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Transnational Corporations: Dynamic Structures, Strategies, and Processes

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6 Transnational corporations

Dynamic structures, strategies, and processes*

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Introduction

Transnational corporations (TNCs) – also called multinational corporations, multinational enterprises, and global corporations – may be defined as firms that sell products in more than one country. They sell in countries other than their own both through exports from their home country locations and through sales from host country foreign affiliates (or subsidiaries) that have been created through the export of capital or foreign direct investment (FDI). According to the *World Investment Report 2002*, TNCs now number some 65,000 firms, and are associated with about 850,000 affiliates worldwide, with the world's 100 largest non-financial TNCs accounting for more than half of total sales of all foreign affiliates (UNCTAD 2002). The emergence of TNCs as a central force in the globalization process of the last two decades is closely tied to two developments, one a consequence of a long-term historical, technological evolution and the other a consequence of institutional change in the world economy largely initiated and carried out by a small number of advanced economy nations. The first is simply the continuing but recently more dramatic fall in goods transportation and information transfer costs. The second is the determination in the 1980s by many in the largest advanced economies to initiate an international financial liberalization. To understand the latter as a unique historical event that occurred against the backdrop of the former, the history leading up to the financial liberalization of the 1980s needs to be briefly reviewed.

Free capital movements had been excluded from the postwar Bretton Woods regime, which secured the principles of a liberal international trading regime after the disaster of interwar national protectionist policies, combined with a rescue system for countries in balance of payments difficulties in the form of the International Monetary Fund. Without the free flow of capital internationally, countries were able to peg their exchange rates, and freely pursue full employment policies and the expansion of the welfare state, effecting a temporary labor-capital accord with rising real wages linked to productivity growth, profits for industry, and increased social services. The breakdown of Bretton Woods – symbolized by US President Richard

Nixon's 1971 abandonment of dollar-gold convertibility – came about as a result of the US attempt to maintain both the "Great Society" war on poverty and wage war in Vietnam, and also because of the rising competitiveness of the Japanese and European economies that undermined the postwar US trade advantage and balance of payments surplus. However, when exchange rates became flexible and free-floating, firms engaged in international trade found it necessary to hedge their foreign exchange positions against fluctuation in currency values. This necessitated liberalizing short-term international capital flows, without which the expanded level of postwar international trade would have been jeopardized just as surely as if there had been a new era of protectionism.

But the broader logic of the situation did not escape the leadership of large national corporations. If one moved financial capital into foreign exchange positions as a hedge against loss in value of one's exports and imports, then one should also move production capital into foreign locations as a hedge against loss in value of one's national operations. Thus corresponding to short-term international capital flows there should also be long-term international capital flows. In part this conjunction came about because capital is fungible. Attempts at regulation were not likely to have been entirely successful in discriminating trade-financing capital movements from long-term capital movements. But more important was the recognition on the part of those in large national corporations that significant profit opportunities were available from relocating production to more countries. These were associated with being able to selectively dominate markets in new national locations when acquiring "local" reputation, tying supplier networks more closely to final goods markets, escaping costly home country regulatory structures while seeking regulatory concessions as a part of foreign location, transforming bargaining conditions at home and simultaneously gaining advantages elsewhere by relocating to countries where labor was either weakly organized or not organized at all, and gaining political influence vis-à-vis government authorities in foreign locations in which national economies were small relative to the TNC.

The second section of this chapter briefly reviews recent evidence concerning the importance of TNCs and their foreign affiliates in the world economy, including evidence regarding the extent of FDI which firms carry out in establishing foreign operations and achieving multinational status. The third section distinguishes four competing theories of TNCs: the market power approach, the transactions cost internalization approach, the Dunning eclectic paradigm, and the technological accumulation approach. Section four examines five transformational impacts that TNCs have had or may continue to have on the world economy in the future in the spread of their global operations. The final section provides concluding remarks on national sovereignty issues and the possible future role of TNCs in the world economy.

Evidence on TNCs and their foreign affiliates

One measure of the increasing importance of TNCs is the increased share of sales in world markets by their foreign affiliates. Rather than sell goods from home locations, since the mid-1980s TNCs have increasingly sold them from foreign locations, both in host country markets themselves where they have established production and distribution affiliates, and in the form of exports from these new locations. Whereas in 1990 the sales of foreign affiliates of TNCs were about equal to world exports, in 2001 sales of TNC foreign affiliates were almost twice as high as world exports. Over this same period the stock of outward FDI creating foreign affiliates increased from $1.7 trillion to $6.6 trillion. Foreign affiliates of TNCs now account for one-third of world exports and one-tenth of world GDP (UNCTAD 2002).[1] Table 6.1 shows the value of sales, gross product, total assets, and exports of foreign affiliates in constant prices for the years 1982, 1990, and 2001.

