

C EXTENDED ESSAY

The Global Political Economy of Transnational Corporations

A theory of asymmetric interdependence

ANDREAS JARBLAD

Department of Business Administration and Social Sciences
Division of Political Sciences - History - Geography
Supervisor: Nils-Gustav Lundgren

Table of Contents

Dedication	1
Acknowledgements	2
Introductory Part	
Introduction: Problem Discussion and Initial Theoretical Background	3
The Political Economy of Globalisation	3
Where Do We Stand? The Traditional View of the Interrelation	4
<i>The Obsolescing Bargain</i>	4
Purpose and Research Questions	7
Research Method	8
Thesis Outline	8
Notes	9
Part One: Theoretical Framework	
Chapter 1: Transnational Corporations and Foreign Direct Investment	11
What Is a Transnational Corporation?	11
Explaining TNCs: Theories of Foreign Direct Investment	12
<i>The Eclectic Paradigm</i>	13
<i>Strategic Management and the International Value Chain</i>	15
<i>Managerial Structures and Locational Choices of Global Transnationals due to Strategic Theory</i>	16
The Transnational Corporation in the International Economy	18
Notes	20
Chapter 2: Transnational Corporations and States in a Global Economy	22
The Benefits of Foreign Direct Investment	22
<i>Policy Implications</i>	24
<i>A Second Look at the Bargaining Relation</i>	25
Notes	28
Part Two: Empirical Testing	
Chapter 3: Empirical Research: Examining the Perceived Policy Implications	30
Method and Selection of Representative Respondents	30
Interview Results Summary	32
<i>The Politics of Economic Growth</i>	32
<i>The Political Role of Foreign Direct Investment</i>	33
<i>The Task of Attracting Direct Investment</i>	34
<i>The Interdependency Relation</i>	36
Notes	38
Part Three: Asymmetric Interdependence	
Chapter 4: Final Analysis and Discussion of Results	40
Reconsidering the Bargain	40
Asymmetric Interdependence: A Function of Relative Scarcity	41
<i>Considering the Strategic Incentives of States for Competitive Bidding</i>	43
Outcome of the Theory	46
Wider Implications of the Asymmetry	48
Notes	49
References	50
<i>Bibliography</i>	50
<i>Interviews</i>	53

Till Daniel,

*För alla de livliga diskussionerna och filosofiska samtalen
genom åren, såväl som de sorglöst verbaliserade tankarna om
livets många besynnerligheter och timmarna vid schackbrädet.*

Acknowledgements

There are many people who need to be mentioned, and to whom I am truly grateful. These are people who have supported and encouraged me, during this writhing or in other times. First, I would like to thank my supervisor Jan-Eric Jacobsson for interesting discussions on the theoretical reasoning of the thesis and on the wider implications of my theory. Additionally, I would like to thank the respondents for taking their time to meet with me despite busy schedules: Dr Lars Heikensten, Governor of the Riksbank; Lotta Fogde, state secretary at the Ministry for Foreign Affairs; Sven Hegelund, state secretary at the Ministry for Finance; Anders Sundström, former Minister for Industry, Employment and Communications; Kurt Hellström, President of Telefonaktiebolaget LM Ericsson and Malin Persson, Head of Corporate Strategy and Business Development, AB Volvo. Needless to say, this thesis would not have existed without your participation. I would also like to thank Jörgen Centerman, former CEO of ABB, Switzerland, and Mike Rance at Astra Zeneca, UK, for great assistance with the interviews that in the end were not possible to carry out.

For encouraging me to press ahead with postgraduate research in international political economy I would like to thank Håkan Myrlund, Division of Political Sciences, Luleå University of Technology; Christer Berglund, Division of Economics, Luleå University of Technology; Dr Kara Shaw, SPIRE at Keele University; Dr Beate Jahn, University of Sussex; Marga Lyall, Department of Politics and International Relations, Oxford University; Massimo M Beber, Cambridge University, and Professor Robert G Gilpin, Princeton University.

I would also like to acknowledge my family; Berth, Lena, Daniel and Simon for their never ending encouragement and support, and Jörgen Grahn, Piteå, for an indefatigable, inspiring friendship.

Andreas Jarblad

Svensbyn, a cold evening in January, 2003.

INTRODUCTION

Problem Discussion and Initial Theoretical Background

THE POLITICAL ECONOMY OF GLOBALISATION

According to Cohn, globalisation is a process that has two major aspects: “the broadening and deepening of interactions and interdependence among societies and states throughout the world.”¹ He points out, in regard to broadening, that globalisation extends geographical linkages to include virtually all major societies and states. As a consequence, events and policies adopted in one part of the world tend to have major impact on distant locations. In regard to deepening, he illustrates how globalisation increases the frequency and intensity of interaction and interdependence. Globalisation contributes to fundamental changes in the relationship between markets and states. Globalisation is an “economic process with political consequences.”²

The transformation of the definition of globalisation exposes the extent to which it has proceeded in the last decades. If we glance at the 1970s, globalisation was by political scientists seen only as the increasing interdependence among states.³ Today interdependence among nations has increased even more but despite that, state interdependence is of less central interest. This is a world where borders are less consequential, where products and services are crossing borders at an increasing rate, supplying the needs and wants of consumers, business and other organisations in a variety of ways and across a variety of geographic and cultural locations.⁴ Now attention turns to other powerful global actors such as *transnational corporations* (TNC) and international financial institutions.

