.

Interestingly, however, trade barriers can also encourage certain types of TNC behavior. Some FDI is an unintentional result of mercantilist policies designed to keep out foreign products. A foreign firm can get around a country’s tariff barriers by establishing a factory in that country; in a sense, this transforms the foreign firm into a domestic firm. In the early 1980s, for example, the United States negotiated a voluntary export agreement with Japan that was intended to protect U.S. automobile firms while they developed more fuel-efficient models. The agreement put numerical limits on car exports from Japan to the United States. The limits did not apply, however, to automobiles assembled in the United States and sold by Japanese firms, so long as most of the parts came from the United States or Canada. Honda, Toyota, and Nissan all began to invest in production facilities in North America so that they could expand their market shares despite the trade barriers.

In the U.S.-Japan automobile agreement case, a policy that was intended to keep out foreign cars instead attracted foreign FDI and probably strengthened the Japanese
firms. Of course, it is not always possible or profitable to employ FDI to get around protectionist trade barriers, but where it is, it helps us understand why firms invest abroad.

Politics can affect FDI patterns in other ways as well. The Boeing Company, for example, markets its commercial aircraft to many airlines that are owned by governments or whose decisions are strongly influenced by government policy makers. Boeing often finds that, to get a large order for its aircraft, it must accept "offsets," which are agreements that certain components will be produced in the country buying the airplanes. Sometimes investments are made and technological know-how is transferred in exchange for purchase orders. In situations like these, as IPE scholar Susan Strange pointed out, TNCs may become so involved in international politics that their negotiations, with host states and home states as well as with other TNCs, are more like diplomacy than simply business.

Currency Instability
TNCs are especially susceptible to the effects of unstable foreign exchange (FX) rates because they often have costs that are denominated in one group of currencies and earn revenues in other currencies. An unexpected shift in exchange rates can raise effective costs and reduce revenues. Some international businesses have seen profits collapse and foreign markets disappear due to exchange rate swings. In 2003, the world's largest food company, Nestlé, announced that profits had fallen by half despite a higher quantity of goods sold, due to the unexpected appreciation of the Swiss franc. What Nestlé gained through its increased sales, it lost many times over in the FX markets.

There are many ways to reduce this exchange rate risk, including the use of complex financial instruments. One very direct way is to establish production facilities in each major market so that costs and revenues largely accrue in the same currency. The problem of currency instability is a factor that drives TNCs to behave more like national firms than like global giants.

The combination of trade barriers and exchange rate factors encourages firms to produce goods in the countries where they are sold rather than simply export them from a central location. The globalization of markets, therefore, is sometimes associated with what might be called "multi-local" production and a corresponding pattern of TNC investment. That is, the corporation is regional or global, but its operations in different countries are configured along more national or local calculations in order to minimize or avoid trade barriers and currency problems.

Another pattern of FDI occurs when FX rates are misaligned (either undervalued or overvalued), as explained in Chapter 7. When a currency is overvalued, for example, imported products are systematically less expensive than domestic goods. This can be a strong incentive for firms to invest in foreign production facilities. The foreign factories may be more or less efficient, but they benefit from advantageous FX rates.

For example, because the U.S. dollar was considerably overvalued during the early 1980s, U.S. firms had an incentive to set up offshore production facilities. And in the late 1980s, a situation called endaka—meaning an overvalued Japanese yen—forced Japanese firms to set up production networks throughout East Asia and Southeast Asia and to ruthlessly cut costs at factories in Japan. Endaka was
very stressful for Japanese businesses, but it forced them to evolve into super-
efficient TNCs. More recently, the weak dollar (it depreciated by approximately
30 percent against the Euro between 2000 and 2012) has driven many European
countries to set up operations in the United States.

Location-Specific Advantages

FDI may also be influenced by location-specific advantages. Some of these
advantages are obvious, such as access to natural resources that are available
only in specific areas—a powerful impetus for a lot of Chinese FDI in Africa
and Latin America. At other times, the advantages are more complicated. For
example, if a company wants to compete in the computer software market, it
would need to set up shop where the best people are. This means that it would
invest where many other firms have also located, so that it can benefit from the
pool of highly trained individuals in that area and the intense competition and
constant innovation that is built into this environment. It would channel FDI
to Redmond, Washington (Microsoft’s home), the Silicon Valley of California,
Israel, and probably Bangalore, India. These and just a few other places in the
world have the right technological and human environment to make a firm very
competitive.

In the same way, if a company wanted to compete in the world market for
eyewear such as designer sunglasses, it would probably open a facility near Bel-
luno, Italy. As Michael Porter explains in his book The Competitive Advantage
of Nations, this region of northern Italy is where the world’s top eyeglass design
and manufacturing facilities are found and where the world’s pickiest eyeglass
customers live, too. It is impossible to compete successfully in the global market
without being exposed to the intense and innovative competition in this local market. Most
of the quality eyewear in the world is manufactured by companies that have at
least some of their facilities in Belluno.