This increased role for TNC foreign affiliates reflects broad changes in the world economy in the relationships between national economies, trade, and FDI since the mid-1980s. Whereas from the 1970s to 1985 the growth rates of trade, FDI, and world GDP were similar, since then the growth rate of trade has significantly exceeded the growth rate of world GDP, while the growth rate of FDI has significantly exceeded the growth rate of trade (Table 6.2). This means that not only are national economies becoming more globalized in that national firms increasingly produce for export, but they are also becoming more globalized in that foreign firms are increasingly involved in countries' export and domestic markets. TNCs have thus not only substituted expanded exports for further growth in domestic sales, but they have also substituted expanded sales by their foreign affiliates for further growth in exports. Thus a world economy previously made up of nations engaged in production and trade through domestic firms is more and more being replaced by a world economy made up of TNCs engaged in production and trade with one another across nations. Beside the old model of trade between nations we now have a new model generally referred to as one involving an international system of production.

Table 6.1 Foreign affiliates sales, gross product, total assets, exports and employment, 1982, 1990, 2001 (constant prices, US$ billion or '000 workers)

	1982	*1990*	*2001*
Sales of foreign affiliates	2541	5479	18,517
Gross product of foreign affiliates	594	1423	3495
Total assets of foreign affiliates	1959	5759	24,952
Exports of foreign affiliates	670	1169	2600
Employment of foreign affiliates ('000)	17,987	23,858	53,581

Source: Adapted from UNCTAD (2002: 4).

Table 6.2 FDI, GDP, and export growth rates (percentage)

Item	*1986–1990*	*1991–1995*	*1996–2000*
FDI inflows	23.6	20.0	40.1
FDI outflows	24.3	15.8	36.7
GDP (in current prices)	11.5	6.5	1.2
Exports	15.8	8.7	4.2

Source: Adapted from UNCTAD (2002: 4).

When corporations establish foreign affiliates, they do so through FDI, either by creating entirely new facilities (termed greenfield investment) or, more commonly, by purchasing existing firms and/or existing facilities through mergers and acquisitions (M&A). For 1999, the latter form constituted over 75 percent of total FDI, most of which was in the form of acquisitions rather than mergers, and two-thirds of which involved TNCs acquiring 100 percent interest in the acquired firm (UNCTAD 2000).[2] Thus when TNCs locate in other countries, they generally fully acquire existing national firms. This provides them with established production and/or distribution systems, including supplier networks, and any history of regulatory compliance. It also generally involves them taking over acquired firms' employees together with a history of the acquired firm's past labor agreements and expectations of management regarding those agreements.[3] In this way, TNCs acquire earnings streams additional to those from their existing production, and – should they choose to introduce their own products alongside the continued manufacture and sale of acquired firms' products – they also gain the opportunity to produce and distribute their products where they may have been unable to do so before, either because of tariff and non-tariff structures, brand recognition problems, and/or the ability of host country firms to exclude competition from foreign firms. Thus expansion in other countries constitutes a broad-based strategy for TNCs long-term development the logic of which is likely to be sustained in the future.

TNCs are often ranked according to total foreign assets, since this gives an indication of the scope of their reliance on foreign affiliates. But a preferred measure of TNC multinational status, provided by the United Nations Conference on Trade and Development (UNCTAD), is the transnationality index (TNI) which is calculated as the average of three ratios: foreign assets to total assets, foreign sales to total sales, and foreign employment to total employment (UNCTAD 2002). To see what the index involves (see Table 6.3), note that Vodafone, the UK telecommunications TNC, was ranked first in 2000 in terms of total foreign assets, but fifteenth according to its TNI. Also, General Electric, the US electrical and electronic equipment TNC, was ranked second in 2000 in terms of total foreign assets, but only seventy-third according to its TNI. TNCs, then, that are simply very large in size, have many foreign affiliates, and have commensurately large foreign assets, may be

Table 6.3 The world's top 10 non-financial TNCs, 2000

Ranking by foreign assets	*Ranking by TNI*	*Corporation*	*Home economy*	*Industry*
1	15	Vodafone	UK	telecommunications
2	73	General Electric	US	electrical and electronic equipment
3	30	Exxon/Mobil	US	petroleum expl./ref./dist.
4	42	Vivendi/Universal	France	diversified
5	84	General Motors	US	motor vehicles
6	46	Royal Dutch/Shell	UK	petroleum expl./ref./dist.
7	24	BP	UK	petroleum expl./ref./dist.
8	80	Toyota Motor	Japan	motor vehicles
9	55	Telefónica	Spain	telecommunications
10	47	Fiat	Italy	motor vehicles