Globalisation today is by some argued to be much of a triadisation. The process of integration is at its most intense among the three regions that contain most of the world’s developed market economies: North America, Western Europe and East Asia.⁵ The states in these regions are the main sources of initiating *foreign direct investment* (FDI), and the main part of their own FDI is directed within the “triadised” nations. For example, in 1995 the developed market economies accounted for 92.2 percent of the outward stocks of foreign direct investment, and for 72.1 percent of the inward stocks of FDI. The international trade flows are also dominated by the nations within these regions, and trade significantly more with each

other than the rest of the world. Asia, North America and Western Europe accounted for 84.2 percent of global merchandise exports in 1993, and then also 90.2 percent of world manufactures exports.⁶

The globalisation of markets is well documented,⁷ and has been defined through emphasizing (1) *convergence*; the trend within the Triad that production financial and technology structures are becoming increasingly uniform. Additionally, consumer tastes within these countries have become substantially homogenous, generating global markets and global products. Tariff rate differentials have lessened, as well as corporate tax differentials. Another indication of the globalisation of markets is what is commonly referred to as (2) *synchronisation*. By synchronisation is meant the “tandem-moving” tendency among the Triad countries, which increasingly experience similar business cycles, a development which has been hastened by various intergovernmental agreements concerning monetary, exchange rate and fiscal policies. Additionally, the microeconomic and structural policies have become considerably similar; liberalisation, privatisation and deregulation is applied in order to encourage development and growth. *Interpenetration* (3) refers to the increasingly central economic importance of trade, investment and technology flows within the economies of the world. It is important to be aware of this development, in order to fully understand the environment in which the transnational corporation now operates.

WHERE DO WE STAND? THE TRADITIONAL VIEW OF THE INTERRELATION

The Obsolescing Bargain

The “Obsolescing Bargain” model, developed by Vernon,⁸ explains the interrelations between TNCs and host countries as a function of goals, power resources and constraints of each party. This model makes the assumption that each party possesses assets valuable to the other, and each party is able to withhold these assets. Each party is also constrained in its exercise of this power, and the party with the larger actual bargaining power gains a larger share of the benefits. This game is positive sum, so that both parties may win absolutely, but only one can win in relative terms.⁹ This theory, which has been used extensively in IPE¹⁰ studies of transnational corporations, implies that TNC/host state relations are dynamic and evolve over time. Before the TNC has established in a country, the host Government’s bargaining position is assumed to be weak. Since investments in a new country always are related to uncertainty,

and given the reality that the transnational corporation is likely to have other potential investment sites available, the host will be forced to offer concessions in order to attract the FDI project. According to the model of the obsolescing bargain, this power shifts once the investment has been made, due to dissipation of uncertainty, commitment of immobile resources and an increasing independence of the host on the TNC for capital, technology and access to markets:

“Once invested, fixed capital becomes ‘sunk’, a hostage and a source of bargaining strength. The high risk associated with exploration and development diminishes when production begins. Technology, once arcane and proprietary, matures over time and becomes available on the open market. Through development and transfers from FDI the host country gains technical and managerial skills that reduce the value of those possessed by the foreigner.”¹¹

Thus, according to the theory of the obsolescing bargain, the host government is thought to gain relative power as the overall domestic economy has developed due to the FDI package. However, the host is thought to have further incentives to renegotiate the bargain, in order to gain more of the potential benefits. Consequently, the TNC need to try to keep the host dependent on it for new technology, products or access to export markets. The alternatives are obviously to exit or give in to state demands.¹²

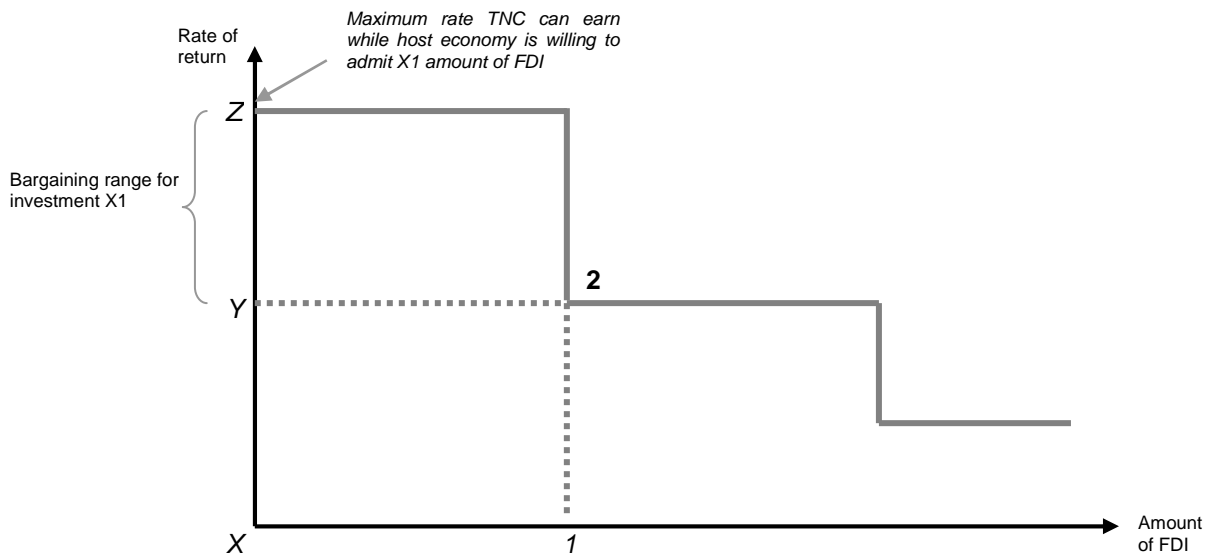


Figure 3.1 A model of the bargaining relationship between TNCs and states.