Competition

Finally, it is important to remember that TNCs are transnational because the
markets where they compete are throughout the world. In some cases, a firm may be
driven to invest abroad because of simple competitive pressures: If one firm does
not contest this market, other firms will, and they may gain an advantage from
doing so. In this regard, firms may act a bit less like rational profit-maximizing
enterprises and a bit more like mercantilist states, which see an opponent’s gain as
their own potential loss.

To summarize, some TNC investments are driven by the desire to exploit low
wages or cheap natural resources but, given the types of products that TNCs manu-
ufacture and their actual pattern of FDI, other factors are much more important.
TNCs invest abroad to protect a competitive advantage, to exploit a monopoly
position, to get around trade barriers, to avoid currency problems, to take advan-
tage of special production environments—and because they are driven to do so by
their competition with other TNCs.
HOW POWERFUL ARE TNCs?

Many people assume that TNCs are very powerful because they are such large organizations and because, through their FDI flows, they influence the global distribution of investment and technology. Some people go so far as to assert that TNCs are as powerful as states—or more powerful than states.

One commonly cited "fact" is that around half of the top 100 "economic entities" are corporations—and the other half are countries. This statistic is based on comparisons of the GDPs of countries with the total revenues of corporations. But to make these comparisons is to misunderstand what a TNC is and also to misunderstand what a state is.

From a technical standpoint, comparing countries and TNCs this way is comparing apples with oranges. The GDP of a country is not equivalent to the total revenues of a corporation. Wal-Mart has high revenues, to be sure, but why are its revenues the correct measure of Wal-Mart's power and not its wage bill, its net profits, its employment total, its FDI resources, or the technology that it can potentially offer a host country? One suspects that total revenues are selected simply because they make Wal-Mart appear larger than states. TNCs do have tremendous influence over economic resources, but not so much as this biased methodology suggests.

The second problem is that this analysis compares TNCs and nation-states in strictly monetary terms, ignoring many factors that really matter a great deal more. This focus on one factor, money, is ironic because many critics of TNCs criticize corporations for ignoring important nonmonetary factors, such as security or the environment. States possess territory and make laws; they have sovereignty, citizens, and armies and navies. They have legitimacy, too, which means that the international community accepts their right to make important social decisions. TNCs have none of these things, unless you think that employees or customers are the same as national citizens. Even the giant Wal-Mart, which has over two million employees, has fewer workers than most countries have citizens, if we want to use this as our measure. States are fundamentally different from TNCs, and attempts to compare their power and influence based on simple numerical indicators must inevitably distort reality. Both states and TNCs have power, and so sometimes they must negotiate and engage in diplomacy, but their powers differ and so their relationship is complex and evolving.

CHANGING REACTIONS TO TNCs

Apart from business leaders and economists, who tend to view the growth of TNCs as the natural consequence of emerging regional and global market structures, most authors interpret the expansion of TNCs as a decisive shift in the balance of power in the global economy. They argue about who will benefit from this shift and how. Several quite distinctive viewpoints have emerged that we will discuss in this section: TNCs as a form of capitalist imperialism, TNCs as a tool of U.S. hegemony, and TNCs as state-level actors in IPE.

TNCs and Capitalist Imperialism

TNCs and FDI were distinctive elements of the first modern era of globalization, which reached its zenith about a hundred years ago and ended with the opening
shots of World War I. V. I. Lenin famously characterized this era in a book title as *Imperialism: The Highest Stage of Capitalism*. Lenin focused on “finance capitalism,” not TNCs per se, but his approach and many of his conclusions are easily applied to TNCs. Lenin argued that colonial imperialism had been replaced by economic imperialism. Foreign armies and occupying forces were no longer necessary because the same result (exploitation by and dependency on the capitalist core) could now be accomplished by foreign investors and business corporations. If you read Lenin’s famous little book on imperialism, you will quickly appreciate that it is very much a creature of a particular time and place, full of references to long-forgotten people and events. It was not a book written for the ages but rather an argument written in the present tense. His indictment of international investment as a form of imperialism, however, does live on through books such as William Greider’s *One World, Ready or Not: The Manic Logic of Global Capitalism.*

Stephen Hymer draws a direct link between TNCs and imperialism today, as was discussed earlier in this chapter. Hymer’s path-breaking theory of TNC behavior suggests that many TNCs engage in FDI because they wish to exploit a monopoly position while protecting a key asset, such as a patented process. Their profit-maximizing strategy is to exploit the foreign market in favor of higher profits at home. In terms of financial strategy, terms of trade, and technology transfer, Hymer predicts that TNCs will engage in a pattern of behavior that is imperialism in everything but name.