Source: Adapted from UNCTAD (2002: 86).

less integrated into the global economy relative to their size than smaller firms when affiliate sales and employment are considered. This is important for thinking about the internal culture and global view of different TNCs, since TNCs that have high TNIs probably have accumulated considerable experience in regard to how to carry out operations in host countries. Conversely, very large TNCs in terms of total foreign assets but with comparatively less extensive foreign sales and employment experience may be misled by their sheer size and tend to underestimate what is involved in foreign operations.

Competing theories of TNCs

There are four main explanations of the nature and behavior of TNCs:

a the market power approach;
b the transactions cost internalization approach;
c the Dunning eclectic paradigm; and
d the technological accumulation approach.

Market power approach

Steven Hymer's 1960 MIT PhD dissertation initiated theoretical investigation into TNCs and FDI (Hymer 1960). Hymer argued that neoclassical capital arbitrage theory of portfolio flows was inadequate for explaining the behavior of TNCs as firms and consequently also the long-term capital flows that these firms carried out. He focused on firms' efforts to acquire market power, and argued that, while firms increase their share of domestic markets in the early stages of growth by means of mergers and extension of capacity, at some

point they begin to invest monopoly profits earned at home in foreign operations. They thus strive to transfer the levels of concentration they have achieved domestically to foreign markets. Hymer's focus on firms helped to generate a new, interdisciplinary field of international business studies that emphasized realism and evidence, and amounted to an attempt "to escape the intellectual straitjacket of neoclassical-type trade and financial theory" (Dunning and Rugman 1985: 228). On this view, TNCs had two motivations for carrying out FDI. One was to try to reduce or eliminate international competition, and thereby establish monopoly advantages on a global basis. The other was to increase the returns from the particular advantages that they already possessed in home country markets through the creation of cost-reducing supplier networks that further increased monopoly profits.

Charles Kindleberger interpreted Hymer's thinking more in terms of the industrial organization tradition, employing the traditional structure-conduct-performance model of markets (Bain 1956). TNCs are seen to arise in certain types of market structures, and are less seen as agents involved in oligopolistic interaction actively creating barriers to entry and colluding with other firms in their industries. As he put it, "The nature of monopolistic advantages which produce direct investment can be indicated under a variety of headings – departure from perfect competition in goods markets, departure from perfect competition in factor markets, internal or external economies of scale, government limitations on output or entry" (Kindleberger 1969: 13). Kindleberger then added to this the idea that TNCs were engaged in monopolistic competition over differentiated products. Partly this change in focus reflected a change in the status quo. When Hymer first wrote, the main question to answer was why national firms located operations abroad. Twenty-five years later attention had shifted to how to analyze the advantages of TNCs already operating abroad as well as the way in which international production systems were being organized.

One interesting side to Hymer's work is that he was particularly critical of TNC activities in developing nations, arguing that TNC activity led to a "Law of Uneven Development" in which host countries' interests were subordinated to the interests of advanced nations (Hymer 1972). But the reality in the postwar period was that most FDI was directed toward the advanced countries. Whereas two-thirds of the world's stock of FDI had been located in developing countries in 1938, by the 1970s this share had fallen to about a quarter (Dunning 1983). This meant that much subsequent research on TNCs and FDI focused on the operations of firms in more well-established markets. This produced a change in the kinds of explanations offered to explain TNC behavior and motivations, with the internalization approach emerging as the leading view – associated with Richard Caves, Raymond Vernon, Alan Rugman, Peter Buckley, and Mark Casson.

Transactions cost internalization approach

The internalization approach drew on the transactions cost theories of Ronald Coase and Oliver Williamson, and focused on the efforts that firms made to become more efficient by minimizing transactions costs involved in international activities. The transactions cost framework constitutes a criticism of neoclassical economics that explains trade and investment solely in terms of exchange between independent individuals and/or groups of individuals. On the transactions costs view, when the costs of administered exchange are lower than those of arm's-length market exchange, the market is internalized and efficiency enhanced. Particularly costly to exchange in arm's-length transactions are intangible assets such as technology. Transactions involving technology acquisition are internalized when firms invest in or buy R&D facilities of other firms in other countries. Here technology is treated as being akin to information or potentially public knowledge, which is only one dimension it may assume (Cantwell 1994). Another important dimension of technology are those tacit capabilities that accumulate and become embedded in firms through collective learning processes. TNCs that acquire technology in this sense typically maintain acquired firms' R&D facilities relatively intact to preserve and utilize their embedded technologies. The savings involved stem from not having to buy technologies on open markets but rather in coordinating their development and use through administrative methods.