Figure 3.1 illustrates the bargaining relationship between transnational corporations and host states.¹³ The vertical axis indicates the rate of return which a firm may seek for the X1 amount of direct investment (as indicated on the horizontal axis). Thus, the range within which the bargain may vary is between XY and XZ. XY indicates the lower limit –the minimum rate of return that the TNC is prepared to accept in investing an X1 amount. XZ constitutes an upper limit, indicating the maximum rate of return that the TNC can obtain, given the X1 amount of proposed investment.

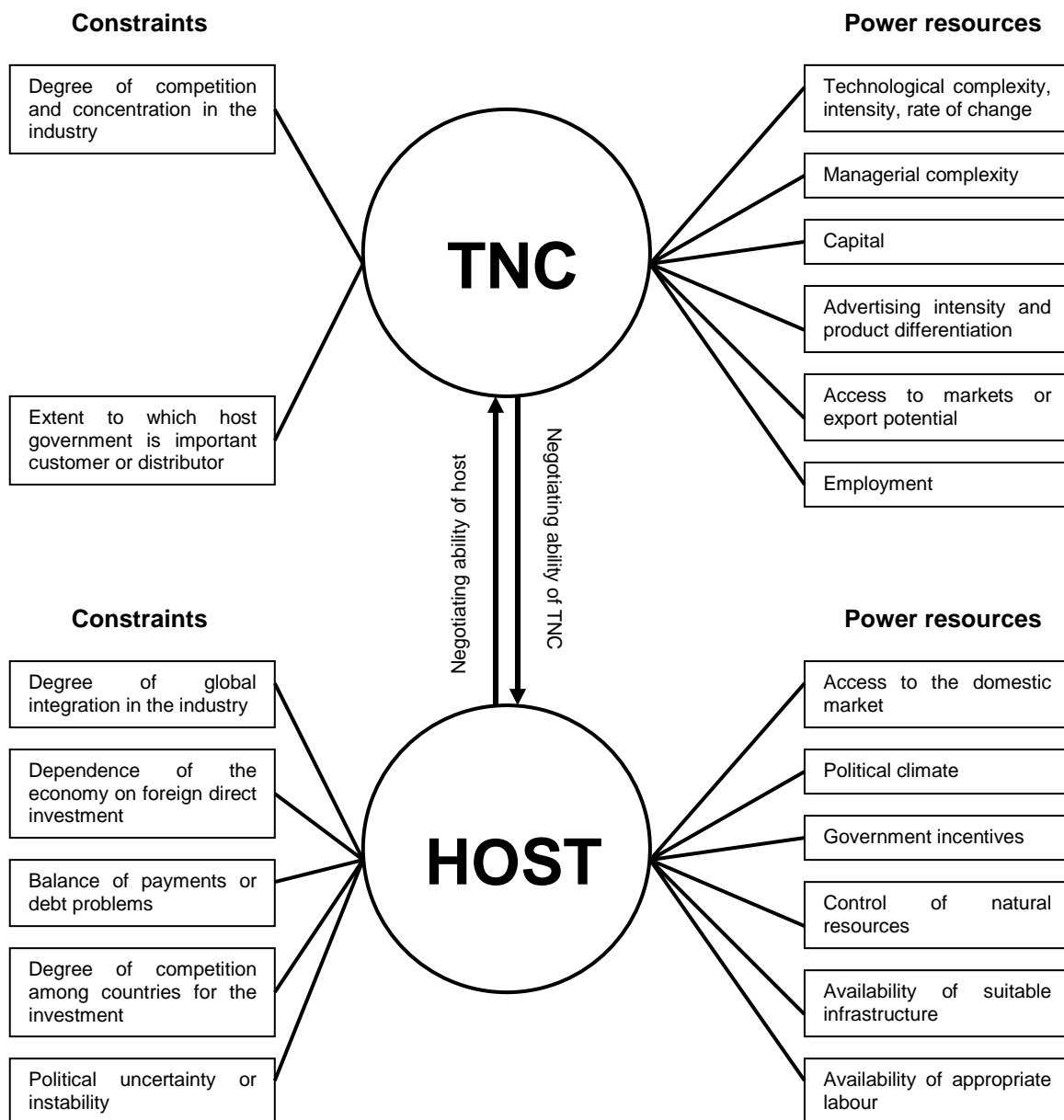


Figure 3.2 A model of the bargaining relationship as a function of power resources and constraints.

It is the upper limit that is of most interest in this study. Both parties are concerned with pushing the upper limit upwards (the TNC) or downwards (the state), in order to strengthen their bargaining position. Exactly which point on the vertical axis that will be the outcome of the bargain is determined by the power resources and constraints of the parties. The higher the host states' competitive advantage is, the lower is the upper limit, i.e. the more possibilities the host economy has of finding alternatives (which are expected to increase through creating an advantageous investment climate), the stronger is their bargaining position.

However, as is evident in figure 3.2, the constraints of the state are significantly more extensive than are the constraints of transnational corporations.¹⁴ This is due to the potential flexibility of the TNC in switching its operations between alternative locations. Obviously, the TNC may also be forced to make concessions if it needs to invest in a particular location controlled by the host government. States that control relatively large, attractive domestic markets have a considerably stronger bargaining position vis-à-vis a market-oriented TNC than does a state with a small domestic market.