**TNCs as Tools of U.S. Hegemony**

TNCs came to be viewed by many as tools of U.S. hegemony during the Cold War era. There were several reasons for this association. First, U.S. TNCs were especially active and focused on foreign expansion in the immediate post—World War II years. U.S. foreign policy seemed to be directed in part to creating opportunities for U.S. firms to expand abroad. And once FDI had taken place, U.S. investments abroad created economic interests favorable to U.S. policies. So it seemed as though the United States promoted its TNCs, and they in turn supported U.S. policies.

IPE scholar Robert Gilpin, writing in his 1975 book *U.S. Power and the Multinational Corporation*, argued that American-based TNCs were a tool of U.S. hegemony. Citing a famous international economist, he asserted:

As Jacob Viner has pointed out, from the initial movement of American capital and corporations abroad the State Department and the White House have sought to channel American investment in a direction that would enhance the foreign policy objectives of the United States. With respect to the foreign expansion of the multinational corporation, these objectives have been seen as maintaining America’s share of world markets, securing a strong position in foreign economies, spreading American economic and political values, and controlling access to vital raw materials, especially petroleum.

One example of Gilpin’s thesis is found in the role that Boeing played in U.S. relations with China in the 1970s. President Richard Nixon went to China in 1972 in a move to solidify U.S. hegemony relative to the USSR (an event so dramatic that it is even cited in *Star Trek VI: The Undiscovered
Country: "There is an old Vulcan proverb: Only Nixon could go to China"). He also went to sell airplanes, specifically Boeing 707s. Although American and Chinese officials made endless toasts, it was the aircraft sale that sealed the deal by providing meaningful economic benefits to both countries. Chinese purchases of Boeing aircraft later in the 1970s were symbolic of China’s commitment to modernization and the U.S. government’s commitment to closer diplomatic relations with China, as was paramount leader Deng Xiaoping’s 1979 tour of Boeing assembly facilities near Seattle.

By the mid-1970s, when Gilpin’s book appeared, U.S. hegemony seemed to be in decline. U.S. wealth and power had not declined in absolute terms, but Europe and Japan had closed the gap, resulting in a relative decline in U.S. influence. Ironically, Gilpin viewed this as a consequence of the strategic use of U.S. FDI:

> From a political perspective, the inherent contradiction of capitalism is that it develops rather than that it exploits the world. A capitalist international economy plants the seeds of its own destruction in that it diffuses economic growth, industry, and technology and thereby undermines the distribution of power upon which that liberal interdependent economy was rested.\(^4\)

Gilpin was concerned that the relative decline of U.S. hegemony would bring an end to the international political environment that had made the expansion of U.S. TNCs and the reconstruction of Europe and Japan possible. He feared a return of protectionism as had occurred when British hegemony declined at the end of the nineteenth century.

Nearly forty years after Gilpin’s book was published, the viewpoint that American TNCs are tools of U.S. hegemonic strategy no longer dominates the debate, but it has not entirely disappeared. U.S. media conglomerates have global influence, U.S. films and television shows are seen around the world, and U.S.-based content providers and social media companies have a large presence on the Internet. For example, Hollywood movie studios control approximately two-thirds of worldwide box office sales. At the beginning of 2013, Menlo Park, California-based Facebook had more than one billion users, and San Francisco-based Twitter had 200 million active users and 500 million registered users. To the extent that these TNCs present world events and ideas in ways that cast a favorable light on U.S. policies and U.S. values and interests, they are a source of what Joseph Nye calls “soft power.”\(^5\) Some have argued that this soft power advantage is even more important to U.S. foreign policy in the long run than is U.S. military dominance.

**TNCs as State-Level Actors**

The decline of U.S. hegemony did not end the era of TNC expansion, as Robert Gilpin suspected, but it did change its pattern. TNCs based in the “triad” of Japan, the EU, and the United States intensified their foreign investment activities. The United States, which had become accustomed to its position as a “home country” for U.S.-based TNCs, found itself also a “host country” to major TNCs based in Japan and Europe. The previously accepted distinction between home and host countries was starting to disappear, replaced with the realization that we are all host countries now.
The list of potential host countries expanded dramatically with the collapse of communism in 1989. Many countries, including even Russia, opened their doors to FDI and the resources and technology that it promised. Other events brought even more countries into the world economy. The end of apartheid in South Africa, for example, attracted inward FDI and allowed South African firms an opportunity to expand abroad. SABMiller, formerly South African Breweries, is now the world’s second largest beer producer, with production facilities in more than forty countries. And perhaps most consequential of all, economic liberalization in China and India opened the two largest countries in the world to inward flows of FDI.

In their 1991 book Rival States, Rival Firms, John Stopford and Susan Strange coined the term triangular diplomacy to describe the pattern of state–TNC relations that they saw emerging. In the past, they wrote, firms had competed with other firms, and states had engaged in diplomacy with other states. By 1990, they said, the largest TNCs had more power relative to states and relative to competitive markets, too. Diplomacy—where actors bargain with each other—was a more accurate description of where the world was heading. Although large TNCs were still in competition with each other, they also often bargained with each other much as states did. More and more often TNCs would form alliances or other working arrangements to develop technologies and spread the risk of new investments (see the box Outsourcing and the Globally Integrated Enterprise later in the chapter).