In the transactions costs approach, TNCs are defined as cost-minimizing organizers of non-market transactions, and opportunities for creating new internal "markets" constitute the overriding motivation for the growth of the firm. However, proponents of the internalization approach also recognize that TNCs may seek to raise profits by restricting competition, and that this may offset the efficiencies associated with overall cost minimization. "Welfare losses arise where multinationals maximize monopoly profits by restricting the output of . . . goods and services . . . where vertical integration is used as a barrier to entry . . . [and] because they provide a more suitable mechanism for exploiting an international monopoly than does a cartel" (Buckley 1985: 119). Nonetheless the internalization approach generally pays less attention to the structure of the final product market in order to focus on more efficient exchange of intermediate products, and thus ultimately shares relatively little with the Hymer market power approach. Indeed, most of the proponents of the internalization approach believe that markets are competitive. One influential individual who nonetheless attempted to combine the two frameworks is John Dunning, whose approach has come to be known as the eclectic paradigm.

Dunning eclectic paradigm

Dunning reasoned in terms of a combination of different types of "advantages" which he believed TNCs sought to act on in foreign locations, and

argued that the different questions one might have about TNCs made attention to one or another of these advantages relevant. Thus, the advantages of internalization were most relevant when concentrating on backward linkages, vertical integration, and resource extraction, whereas the advantages of exercising market power were more relevant when one considered TNCs strategies for competing in final goods markets. Dunning distinguished primarily between competitive or "ownership" advantages which TNCs had vis-à-vis their major rivals – such as are attributable to ownership of intangible assets (entrepreneurial capabilities of managers, reputation and credit worthiness, long-term business agreements with other firms, political contacts, etc.) – and internalization advantages – such as are associated with how more integrated firms are able to coordinate and better realize returns on networks of complementary assets in different countries. That Dunning offers an organizing framework rather than a particular theory of TNCs means that he does not presuppose any specific theory of the firm or definite view of the nature of competition. However, his own view is that competition among TNCs is generally more important than collusion among them: "It is not the orthodox type of monopoly advantages which give the enterprise an edge over its rivals – actual or potential – but the advantages which accrue through internalisation" (Dunning 1988: 32).

Technological accumulation approach

In the technological accumulation approach TNCs are seen to be in long-run technological competition with one another, and the development of technology itself is seen to be a cumulative process (Cantwell 1989). Technology development is a slow, painstaking process that depends upon continual interaction between the creation of new technologies and their use in production. This means that though firms in any given industry are likely to have fairly similar lines of technological development, the particular lines of development they each pursue are nonetheless unique and differentiated. That is, progress takes place in technological "silos". Thus in order to diversify their technological development TNCs use FDI to become global organizers of entire international technology networks that combine different but complementary technology streams from different firms and industries. In this respect, the technological accumulation approach is different from internalization theory which also has been used to explain technology acquisition, since the primary object in this instance is not static efficiency gains in a market for technological knowledge but rather processes of innovation and learning across interlinked R&D centers that as a whole explain the general evolution of technological knowledge.

The technological accumulation approach can also be contrasted with Hymer's market power approach in that the growing connections between technologies produces an increasing technological interrelatedness between TNCs that can be thought to heighten the intensity of competition

between them. One way in which this comes about is in the tendency for TNCs to be attracted to the same leading international centers of innovation where they then compete for the same resources. Collusive agreements in such circumstances tend to be temporary and unstable, and competition through the development of rival technologies may ultimately manifest itself in the form of product differentiation. The view, then, that market power and oligopolistic competition explains TNC behavior may better reflect the earlier postwar experience when FDI was more devoted to the production of standardized products in new national locations, and there were fewer TNCs in competition with one another. For the last two decades, however, the more rapid pace of technology change, combined with ever greater product differentiation tailored to end-users, seems to have led to heightened competition between TNCs on multiple levels.

Five transformational impacts of TNCs on the world economy

The relatively rapid extension of the number of TNCs, their affiliates, and extension in the scope of their operations have had a variety of effects on the world economy, but five transformational effects seem to have been particularly important:

a the establishment of a neoliberal relationship between capital and labor across many of the world's economies;
b the attenuation of comparative advantage as a comprehensive explanation of why countries trade;
c a change in posture of the developing world toward TNC participation in their economies;
d the re-organization of the ownership structure of capital across the world; and
e a fundamental change in the scope for national politics in an increasingly globalized economy.