PURPOSE AND RESEARCH QUESTIONS

The purpose of this thesis is to examine the interdependency relation between the transnational corporation and the state, as actors in the international political arena. The objective is to formulate a conclusion, or a theory, that to some extent explains the nature of this relation in regard to power, where power is defined as the ability to significantly influence the other actor's behaviour in a way that might even, to some extent, conflict with the preferences of this actor. Not only will the "obsolescing bargain" model, that examines the relation in a particular situation, be re-examined; the theory will also attempt to explain this interrelation on a long-term basis from a system perspective, that is, the power relation between transnational corporations as a group and states as a group. Thus, the research questions are:

- (1) *Is the obsolescing bargain model accurate?*
- (2) *Can the interdependence between states and transnational corporations as actors in the international political arena be characterized as asymmetric and, if so, why is it asymmetric and in what way?*

With this thesis I assert an altered structure of the interdependency, characterizing it as asymmetric, due to the nature of today's transnational corporations, which to more extent than ever are geographically flexible between different localisations, co-ordinating production on a global scale, and with a great economic local impact of their activities.

RESEARCH METHOD

The thesis is based primarily on literature studies and in-depth research interviewing. The interviews were semi-structured and were organized around the following topics: (1) the priority of economic growth on the political agenda; (2) the political ambition to attract foreign direct investment; (3) the implications for the interdependency between transnational corporations and states of (a) globalisation of markets (b) global location strategy among TNCs, and (c) the economic benefits of FDI. A more thorough description of the methodological aspect of the research is given in chapter three.

THESIS OUTLINE

The thesis is divided into three parts. First is a theoretical part, consisting of two chapters dealing with the nature of the transnational corporation (chapter 1) and the dynamics between TNCs and states, particularly concerned with the benefits of foreign direct investment (from a state perspective), the bargaining relation and the phenomenon of competitive bidding for FDI among states.

The second part of the thesis is an empirical part, which examines the perceived benefits and policy implications, as well as the interdependency, through in-depth research interviews with central decision makers in the political as well as the corporate sphere.

These two parts are followed by an analytical part, which will attempt to answer the research questions and put together an assumption of how the interdependency can be characterized as asymmetric. Furthermore, some wider implications of this interrelation are being discussed.

NOTES

¹ Theodore H Cohn, *Global Political Economy –Theory and Practice* (Addison Wesley Longman, 2000), p 10.

² Anthony G McGrew and Paul G Lewis “Global Politics: Globalisation and the Nation-State” (Cambridge: Polity Press 1992).

³ Christer Jönsson, *Internationell Politik* (Lund: Studentlitteratur 1992), p. 180.

⁴ Esmail Salehi-Sangari and Tim Foster, “Curriculum Internationalisation”, in *European Journal of Marketing* (vol. 33, 7/8 1999), p 760.

⁵ See for example Riccardo Petrella: “Globalization and Internationalization: The Dynamics of the Emerging World Order”, in Richard Boyer and Daniel Drache, eds: *State, Against Markets: The Limits of Globalization* (London: Routledge 1996), pp. 77-78.

⁶ United Nations, World Investment Report, 1996, pp 239-247.

⁷ See for example Yves Doz, *Strategic Management in Multinational Enterprises* (Oxford: Pergamon Press, 1986), Ch. 6; Investment Canada, “The Business Implications of Globalisation”, *Investment Canada Working Paper Series No. 1990-V* (Ottawa: Government of Canada, 1990); United Nations Center for Transnational Corporations, *Transnational Corporations in World Development* (New York: United Nations, 1988), Part. 1.

⁸ See Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of US Enterprises* (New York: Basic Books, 1971), pp. 46-59; and *Storm Over the Multinationals* (Cambridge, MA: Harvard University Press, 1977), pp. 151-173.

⁹ Lorraine Eden, “Bringing the Firm Back In: Multinationals in International Political Economy”, in *Millennium Journal of International Studies* (vol. 20, No. 2 1991), pp. 200-201.

¹⁰ International Political Economy is commonly referred to as “IPE”.

¹¹ S. J. Kobrin, “Testing the bargaining hypothesis in the manufacturing sector in developing countries”, in *International Organisation* (vol. 41 1987), pp. 611-612.

¹² Eden, *op. cit.*, in note 10, pp. 200-201.

¹³ The figure is extracted from F. Nixon, “The political economy of bargaining with transnational corporations: some preliminary observations”, in *Manchester Papers in Development* (vol. IV 1988), pp. 377-390, as set forth in Peter Dicken, *Global Shift: Transforming the World Economy* (London: Paul Chapman Publishing, 2001) p. 271.

¹⁴ The figure is, as modified by the author, extracted from S. J. Kobrin, “Testing the bargaining hypothesis in the manufacturing sector in developing countries”, in *International Organisation* (vol. 41 1987), pp. 609-638.

PART ONE

THEORETICAL FRAMEWORK

CHAPTER ONE

Transnational Corporations and Foreign Direct Investment

WHAT IS A TRANSNATIONAL CORPORATION?

The largest transnational corporations can in many ways be considered main agents of globalisation. These firms produce and distribute goods and services across national boundaries, spread ideas, tastes and technology throughout the world and plan their operations on a global scale. It has been said that these powerful corporations "...now dominate all the underlying structures of the global economy: production, finance, technology, security, energy and trade."¹⁵