An example of firm-to-firm diplomacy was New United Motor Manufacturing, Inc. (NUMMI), a joint venture between fierce competitors Toyota and General Motors (GM). NUMMI was established in 1984 when Toyota agreed to take over operations in GM’s least efficient factory, located in Fremont, California. Using Japanese management techniques, Toyota soon had the NUMMI factory running at world-class quality and efficiency, churning out cars for both Toyota and GM. The NUMMI alliance, just one of many among automobile companies, allowed GM and Toyota to share risk, share markets, and combine strengths even as they competed for the same customers.

State–TNC bargaining is the third side of the diplomacy triangle. Both states and TNCs control valuable resources, and they need each other. States would like the investments and technologies that TNCs can offer. TNCs, for their part, desire access to the natural resources and skilled labor that states control and, of course, they also seek access to national markets for the goods and services that they produce. (A state that fails to adequately educate and train many of its citizens and thus offers mainly unskilled labor has little to bargain with and can expect to attract sweatshop-type FDI.) Since each side has much to offer and much to gain, it would seem that mutually advantageous agreements should be easy to achieve. But it is not as simple as that.

Because TNCs compete with each other for transnational markets, they have a strong incentive to attempt to negotiate the most favorable terms possible for their FDI projects. TNCs typically seek favorable tax treatment, state-funded infrastructure, and perhaps even weakened enforcement of some government regulations. A weak state, or one with few productive resources and a weak market system, may be at a fundamental disadvantage in such negotiations. Competition from other
states may force it to grant many concessions to attract FDI. This is true both in LDCs and in advanced industrial economies.

In the early 1990s, for example, the German automaker Mercedes-Benz announced that it would build a factory in the United States to produce a Mercedes sports-utility vehicle (SUV). Mercedes-Benz had much to offer in this FDI project, although perhaps its most valuable bargaining chip was its reputation for quality. The ability of a state or locality to satisfy Mercedes-Benz would be a sign to other companies that the area could meet high quality standards. More FDI would be likely to follow. The stakes, therefore, were very high in bargaining over this investment.

Mercedes-Benz increased its bargaining power by creating competition for its FDI. It published its requirements for the FDI project and invited a large number of state and local governments to make bids for the factory. By 1993 the list was narrowed to three potential factory sites in South Carolina, North Carolina, and Alabama. All three states had right-to-work laws that limited union power. North Carolina offered $108 million of investment incentives. South Carolina offered a package similar to the one that had previously attracted a BMW factory; the total value was about $130 million. Alabama won the bidding, however, by pledging to Mercedes a package worth $233 million.

The Alabama–Mercedes story highlights the bargaining power TNCs often have in negotiations with states. Alabama gave Mercedes tax abatements on machinery and equipment, improved highways and other infrastructure the company needed, and spent money on education and training that would benefit the company. The University of Alabama even agreed to run a special “Saturday School” to help the children of German Mercedes managers keep up with the higher standards in science and math back home in Germany. All this was paid for by the taxpayers of Alabama. The governor of North Carolina was particularly upset by a tax break the Alabama legislature passed (labeled by some the “Benz Bill”), which allowed Mercedes to withhold 5 percent of employees’ wages to pay off Mercedes debts.

The wooing of Mercedes went beyond financial incentives. It included an offer to name a section of an interstate highway “the Mercedes-Benz autobahn,” airplane and helicopter tours for Mercedes-Benz executives, and the governor driving a Mercedes as the official state car. It is not surprising that a Mercedes executive claimed it was “Alabama’s zeal” that was the deciding factor. In return, 1,500 workers got good-paying jobs, with the likelihood that thousands of other new jobs would be created in supplier firms, restaurants, and the like.7

The lesson seems clear: TNCs are “footloose” and have many possible investment options, whereas states are rooted, like trees, in the territory they control. When a TNC has unique resources to offer while the state has few and faces stiff competition from other states, the TNC has a tremendous advantage and the diplomacy can be very one-sided. However, this need not always be the case; if states make their own investments in education, resources, infrastructure, and so forth, then they can have the upper hand. The competition that TNCs face from each other can press them to make concessions, too. For example, several European countries held auctions for third-generation (3G) wireless telecommunications
true both in
for qual-
ity the TNCs (and
their resources) as
much as the TNCs
need the states
(and their resources).
When
competition drives a
bargain too far on
either side, it puts
the other party at risk
and suddenly the whole enterprise is in jeopardy.