Establishment of a neoliberal relationship between capital and labor

Globalization is often understood as a process involving increasing integration between countries, peoples, and economies. However, this process of *integration* through trade and capital movements has been an important cause of a parallel process involving the *disintegration* of production and communities (Feenstra 1998). For most of the twentieth century production in the industrialized countries was organized vertically in that materials processing and the early stages of goods manufacture were carried out in the same productive concerns and the same locales as final stage assembly of goods. However, in the 1970s in the US, under the pressure of increasing international competition, large manufacturers began to sub-contract separable stages of the

production process to small, often non-unionized, highly competitive, low profit firms. This set a precedent for more extensive re-organization of the production process, or dis-integration of the value-chain, that was subsequently acted upon by TNCs across international boundaries as trade barriers came down in successive rounds of trade liberalization through the General Agreement on Trade and Tariffs (GATT) and later the World Trade Organization (WTO). Indeed, enhanced information control methods through computers and lowered transportation costs made it possible for firms to subcontract whole stages of the production process to producers across the world. Not only, then, was the production process itself fragmented and transformed, but the social communities tied to formerly integrated production sites were fragmented and disrupted in an economic-social process widely understood as "deindustrialization" (Bluestone and Harrison 1982).

US trade legislation originally facilitated this development through offshore assembly laws that restricted tariffs to only the foreign value-added on US components shipped abroad for further manufacture and subsequent reimport to the US (see US International Trade Commission 1997). A more recent worldwide development is the creation of entire export processing zones (EPZs) or foreign trade zones (FTZs) to which foreign goods can be shipped, further processed, and then re-exported without payment of normal duties and fees. These duty-free zones have become magnets for FDI as countries have expanded them into industrial and science clusters supported by linked infrastructural and human capital investments. Interlocking global networks of these expanded EPZs increasingly constitute TNC-created international production systems in which semi-processed to final goods are shipped around the world multiple times to undergo different stages of manufacture according to national production advantages and government incentives.

The impact on organized labor, especially in the US and the UK, has been significant. Having given up bargaining for wage increases in the period of general economic stagnation in the 1970s, trade unions made job retention their primary objective. But their efforts have only slowed the process of job loss as contracts expired, and firms closed down plants and operations by relocating them both domestically and internationally. Since this often involved the construction of new factories, and since it was believed by many in the US and the UK that much existing domestic productive capacity was obsolete in comparison with that of postwar Japan and Germany, new factories were often designed with new forms of flexible production. Flexible production involves having a capacity to re-structure and re-organize factory-level, shop-floor production methods to respond quickly and efficiently to design changes in products necessitated by changing markets and consumer tastes. From the point of view of labor, however, flexible production meant reduced commitments on the part of firms to wage growth, benefits, and long-term employment. Firms defended this new stand by arguing that *flexible production* in a world of competitive international markets implied a need

for *flexible labor markets*. Neoliberalism constituted the social ideology appropriate to this new state of affairs, because it explained individuals as independent and self-reliant, thereby undermining the view that employers and society more generally had any responsibilities toward employees. Thus an argument can be made that the emergence of neoliberalism at the end of the century is in large part a consequence of the development of an international system of production organized by TNCs.

Attenuation of the comparative advantage explanation of trade

For over 175 years David Ricardo's logic of comparative advantage has been used to explain the basis for international trade. Its full development came in the 1930s in the form of the neoclassical Heckscher-Ohlin theory, which explained that countries specialize in and export goods that are intensive in resources or factors with which they were well endowed relative to their trade partners, while importing goods that are intensive in factors with which their trade partners were relatively well-endowed. This scarcity-based conception had as its chief achievement the explanation of the prices (or the terms of trade) at which goods might be traded internationally. A principal assumption behind the theory dating from Ricardo's original explanation of the principle of comparative advantage is that resources are immobile between countries. When this is the case, countries can differ significantly in their resource endowments, and accordingly find it to their mutual advantage to trade with one another. The mobility and migration of capital through FDI, however, reduces resource endowment differences between countries, and raises the question whether new theories are needed to explain international trade. Indeed in the postwar period a number of new theories about the nature of international trade and the patterns of trade were advanced, including ones that emphasize imperfect competition, product cycles, economies of scale, and differences in tastes and incomes.