The importance of the transnational corporation in a global economy has been stressed by contributors across the range of social sciences. Many analysts argue that the critical problem in the study of international political economy today is the tension between states and transnationals, not states and markets.¹⁶ According to Gilpin, a transnational¹⁷ corporation tends to be of oligopolistic nature and its ownership, management, production, and sales activities extend over several national jurisdictions.¹⁸ Dicken lists three basic characteristics for this global corporation: it co-ordinates and controls various stages of individual production chains within and between different countries, it has a potential ability to take advantage of geographical differences in the distribution of factors of production (e.g. natural resources, capital, labour) and in state policies (e.g. taxes, trade barriers, subsidies, etc.) and it has a potential geographical flexibility -an ability to switch and reswitch its resources and operations between locations on an international, or even global, scale.¹⁹ The transnational corporation is by Dicken, and many other contributors to the field, claimed to be the primary 'mover and shaper' of the global economy. The TNCs' decisions to invest or not to invest in particular geographical locations and the resulting flows of capital, materials, components and finished products, as well as of technological and organisational expertise are clearly essential to economic development and welfare in areas in which these corporations operate.²⁰

The technical definitions of transnational/multinational firms are many and to some extent varied. The United Nations defines a TNC as an enterprise that controls assets such as factories, mines, sales offices and so on, in two or more countries (UNCTC 1988). The use of the term "transnational" is intended to make a distinction between foreign-owned affiliates

specifically linking with TNCs and those joint ventures aimed at achieving regional integration between neighbouring countries. TNCs are usually defined as firms that control assets in at least two countries, but some writers argue that there must be more of an international presence. Vernon, for example, argues in his classic study on multinational firms that only enterprises with manufacturing subsidiaries in at least six countries are “entitled to” the MNC label.²¹ The reason for favouring more restrictive definitions are often due to a belief that the most important investment issues relate to the largest firms, which establish a number of foreign affiliates as part of a global strategy. This is also the author’s opinion, and in this thesis the term “transnational corporation” will be used as a reference to a very large firm of a particular nationality with partially or wholly owned subsidiaries operating within several countries coordination foreign direct investment (FDI) projects in which it has management rights or other significant control. This exclusion of several internationally active firms is not a problem for the relevance of the thesis; already in 1988, when Dunning asserted the “new style MNE”, the 500 largest transnational corporations accounted for about 80 percent of all foreign production and had sales turnovers well over \$ 100 billion.²²

EXPLAINING TNCs: THEORIES OF FOREIGN DIRECT INVESTMENT

The literature dealing with the phenomenon of transnational corporations in the various stages of its historical development and the causes of foreign direct investment is, to put it mildly, extensive. I will here deal with the perhaps most influential theory of FDI, put forward by the British scholar John H Dunning who attempted to provide a general explanation of the TNC with his eclectic theory of foreign direct investment.

Additionally, a strategic theory of FDI mainly identified with Porter’s extensive empirical research on the firm as a strategic player in the game of international economic competition, and have come to infiltrate the former eclectic paradigm, is considered.

Fundamentally, to understand FDI, there are two questions that require to be answered. First, given a demand for a certain good in country A, why is it not met either by (1) local firms in A, or (2) exports from country B. Second, we need to understand why a firm in country B that wishes to expand does not (1) produce more of this good in country B and export it to country A, (2) expand into some other line within B, (3) commence portfolio investment in country A, or (4) licence a firm in country A to use its technology in producing this good? An empirical

study allows us to understand that subsidiaries owned by the firm in country B but active in country A producing this good has some competitive advantage in comparison with other potential suppliers and that the profits from FDI apparently exceed those from alternative market entry modes, but an empirical analysis does not explicitly let us know why. An extensive amount of literature has been written, trying to explore the rather complex issue of why firms become TNCs or, in other words, the fundamental causes of foreign direct investment.

The Eclectic Paradigm

Dunning identified two central weaknesses in the literature in his survey of international production in 1973.²³ These were (1) the failure of the various approaches to isolate the determinants of international production at the levels of the firm, industry and country, and (2) the lack of any formal synthesis of the contractual and equity-based forms of international involvement into a unified theory of international market servicing. Dunning developed an eclectic paradigm, which will here be explained.

The OLI paradigm argues that TNCs appear and evolve due to possessing three sets of advantages relative to other firms. These advantages, sometimes referred to as the OLI tripod, are in (O) ownership, (L) location and (I) internalisation.

The ownership advantages, which, as well as the other advantages, stem from market imperfections, are a necessary condition for foreign direct investment. These may already have been present in a firm, but can also develop through the act of FDI. Such existing ownership advantages may be in technology and skills, industrial organisation and size, access to various raw materials and markets, and in finance. The *technological* advantages are usually such as superior products, processes, marketing skills or management techniques. These can be considered public goods within the corporation, since utilization of them in one part of the organisation does not interfere with simultaneous use of them in another part of the firm. This implies an ideal prospect for expansion. Also, *large and diversified organisations*, often having achieved firm-level economies of scale, are often better equipped for extensive innovation and have the capacity to survive price wars and fight legal suits over patents. Wide-ranging *access* to land factors of production, such as raw material is another noteworthy

ownership advantage, while access to markets can arise from actions by governments. The political influence by governments can also help TNCs in gaining advantages in foreign markets. Concerning the *finance* element of ownership advantage, it can be noted that large and diverse firms tend to be able to raise money more cheaply, since their profits often are more stable over time. This relative stability is due to the perception that problem in one country, or market, are often offset by achievement in another. Additionally, there is to a TNC an obvious access to a variety of capital markets and a freedom to deal in several currencies. But they are also, which may be even more important in this context, able to with ease shift activity in response to changing factor endowments or government policy, and there is a certain freedom from dependence on a single government.²⁴ TNCs obviously have an ability to exploit differences between countries on a global scale.²⁵