This is what bothered Raymond Vernon when he wrote his 1998 book In the
Hurricane's Eye: The Troubled Prospects of Multinational Enterprises. Vernon
was concerned that competition among TNCs was forcing them to squeeze states
for more and more concessions. Although we say that the states are squeezed, it
is of course the citizens of the states who feel the pressure from higher taxes or
reduced government services, lower labor standards, and lax environmental
enforcement. How would they react? One possibility is that they would put political
pressure on their governments to adopt protectionist measures generally. This was
Vernon's fear. Although Vernon wrote prior to the protests at the 1999 WTO
meetings in Seattle, the chaos of those protests is very much the eye of the
hurricane he was describing.

TNCs thrive in a liberalized global climate. Many observers were predicting
the endless expansion of TNCs, as indicated by the title of Kenichi Ohmae's influ-
tial book The Borderless World and the title of David Kotler's book When
Corporations Rule the World. In contrast, Vernon saw the potential for a great
collapse. The Hurricane's Eye concludes with this warning:

The great sweep of technological change continues to link nations and their
economies in a process that seems inexorable and irreversible. ... Yet the basic
adjustments demanded by the globalization trend cannot take place without
political struggle. Too many interests in the nation-states see the economic
risks and costs of the adjustments involved, even if justified in the longer
terms, as unfairly distributed and deeply threatening. ... But a prolonged
struggle between nations and enterprises runs the risk of reducing the effec-
tiveness of both, leaving them distracted and bruised as they grope towards
a new equilibrium. To shorten that struggle and reduce its costs will demand an
extraordinary measure of imagination and restraint from leaders on both sides
of the business-government divide.

A GLOBAL FDI REGIME?

In the mid-1990s, the Organization for Economic Co-operation and Develop-
ment (OECD) sponsored talks between business and government leaders with
"imagination and restraint" over a Multilateral Agreement on Investment (MAI).
The intent was to create a regime to govern FDI in the same way that the WTO
governs international trade. What kind of governance? The goal of the MAI talks was to set norms and standards for state-TNC negotiations.

Both sides of the table had something to gain from an international investment agreement. TNCs, for example, want to be assured of “national treatment.” Under WTO rules, nations can impose certain trade restrictions at the border, but once a product enters a market it cannot be discriminated against in favor of domestic products. National treatment in trade prevents domestic discrimination against foreign products.

National treatment for FDI would mean that, while a state has the right to regulate inward investment at the border, once that investment has been made the state must treat the local subsidiary of the foreign TNC the same as it treats similar domestic firms. There must be no domestic discrimination against TNC affiliates, even if this means giving them tax preferences and subsidies intended for domestic firms only. TNCs believe that recognition of this principle would make FDI more efficient and less vulnerable to political forces.

TNCs would also benefit if nation-states coordinated or harmonized their regulations on big businesses. As we have noted, TNCs are forming more alliances and merging operations in order to be competitive with other TNCs. But because of their broad reach, TNCs often find themselves subject to antitrust or competition regulation in several different jurisdictions. For example, the United States and the European Union have adopted different norms for business mergers, and when TNCs wish to join operations, they frequently need to gain approval in both places. In 1996, EU competition regulators initially opposed approval of a merger between two U.S.-based aircraft firms, Boeing and McDonnell Douglas, which had been given a green light by U.S. authorities. It was suddenly clear that the EU could veto an agreement between two U.S.-based firms if they both had important operations in Europe. Subsequently, the EU did veto a merger in 2001 between General Electric and Honeywell—both U.S.-based TNCs—despite prior U.S. government approval because EU officials feared that the merger would reduce competition in the markets for aviation electronics and airplane engines.

Although TNCs cannot escape government regulations on things such as approval for mergers and acquisitions, they would clearly benefit from being subject to just one set of rules instead of several contradictory ones. For their part, states have important interests that could be served by a multilateral investment agreement. These might include a set of standards for TNC behavior (to prevent labor rights abuses, for example) and rules on transfer pricing. When a TNC transfers resources (say, auto parts) from one subsidiary to another, it has to set an internal price, called the transfer price, which is used to calculate the profits and therefore establish the tax liability of operations in each country. It is well known that transfer prices can be manipulated to create artificially low profits in jurisdictions where tax rates are high and artificially high taxable income for operations in countries where tax rates are low. Transfer price manipulation is essentially a way for TNCs to lower their tax burden and deprive states of tax revenues. An investment agreement could prevent this.

A multilateral agreement would also be useful if it prevented states from getting caught up in bidding wars for TNC projects. If states agreed to abide by rules about what incentives they could provide, all might benefit in the long run.
Some studies suggest that state incentives and giveaways are ultimately not very important in the pattern of FDI location, except perhaps on the margin. Typically, market factors tend to be more important in the decision to invest abroad at a particular location than all the goodies that states offer to entice foreign firms. In the end, FDI largely goes where it would have gone, but with the bonus payments thrown in. The only way to stop this, however, is for all the states involved to agree to tie their own hands, and that is what international treaties and agreements are supposed to do.