For our purposes, however, more interesting is the increasing importance of the distinction between "arm's-length" trade and intra-firm trade. The former involves trade *between* independent firms across national boundaries, and is the subject of standard trade theory. The latter involves trade *within* firms across national boundaries, or more accurately between a firm and its foreign affiliates and subsidiaries in other countries, and thus falls outside the bounds of standard trade theory. "Arm's-length" trade, because it is between independent firms, involves market exchange and market prices. Intra-firm trade, by definition, involves administrative decision-making and transfer prices. While the logic of comparative advantage can be applied to the former, it is not easily applied to the latter. TNCs employ transfer prices for a variety of reasons, including tax avoidance, inter-unit cross-subsidization strategies, and accounting purposes. Though there is no comprehensive theory of transfer pricing, the different explanations which have been offered have very little in common with traditional comparative advantage analysis.

What is important about this distinction is that the increase in the number of TNCs and the spread of their operations through FDI has increased intra-firm trade as a share of total world trade. By some estimates, US trade since the early 1990s has become about 50 percent intra-firm trade, with US TNCs trading with their foreign affiliates and subsidiaries abroad, and non-US TNCs trading with their foreign affiliates and subsidiaries in the US (Graham 1996: 14).[4] The US case, however, differs from that of many other countries, since the strength of the US economy at the end of World War II led to an earlier emergence of outward FDI on the part of US TNCs. Thus, in the world as a whole, closer to a third of total imports and exports has been estimated to involve intra-firm trade (UNCTAD 1994). Arguably this share will continue to rise in the future, as TNCs from other countries become increasingly important, so that traditional trade theory will not only explain a decreasing share of world trade, but also fail to explain that type of trade arising from one of the most dynamic processes in recent years, the dramatic increase in TNC FDI activity.

Change in posture of the developing world toward TNCs

When Hymer first initiated serious investigation into the subject of TNCs and FDI in 1960, developing countries by and large subscribed to the neo-Marxist view that TNCs were agents of industrialized countries' imperialism. They reasoned that TNCs which were set up in their countries were engaged in a process of exploitation that involved removing more value than they created. Among the arguments for this were that resource extraction and agricultural production were carried out under agreements that paid far less to host countries than the value they created, that labor was paid wages lower than was paid in industrialized countries, that profits were always repatriated and never invested locally, and that host countries were compelled to subsidize TNC infra-structural needs without adequate compensation. Indeed, to the extent that TNC FDI in developing countries in the postwar period until relatively recently was predominantly for resource extraction and agricultural production, there was some truth to many of these arguments.

However, the increasing disintegration of manufacturing production in the industrialized countries (as explained above) has meant that recent FDI now involves a significant export of capital for manufacturing purposes. This combined with higher rates of technical advance in manufacturing has meant that the location of new plants and factories through FDI typically involve technology spillovers to host countries. These may arise from the training of local work forces to technology-sharing with local suppliers to "reverse" engineering learning opportunities created by the presence of new products and methods. Developing countries, then, have generally reversed their past thinking about the presence of TNCs in their economies, and sought to compete internationally for FDI flows.[5] For a number of reasons, however, many countries (particularly in Africa) have to date been relatively unsuccess-

ful: their relative states of underdevelopment have often made them costly locations for foreign firms, despite their low wages; markets to which TNCs expect to supply goods are concentrated in the industrialized countries, making location closer to those markets advantageous; and, technology gains *to* TNCs from locating where technical progress is high are unavailable in most developing countries.

One important consequence of this is that growth rates between the advanced economies and the developing world continue to widen. Moreover, the fact that the extent and depth of poverty in the developing world seems to be becoming more intractable may lead to political instability, and thus create further disincentives to TNC operations and FDI there. Thus while recent *World Investment Reports* indicate an increasing number of countries have significant inward FDI flows, they also show that the share of FDI going to the poorest nations and regions of the world such as Africa is constant or decreasing. With government-to-government aid a very limited source of development support at the end of the twentieth century, the lowest income developing countries face particularly poor prospects for the future.

Re-organization of the ownership structure of capital across the world

Keynes argued in *The General Theory* (1936) that the first decades of the twentieth century saw a fundamental change in the way in which investment was carried out in the industrialized economies on account of the increasing separation of management and ownership in business firms. Whereas most firms at the end of the nineteenth century in the UK were owner-operated, in the space of a few decades professional managers had largely replaced owners, many of whom had lost their commitment to those firms in which they and their families had previously been involved. This increased the importance of stock exchanges as a vehicle for the pursuit of gain through the buying and selling of stocks by those who had inherited wealth – a new rentier class as Keynes termed it. Keynes's concern was that this change had produced an increase in speculative activity in capitalist economies, and that this led to greater instability in business investment and greater likelihood of business downturns. A parallel but slightly different state of affairs can now be argued to obtain in the more globalized postwar world economy. Whereas Keynes's experience was that of the creation of a *national* rentier class, our present experience is that of the creation of an *international* rentier class.