The second advantage of transnational corporations is the locational advantage. These are country specific advantages and determine which countries that are hosting foreign production of TNCs: ownership advantages are to be used combined with immobile factors in foreign countries. The locational advantages can be categorised as economic, social and political factors. A country's factor endowments of capital, labour, technology, management skills and natural resources are potential economic advantages, but also market size and infrastructure can be important. Social advantages may be in language or business customs, but also of cultural or ethnic character. Among a country's potential political advantages is the general attitude towards foreign transnational corporations, but also specific policies affecting establishment of FDI projects and production. Such policies may be of hostile character, featuring trade barriers or investment regulation, but can also be of competitive character, specifically aiming to attract foreign investment. This may be done in many ways, e.g. through special tax concessions for FDI, other investment grants, low tariff rates or various free-trade agreements.²⁶ Foreign production is expected to have a tendency to move to countries that have beneficial locational advantages.²⁷

The third advantage, the internalisation advantage, are according to many economists a key condition for FDI. These gains arise due to market imperfections preventing an effective sale of ownership advantages to other firms. Thus, to exploit these ownership advantages, the only rational option is to do so within the original owner/firm. The internalisation issue was first identified by Coase in 1937. He explained that the reason why the market rules for

transactions between firms, but not within firms, is that transactions within firms are cases where transaction costs outweigh any efficiency gains that the market may have over administrative allocation.²⁸ Any transactions subject to such market costs will, according to Coase, eventually be internalised in order to eliminate the market. To develop further, internalisation advantages can be said to arise from exploiting the differences among exogenous imperfections in external markets. The imperfections are of two characters, of which the first is inherent to certain types of markets. These may be due to the public good aspect of knowledge, uncertainty, or the transaction cost aspect of external markets mentioned above. Thus, by using markets internal to the TNC, it is possible to avoid these problematic issues. The second types of imperfections are state generated, including tariffs, foreign exchange controls and subsidies. By replacing an external market with an internal, consisting of a hierarchical control structure, the impact of such market failures can be reduced.

Strategic Management and the International Value Chain

The strategic theory, set forth by Michael Porter in *The Competitive Advantage of Nations* and several of his other writings, claims firms to be engaged in a range of activities, a so-called value chain consisting of primary activities and support activities.²⁹ Primary activities are related to physically creating a product, while support activities are aimed to provide infrastructure necessary to support the primary activities (R&D, marketing, finance, etc). It is essential for a firm to determine shape and length of the value chain. This involves decisions on the number of products, the number of value adding activities and the number of geographical areas in which these activities should take place. Following the lead of Alfred Chandler's classic contributions to international business studies, Porter argues that these decisions are all due to global strategy, affecting choice of structure and location of economic activities throughout the world economy.³⁰ According to Porter, TNC global strategies can be categorised as: (1) *global cost leadership* or differentiation, which means selling a wide range of products globally, (2) *global segmentation* through selling a narrow product line worldwide or a wider range in a subset of countries, (3) *protected markets* strategy, which aims to establish production inside markets protected from foreign competition by host governments, or (4) *national responsiveness*: product development aimed to meet local demand in particular countries.³¹ Obviously, transnational corporations have an advantage relative to even the largest domestic firms in being able to adopt a wide array of strategies, taking advantage of

economic, political, social, geographic and cultural differences between countries. In contrast to a domestic firm, a multinational firm can carry out its activities at the most efficient location for each particular activity anywhere in the world. The extensive amount of options available to pursue global strategy does not only include foreign direct investment, but also strategic alliances, outsourcing of component production and licensing technologies. Hence, internal complexes, or networks of corporate relations with the parent firm in another economy, arise. Contemporary information technology and monopoly of information resources allows the TNC to become universally dominant. According to Gilpin, such perspectives on transnational corporations imply that these firms indeed “have become worldwide institutions coordinating economic activities that are located in many countries.”³²

A combination of the OLI tripod and the international value chain provides a rather uncomplicated explanation for the existence of vertically and horizontally integrated transnational corporations. A TNC that is horizontally integrated produces at the same stage of the value chain in several plants located in diverse countries. Thus, it is able to earn additional rents in the foreign location due to its firm-specific assets. A TNC that is vertically integrated controls and co-ordinates several altered value adding activities (such as resource processing and manufacturing), often motivated by the ability to avoid exogenous transactions and governmental costs.

Managerial Structures and Locational Choices of Global Transnationals due to Strategic Theory

The executive lines of authority, lines of communication, information flows and how they are channelled and processed determine the managerial structure of a firm. Transnational corporations have available to them many kinds of international managerial structures, a fact that has become particularly adequate due to the vast development in the area of information technology.³³ Nowadays, TNC affiliates can be interconnected via telecommunications on a global scale. This significantly improves the co-ordinating power of the headquarters, being able to efficiently monitor foreign operations. Additionally, information technology and globalisation is homogenising tastes through increasing mobility of consumers and information, making international brand recognition important. Advantages of moving to a global cost leadership encourage the integration of international and local planning. A more

integrated structure weakens the local autonomy of affiliates, contributing to organisational structures that promote global planning objectives. Thus, as have been pointed out by Eden, tensions between the national objectives of states and the global goals of transnational corporations are likely to arise.³⁴