The OECD’s attempt to negotiate a final version of the Multilateral Agreement on Investment failed in 1998, perhaps predictably. Instead of binding rules, all that could be agreed on was a set of voluntary guidelines. Why did the MAI negotiations collapse? The short answer is that states were unwilling to give up the right to pursue their national self-interest. They wanted to be able to discriminate in favor of domestic firms when this seemed prudent and to bid lavishly for TNCs’ factories when the opportunity was presented.

Instead of one global agreement on FDI, UNCTAD reports that as of 2011 there were over 6,000 separate International Investment Agreements (IIAs) between TNCs and nation-states, creating a complex hodgepodge of rules and standards. This system of IIAs does nothing to reduce the incentive for states to engage in “beggar thy neighbor” bidding wars to attract TNCs, nor does it facilitate enforcement of uniform labor and environmental standards in TNC operations. In the absence of multilateral agreements to regulate TNC behavior, NGOs have stepped into the breach and mounted campaigns to pressure TNCs to treat their foreign workers fairly. TNCs have responded by adopting more corporate social responsibility standards. The success of these is a matter of intense debate as compliance is hard to monitor and enforce (see the box TNCs, Global Commodity Chains, and Accountability).

**TNCs, Global Commodity Chains, and Accountability**

Traditionally, many TNCs had one of two types of organizational structure. They were either vertically integrated or horizontally integrated firms. More recently, a new TNC structure has appeared: the globally integrated enterprise based on a global commodity chain (also referred to as a global supply chain), whereby the TNC does not own most of the elements of its foreign operations. With improved information technology, some TNCs can “outsource” vital functions to foreign-owned firms. The TNC builds a transnational network of contacts and contracts that it coordinates to create a regional or global business presence.

Nike, for example, is a high-profile TNC, but you will not find it ranked near the top of the FDI rankings of firms. It owns very few production assets either outside or inside the United States. Most Nike products (its line of baseball caps is a notable exception) are manufactured and distributed by foreign-owned firms under contract to Nike. Everything from production of raw materials, to apparel sewing to distribution is coordinated by Nike through chains of contracts and business relations with other firms. The assets that Nike absolutely controls and guards jealously are its brand name, its image, and the famous “swoosh.”

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trademark. Similarly, Apple outsources most of the manufacturing and assembly of components for iPhones and iPads to companies in countries like China, Japan, and Taiwan while maintaining firm control over the design and reputation of its iconic products.

Global commodity chains raise all sorts of interesting questions in IPE. Are TNCs accountable for what is done in their subcontracting firms? When Nike was criticized for labor conditions in factories in its chain, it did eventually change them. More recently, Apple has come under increasing pressure to improve conditions at one of its major suppliers, Foxconn, a Taiwanese-owned company that employs 1.2 million workers in China. A TNC like Apple or Nike might not be legally accountable for its suppliers’ actions, but in competitive market environments it sometimes must establish accountability for actions of other firms in order to have credibility in the marketplace and legitimacy in its negotiations with other actors that are concerned about corporate social conduct.

The issue of sweatshop conditions in some apparel global commodity chains illustrates this point. Some of the NGOs that have targeted sweatshops supplying TNCs and focused on improving working conditions in them are Global Exchange, Clean Clothes Campaign of Europe, Co-op America, Sweatshop Watch, and the United Students Against Sweatshops. Some university groups are part of a large network of more than 110 academic institutions focused on generating a code that permits only “sweat-free” clothes to bear their name. In September 2002, some twenty-six apparel companies signed an agreement to establish a monitoring system that would oversee working conditions in their subsidiaries in developing countries. Some 250 U.S. companies, including Apple and Nike, have created codes of conduct for their subcontractors.

Many TNCs have taken the issue of accountability very seriously. The NGO Business for Social Responsibility (BSR) defines its goal as “achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment.” BSR argues that corporate social responsibility (CSR) can have a positive effect on businesses by reducing operating costs, enhancing brand image, increasing sales and company loyalty, and raising productivity and quality. Companies that have been recognized for their commitment to CSR are the Co-operative Bank, Starbucks Corporation, B&Q, and Novo Nordisk.

It remains to be seen, however, whether the CSR movement will create widespread change in TNC behavior. Some scholars have questioned the effectiveness of CSR, seeing it as window dressing by a few high-profile TNCs and therefore likely to result only in marginal changes in business conduct. Robert Reich, for example, argues that “companies are neither moral nor immoral” and that what drive the behavior of TNCs are deeper structural forces and not the ethics of their top executives. Reich and others advocate multilateral and national regulations that would apply to all corporations. As global commodity chains become more important in transnational production, the question of their accountability and how to respond to them will continue to be a central issue on the public policy agenda.

References


See the website of Business for Social Responsibility, at www.bsr.org.