One fundamental change in recent decades is the increased ease of access for investors to different national stock exchanges and other property acquisitions, combined with a tendency toward centralization of national exchanges across borders as international exchanges. Though there remains a significant national bias in individuals' stock holdings, the tendency toward liberalization of rules for foreign participation in national stock exchanges (for example recently in Japan) opens up the possibility that the future will increasingly be

characterized by a class of international wealth-holders with little or no loyalty to any particular collection of national firms. This contrasts with Keynes's experience, where if investor attachment to particular firms could no longer be expected, nonetheless wealth-holders generally retained an attachment to national firms. Evidence of the more general problem of capital mobility this can produce can be found in the 1997 Asian financial crisis when large amounts of capital were quickly withdrawn from a number of the most dynamic East Asian economies when exchange rate depreciations appeared to be at hand. In contrast to short-term portfolio capital flows, much of this involved capital that took the form of lending to Asian banks, which had then made loans to domestic firms which in turn put up their equity as collateral (Eichengreen 1999). However, as it turned out, this foreign lending typically included contractual "escape" clauses, whereby foreign lenders could demand immediate re-payment of loans from banks in the event of significant changes in key national indicators, and banks were forced to demand repayment of the loans they had made to their customers. Essentially, then, the Asian crisis was a product of the mobility of highly footloose international capital in pursuit of gains unavailable in domestic markets. This suggests that international financial crises are likely to become more rather than less common in the future, with "contagion" risks across economies increasingly a problem.

Fundamental change in the scope for national politics

Dani Rodrik (2000) has argued that the world social-economic system is caught in an international trilemma involving fundamental choices over what form politics and economics will take in the future. His trilemma argument is that only two of the three following things can be combined in the future global system: survival of the nation state, the continuance of democratic or "mass" politics, and the integration of national economies. The immediate postwar period combined the nation state and mass politics in what Rodrik labels the Bretton Woods compromise. Global economic integration was limited to what was compatible with there being relatively independent national economic policies, which themselves were generally responsive to popular political pressures. In particular, capital mobility was highly limited. The current period is closer to what has been called the "Golden Straitjacket" (Friedman 1999). Here it is mass politics which seems to have been curtailed as nations pursue liberalized trading regimes, and compete with one another for FDI, irrespective of whether this may involve job loss and erosion of social safety. Finally, a third possibility for the future is that mass politics will be re-established on a global, non-national basis through a variety of types of international political organizations, global economic integration will proceed apace, but the nation state will become increasingly irrelevant.

What does the future hold in Rodrik's view? On the one hand, it seems that the world cannot go back to the past and the Bretton Woods compro-

mise without significant disruption, since capital mobility and the current more liberalized world trading regime have dramatically transformed almost all of the world's economies, while creating GDP growth resulting in higher per capita income levels in many countries. On the other hand, the scenario that Rodrik prefers – that politics become global to catch up with an economic system that has become global – strikes him as utopian at the current point in time. This leaves the "Golden Straitjacket" which combines a globalizing world economy with nation states in competition with one another. For Rodrik, however, this is an unstable and unlikely permanent outcome, since it sacrifices democratic and mass politics which are deeply embedded in the history of the advanced economies. It also further threatens safety nets, and jeopardizes countries' cultural and social traditions. At the same time, nations' competition with one another for trade and FDI will almost certainly continue. Thus how politics and economics combine in the future is unclear, and perhaps the only thing one can be confident about is that the nation state will be a site of social conflict between those who regard it as a vehicle for countries' competition in the international economy and those who see it as having evolved not only as a democratic institution, but as the only significant means for democratic politics in the world today.

In this contest, TNCs are likely to be at the center of controversy. As intrinsically hierarchical institutions, they share little with the democratic political process. Yet as foreign firms they have a need to accommodate themselves to national priorities in the countries in which they locate, suggesting that they will at least attempt to engage national political constituencies. One complicating factor in this regard is the fact that many TNCs are economically close in size (measured in terms of sales) to the nations where they locate (measured in terms of GDP). Another complicating factor is that as specifically multinational firms, TNCs have multiple allegiances. In any event, what seems clear is that as agents of change in the global economy, TNCs will continue to play a major role in the future fortunes of nation states and democratic politics.