Strategy also tends to determine geographical locational choices of TNC investments. The strategic role that the affiliate is intended to play within the TNC is the key aspect in the selection of a particular location, determining initial FDI and trade patterns. There are a variety of reasons initiating foreign direct investment by TNCs, but the list can be recapitulated as (1) securing natural resources, (2) reducing costs and (3) access to foreign markets. These strategies lead to three locational structures, intimately connected to the relevant strategy. Resource seeking strategic investments are performed by so called “Extractors”, securing natural resources essential to the production process, while “Processors” turn raw material into fabricated materials.³⁵ Cost reducing strategic investments use so called “Offshores” for cheap local inputs such as low wage labour to produce components that are re-exported to the TNC for further assembly. If a wage raise occur in a country where an Offshore is located, it tend to search for another low cost site elsewhere. “Source factories” may also provide access to such low-cost inputs, but are also responsible for development and production of specific components. Due to the fact that these factories’ output is sold within the TNC, they are a tightly integrated part of it.³⁶ There is also a wide range of industries associated with market access strategic investments. First, “Importers” make possible TNC sales in a certain host country, and endow with marketing, sales and services. “Local servers” also serve local markets, but usually assemble subcomponents for domestic sale. These are the most common choice of location when state regulations require TNCs to maintain a local presence. The globally rationalised firms that mass-produces one or two product lines for sale in local and foreign markets are called “Focused factories”. These are relatively autonomous and nationally responsive units with some process technology facility. Other plants are in fact assembling and selling a full range of products, similar to the parent in the local market, and are referred to as “Miniature replicas”. They are frequently operating due to a shelter strategy adopted by the transnational corporation in response to host country trade barriers. However, such factories are commonly very costly and inefficient as they are sited in small domestic markets. The so-called “Lead factory” is an equal partner to the parent in developing new products and technology for global markets. These factories are

insiders in each of their major strategic locations, which is normally within the Triad. Finally, transnational corporations can also inaugurate research and development intensive investments called “Outposts”. These are set up from one of the Triad states in the other Triad markets in order to source knowledge worldwide and to channel information on technology developments.³⁷

In summary, transnational corporations consists of a set of strategically located foreign affiliates, operating due to their strategic industrial function within the firm, which may be resource, cost or market oriented. If they are owned and controlled by the parent firm, these affiliates are a part of the firms direct value chain. An affiliate may also be linked to the TNC through contractual arrangements or strategic alliances, and will thus be a part of the indirect value chain.

THE TRANSNATIONAL CORPORATION IN THE INTERNATIONAL ECONOMY

In the first decades of the twentieth century there was a rapid growth in the number of transnational corporations, as we know them today. These powerful entities, which play important roles in international economic, political and cultural relations, saw an even more dramatic increase after the Second World War, and there are currently more than 60 000 transnational corporations with over 820 000 foreign affiliates operating on the world market.³⁸

In an economic context, the role of the transnational corporation can be emphasized due to the vast growth of foreign direct investment as well as its central role as a global industrial producer. The world’s largest transnational corporations account for approximately four-fifths of world industrial output, and the 500 largest TNCs account for 90 percent of all the worlds’ foreign direct investment.³⁹ FDI constitutes one of the major components of the capital accounts of a nation’s balance of payment,⁴⁰ and has grown significantly in recent years, reaching record levels in 2000, at \$1492 billion.⁴¹ As a comparison, FDI outflow level in 1995 was \$315 billion. Although the 1995 figure was due to a rapid growth: from 1973 to 1995 annual FDI outflows multiplied more than 12 times, from \$25 billion in 1973. At the same time, merchandise exports multiplied 8.5 times.⁴² About one third of world trade today consists of intrafirm trade within TNCs, which take place at transfers prices set by the firms

themselves. This is, as have been explained earlier, due to global corporate strategy, which implies that such transactions do not necessarily conform to conventional trade theory based on concepts of comparative advantage. Another third consists of TNC exports to nonaffiliates, and the remaining third consists of trade among national firms.

The increasingly central position of TNCs has caused many analysts to assert a profoundly altered structure and functioning of the global economy. These enterprises and their global strategies have become major determinants of such fundamental international economic factors as flows of trade, investments and location of industries. A significant amount of FDI is in capital and technology-intensive sectors,⁴³ and TNCs have become the single most important actor in the expansion of technology flows to both industrialised and industrialising countries and are therefore central in determining the economic, political and social welfare of numerous nations. The fact that these powerful entities control a considerable quantity of the world's investment capital, technology, and access to global markets, implies a key role not only in international *economic* but also international *political* affairs. FDI frequently has important distributive effects on domestic economies and particularly on the division of income between capital and labour.⁴⁴ According to DeAnne Julius, notably one of the world's foremost experts on the TNC, the remarkable expansion of FDI, intercorporate alliances and intercorporate trade throughout the 1980s and 1990s reached a level where a "qualitatively different set of linkages" among advanced economies was created; indeed, the number of cross-border mergers and acquisitions (M&A) reached record levels in 2000, and the number of M&A deals worth more than \$1 billion increased from 114 in 1999 to 175 in 2000, and the value of these mega-deals as share of total value of world M&As reached a level of 75 percent.⁴⁵ The world economy has been claimed to have reached a takeoff point comparable to that wrought by the great expansion of international trade in the late 1940s and the subsequent emergence of the highly interdependent international trading system.⁴⁶ The growth of foreign direct investment, in all essentials carried out by transnational corporations of various nationalities has linked nations even more tightly together with further impact on the global economy.⁴⁷