CONCLUSION

TNCs Today

Change and uncertainty are the hallmarks of this period of transition in the global economy and international relations. Nevertheless, we can identify some powerful currents that are likely to affect the pattern of FDI flows and perhaps the behavior of TNCs. The developments we discuss here raise many crucial questions, making this an exciting time for students of IPE and TNCs.

A potentially game-changing development, as we have alluded to already, is the spectacular economic growth of countries like China and India. Just as the rise of Japan and the newly industrialized countries spawned successful competitors to Western TNCs in previous years, we are now seeing enterprises from countries like Brazil, Russia, India, and China (the BRICs) challenge the dominance of Western TNCs. A recent book by members of the Boston Consulting Group argues that the process of globalization has advanced so far that we are now in a condition they call "globality." Whereas global business used to be a "one-way street" benefiting Northern TNCs, it is now a two-way process, with TNCs from the North and the BRICs "competing with everyone from everywhere for everything."  

Partly in response to this intensified competition and partly in response to changes in communication and transportation technologies, we are beginning to see the arrival of what Samuel Palmisano, the former CEO of IBM, calls globally integrated enterprises that are adept at linking together multiple partners and suppliers from around the world to collaborate and share in the finance, design, and production of new products. In contrast to the pressures to internalize activities implied by the appropriability theory and the branch factory syndrome we discussed earlier, TNCs are increasingly externalizing some of the activities they used to conduct in-house.

There are several reasons for adopting "non-equity modes" (NEMs) of international production, the termUNCTAD uses to describe what TNCs do when they coordinate global commodity chains without owning most of the firms in the supply chains. One is to spread the potential risks of operating in a more competitive and uncertain environment. Another is to increase TNCs' flexibility to respond to changes in demand. Disentangling themselves from relationships with suppliers is often easier and less costly than closing a wholly-owned affiliate. And, depending on the complexity of the product, TNCs can gain cost and skill advantages by outsourcing sizeable chunks of their operations. TNCs can outsource much of the production of simple products like toys or garments to lower cost suppliers. Producers of sophisticated products can tap into pools of talented labor across the globe. The following box focuses on the production of Boeing's new airplane, the 787, and provides a striking example of this process at work.

OUTSOURCING AND THE GLOBALLY INTEGRATED ENTERPRISE: BOEING'S 787 AIRPLANE

Boeing, one of the two leading producers of airplanes, launched the development of its new airplane, the 787 "Dreamliner," with a revolutionary new business strategy. The plane would be made primarily of composite material rather than metal, and 70 percent of it would be produced by suppliers and subcontractors located all over the United States and the world (among the countries involved are Japan, China, South Korea, Australia, Russia, Canada, England, France, Sweden, and Italy). What is notable about its new strategy is that certain key partners, known as "tier one suppliers," are responsible for all

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the design, engineering, manufacturing, and assembly of various sections of the airplane. So, for example, the wings, at one time considered by Boeing to be key sources of its competitive advantage, are now being produced by Japanese firms with help from Boeing. Below these firms are hundreds of "tier two suppliers" and their subcontractors who feed smaller parts up the line of a long and complex global supply chain. Boeing now sees system integration and final assembly as the source of its competitive advantage.

The outsourcing, according to Leslie Wayne, "is so extensive that Boeing . . . has no idea how many people around the world are working on the 787 project." Not to be outdone, Boeing's rival, Airbus, itself the creation of four European countries, plans to outsource 60-70 percent of the value of the new planes it produces, with much of this work—and therefore many jobs—going to non-European countries. The advantages to such a business strategy are clear for Boeing, Airbus, and other TNCs. They can gain access to large pools of skilled and talented employees around the world, sometimes at lower cost, as with Boeing's use of Russian engineers in Moscow. They can sweeten their relations with foreign governments by building up the technological and managerial expertise of their suppliers, thereby facilitating better state-TNC interactions and in Boeing's case, bigger sales of its airplanes. And they can reduce their financial risk when embarking on expensive new products and projects by sharing the cost with partners around the world (some 40 percent of Boeing's $8 billion development cost is apparently being borne by partners).

But the consequences for the home country are less clear. Boeing workers are especially worried about what this extensive outsourcing means for their jobs. A recent study of Boeing workers, for example, found that some two-thirds of engineers thought that outsourcing threatened their future job security. Interviews with Boeing workers revealed deep anxiety about what this new business strategy meant for the future of the company and the availability of good jobs for Americans. Employees talked about "giving away the farm" or losing "hard-learned and expensive know-how" and worried about how such outsourcing might damage Boeing's long-term viability and shrink the middle class and the "national tax base." Boeing has recently acknowledged that it overdid the outsourcing and that the supply chain was too complex and extensive. To avoid the kind of delays (three years) and cost overruns (worth billions of dollars) that occurred on the 787, it indicated that the production of future planes will involve less outsourcing.