Conclusion

Many see the dramatic increase in FDI and TNC activity as evidence that TNCs are relatively autonomous agents in the world economy that are able to pursue their goals largely as they choose. But it may also be argued that TNCs are constrained and influenced in considerable degree by governments and social-political interests that seek to act on agendas contrary to TNC interests. One such example are the efforts of the US government to discourage foreign TNCs from carrying out activities in Cuba. US Cuba-phobic policies have been contested not only by foreign TNCs but also by their source-country governments. Further, foreign affiliates of US TNCs wishing to do business in Cuba find themselves at odds with US foreign policy. Thus, rather than being relatively autonomous agents, TNCs often find themselves

in circumstances such as these being caught up in conflicts between countries. Another example concerns NGO groups worldwide that seek to achieve their goals on a variety of social and environmental issues by applying pressure to TNCs. Since TNCs are often the visible agents of change in the countries in which they operate, NGOs have frequently worked to change the character of TNC operations and practices, especially when host countries themselves are reluctant to do so. These and other examples suggest that TNCs may often find themselves involved in operations less profitable and successful than originally anticipated when the FDI that created them was undertaken. In this regard they may well be worse off than domestic firms whose political support in their home countries is generally stronger. One might suppose that these types of insecurity would lead to TNCs being more mobile and less committed to long-term involvements in their foreign locations. Against this is the fact that long-term commitments are usually extracted in one form or another by host countries interested in stable economic growth, and that FDI investments are by nature long-term. Thus TNCs have important sources of social and political vulnerability that argues for a more moderate view of their autonomy in the world economy.

A final issue in regard to the influence that governments and countries have vis-à-vis TNCs concerns possible changes in the structure of world trade. Historically world trade has been dominated by trade in intermediate rather than final goods, reflecting national differences in countries' resource endowments and greater degrees of manufacturing development in the industrialized countries. But increasingly – with lower worldwide transportation and communication costs – production processes that transform intermediate goods into final goods are "footloose" or mobile among countries with newly industrializing economies (especially in EPZs) seizing larger shares of this type of production. Partly this reflects the greater importance of the "product cycle" in the development of goods across international markets, and partly it reflects the improved infrastructural capacities of the newly industrializing economies that were previously unattractive sites for FDI and new TNC operations. What this implies from a trade theory perspective is that the principle of comparative advantage – which has greater scope when international markets trade final goods – has now to be accompanied by the emphasis on the principle of absolute advantage, where this concerns relative labor costs and the provision of social overhead capital. Countries, then, that are low in the former respect and more able to address the latter stand to gain in capturing "footloose" production. This trend is likely to be reinforced as the advanced countries seek to be specialized in the most technologically sophisticated goods, thus giving up their earlier concentration in more "mature" final goods whose technologies are more easily copied by new producers. What this development implies for TNCs is that they will be pursued actively by newly industrializing economies that seek to climb the ladder of industrial development. TNC production affiliates offer faster start-ups than home-grown firms, and with technological spillovers leave permanent improvements in domestic production capacity.

TNCs, therefore, will likely experience an increasing importance in the world economy combined with greater controversy over their roles in host countries. Their central role in globalization is now fully recognized, and many across the world today see them as the source of problems and/or as an opportunity for leveraging the process of globalization. This integration into future political, social, and developmental scenarios makes a fully economic analysis of TNCs shortsighted. Rather TNCs need to understood in political-economic terms, influencing and being influenced by the changing social and political organization and evolution of the international economy.

Notes

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1 In addition, TNCs carry out activities associated with a variety of types non-equity relationships (e.g. joint ventures, international subcontracting, licensing, contract manufactures) that indicate further impact.

2 However, the small share of world FDI going to less developed countries is predominantly greenfield investment. This reflects higher levels of investment in primary product industries, and the smaller numbers of firms in less developed countries that might be acquired.

3 Thus M&A FDI does not generate substantial employment gains. The smaller share of FDI in the form of greenfield investment does increase employment.

4 This has interesting implications for the US trade deficit, since it means that a significant share of the large volume of imports that contributes to that deficit are produced by the foreign affiliates of US firms that export goods back to the US. That is, in part the trade deficit is due to US firms selling to their US customers from foreign locations rather than domestic ones, suggesting that the US appetite for "foreign" goods is to some extent simply an appetite for "US" goods produced in foreign locations.

5 One factor in this regard has been widespread abandonment of the import-substitution paradigm of development in favor of the export-competitiveness paradigm. FDI is seen as the easiest way to create export platforms. China is an excellent example in this respect.

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