The emergence of such globally integrated corporations raises several questions for students of IPE. Will the interests of TNCs and home countries become even more complex and decoupled than they already are? Will such cross-national business partnerships and collaboration in production and finance help form a fledgling "global governing class" that shares interests and power but is increasingly deaf to the needs of the citizens of their putative home countries, as Jeff Faux argues in The Global Class War? Will the fact that offshore outsourcing increasingly threatens the jobs of service workers and skilled professionals such as accountants, computer programmers, and engineers—and not just blue-collar workers and the unskilled—create sufficient political heat that politicians will respond with measures to slow the process or assist the vulnerable? And will the spread or export of "good" jobs across the world by these global corporations help raise living standards in developing countries, or will they exacerbate class inequalities?

References


Whereas some political, economic, and technological developments are pushing TNCs to delink their interests from those of their home countries, others are raising concerns about a stealth return of mercantilism or "state capitalism" into the global economy. For example, state-owned TNCs, as their name implies, are majority or wholly owned by a country's government. About two-thirds of China's outward FDI is controlled by the Chinese state. This control enables the Chinese state to underwrite the development of "national champions" to compete against traditional TNCs in world markets and to direct foreign investment to resource-rich countries, thereby ensuring access to the minerals, energy, and agricultural products that are necessary to fuel China's spectacular economic growth.

The rapid growth of sovereign wealth funds (SWFs) (from $500 million in assets in 1990 to almost $5.1 trillion in 2012) and state-owned TNCs (accounting for 11 percent of total FDI in 2011) worries many commentators. Often lacking accountability to shareholders, regulators, or voters, their secrecy and potential investment in strategically important industries poses risks. Larry Summers, the former director of the National Economic Council in the Obama administration, sees a potential threat to the liberal global system from mercantilist actions by foreign governments which, as he puts it, might ask an "airline to fly to their country, want a bank to do business in their country, or want a rival to their country's champion disabled." Defenders of SWFs and state-owned TNCs point out that they have been operating for some time with no evidence that they are pursuing anything other than healthy financial returns.

Does the emergence of the BRICs, SWFs, and state-owned TNCs as important sources of FDI change the role of privately-owned TNCs in the global economy? Can FDI originating from China, a country still ruled by the communist party, still be characterized as an instrument of imperialism? Will the state-owned TNCs act with greater concern for labor and environmental rights than long-established TNCs or will they be compelled to behave like all the others by the pressures of global competition? Whether SWFs and TNCs from emerging countries end up rewriting the rules of the liberal global system or not, there is little doubt that they symbolize a rebalancing of power relations in that system.

Finally, we have to ask what kind of long-term impact the severe economic recession that began at the end of 2007 is likely to have on FDI and TNCs. Is support for globalization among elites and citizens around the world so shaken that we might be in for a period of retrenchment, with less open borders, less international trade, and less FDI? Have popular protest movements like OWS raised enough public skepticism about the actions of large corporations and banks, including TNCs, to galvanize politicians to more severely regulate their activities? Although UNCTAD sees no signs of a major transformation in world investment trends, it is making its best judgment based on current conditions. As the global economy recovers, we can expect underlying economic and technological forces to drive the expansion of FDI and TNCs, but perhaps with less enthusiasm for free-market nostrums. But if the crisis lingers or deepens, the likely fallout becomes more uncertain. History reminds us that in response to severe economic crises, political forces can reshape the international order, as they did for example in the 1930s. Prognostication is therefore a dangerous game.

**KEY TERMS**

- foreign direct investment (FDI) 433
- multinational corporations (MNCs) 434
- transnational corporations (TNCs) 434
- product cycle theory 439
- appropriability theory 440
- branch factory syndrome 441
- transfer price 450
- global commodity chain 451
- corporate social responsibility 452
- globally integrated enterprises 453
- sovereign wealth funds (SWFs) 455
DISCUSSION QUESTIONS

1. What are TNCs and how are they different from other business firms?
2. Why do TNCs engage in foreign direct investment? Explain whether or not the following statement accurate: “Most TNCs invest in less developed countries because of the low wages that they can pay there.”
3. How and why have reactions to TNCs changed in the last half century?
4. How would an international agreement on governance of FDI benefit TNCs? How would such an agreement benefit states? What prevents such an agreement from being realized?
5. Explain recent changes in the pattern of FDI and in the organization of TNCs. What are some of the implications of these changes?
6. Considering the severity of the financial crisis that began in late 2007, what do you think might be some of the consequences for FDI and TNCs over the next ten years? Will liberal economic policies and open borders beat a retreat or does the crisis mean just a temporary setback for the forces of globalization?

SUGGESTED READINGS


NOTES

4. Ibid., p. 260.
11. Useful information about transfer pricing, including links to current articles about it, can be found on the website of the politically active organization called Tax Justice Network, at http://www.taxjustice.net/cms/front_content.php?idcat=139.