NOTES

- ¹⁵ Lorraine Eden, “Bringing the Firm Back In: Multinationals in International Political Economy”, in *Millennium Journal of International Studies* (vol. 20, No. 2 1991), p.214.
- ¹⁶ See for example Lorraine Eden, “Bringing the Firm Back In: Multinationals in International Political Economy”, in *Millennium Journal of International Studies* (vol. 20, No. 2 1991), pp.197-224.
- ¹⁷ Professor Gilpin uses the term “multinational”. In this thesis I will use the term “transnational”, although the characteristics of the type of organisation implied is the same.
- ¹⁸ Robert Gilpin, *The Political Economy of International Relations* (New Jersey: Princeton University Press, 1987), p. 232.
- ¹⁹ Peter Dicken, *Global Shift: Transforming the World Economy* (London: Paul Chapman Publishing, 1998), p. 177.
- ²⁰ See Dicken, *Global Shift: Transforming the World Economy*, pp 177-178; and L Alan Winters, *International Economics* (London: Routledge, 1991), p. 227.
- ²¹ Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of US Enterprises* (New York: Basic Books), p. 11.
- ²² John H Dunning, “Explaining International Production (Boston, MA: Unwin Hyman 1988), p. 328.
- ²³ John H Dunning, “The Determinants of International Production” in *Oxford Economic Papers* (vol. 25, 1973), pp 289-325.
- ²⁴ L Alan Winters, *International Economics* (London: Routledge, 1991), p. 223.
- ²⁵ Lorraine Eden, “Bringing the Firm Back In: Multinationals in International Political Economy”, in *Millennium Journal of International Studies* (vol. 20, No. 2 1991), p. 205.
- ²⁶ In this context, Ireland is an interesting example, providing a special tax rate of 10 percent for manufacturing FDI, and a generally very advantageous tax legislation.
- ²⁷ Freidrich Schneider and Bruno Frey, “Economic and Political Determinants of Foreign Direct Investment”, in *World Development* (vol. 13, No. 2 1985), pp. 1-26.
- ²⁸ R. H. Coase, “The Nature of the Firm”, in *Economica* (vol. 4, 1937), pp. 386-405.
- ²⁹ Michael Porter, *The Competitive Advantage of Nations* (New York: Free Press, 1990).
- ³⁰ Alfred Chandler, *Strategy and Structure: Chapters in the History of the American Industrial Enterprise* (Cambridge, Mass: MIT Press, 1962)
- ³¹ Michael Porter, *Competition in Global Industries* (Cambridge, Mass: Harvard Business School Press, 1986), pp. 46-49.
- ³² Gilpin, *Global Political Economy: Understanding the International Economic Order*, p. 286.
- ³³ Nigel Grimwalde, *International Trade: New Patterns of Trade, Production and Investment* (London, New York: Routledge, 1989).
- ³⁴ Lorraine Eden, “Bringing the Firm Back In: Multinationals in International Political Economy”, in *Millennium Journal of International Studies* (vol. 20, No. 2 1991), p. 209.
- ³⁵ Eden, *op. cit.*, in note 18, p. 210.
- ³⁶ Eden, *op. cit.*, in note 18, p. 210.
- ³⁷ Eden, *op. cit.*, in note 18, p. 211.
- ³⁸ United Nations Conference on Trade and Development: *World Investment Report 2001* (New York: United Nations, 1996), p. 9.
- ³⁹ Gilpin, *Global Political Economy: Understanding the International Economic Order*, p. 289; and Alan M Rugman, “Multinational Enterprises and the end of Global Strategy”, in Dunning and Mucchielli, *Multinational Firms: The Global-Local Dilemma* (London and New York: Routledge, 2002), p. 16.
- ⁴⁰ Phillip Anthony O’ Hara, *Encyclopedia of Political Economy* (London and New York: Routledge, 2001), p. 365.
- ⁴¹ The Economist (September 21, 2002), p. 106.
- ⁴² Theodore H Cohn, *Global Political Economy –Theory and Practice* (Addison Wesley Longman, 2000), p. 274.
- ⁴³ Financial firms accounted for more than 20 per cent of the total cross-border mergers and acquisitions sales and purchases in 2000. See United Nations Conference on Trade and Development: *World Investment Report 2001*, p. 53.

⁴⁴ Robert Gilpin, *The Challenge of Global Capitalism: The World Economy in the 21st Century* (New Jersey: Princeton University Press, 2000), p. 172.

⁴⁵ DeAnne Julius, *Global Companies and Public Policy: The Growing Challenge of Foreign Direct Investment* (London: Pinter, 1990); United Nations Conference on Trade and Development: *World Investment Report 2001*, p. 56.

⁴⁶ Gilpin, *Global Political Economy: Understanding the International Economic Order*, p. 290.

⁴⁷ Gilpin, *Global Political Economy: Understanding the International Economic Order*, p. 290.

CHAPTER TWO

Transnational Corporations and States in a Global Economy

We have now learned something about the nature of the transnational corporations operating in a globalised economy. It is now time to look at the dynamics between activities of TNCs and activities of states. The text is state-centred, thus the impact of TNC activities will be considered from a perspective of the general objectives of states.

THE BENEFITS OF FOREIGN DIRECT INVESTMENT

Nowadays, most governments view foreign direct investment as a positive occurrence, after a somewhat hostile position to these in the 1970s and early 1980s. This changed stance has been explained by Dunning⁴⁸ through a variety of factors: (1) extensive deregulations and liberalisation of markets imply a renewed faith by most states in the workings of market economy; (2) increasing globalisation of economic activity alongside increasing integration of international production due do TNC activity; (3) increased international mobility of key elements contributing to economic growth (such as technology, intellectual capital, organisational competence and learning experience), housed in transnational corporations; (4) worldwide competition for the scarce international resources of those mentioned key ingredients of contemporary economic growth is increasing, due to extensively increasing economic development in a growing number of economies (in particular the tiger-economies of East Asia); (5) a convergence among the major industrialised nations economic structures, which leads to more intensive competition between their firms; (6) changed criteria for judging the success of FDI by governments, leading to a cooperative rather than confrontational stance between foreign investors and host governments. This is since the wider impact of foreign affiliates, including its upgrading of a host country's indigenous capabilities and the promotion of their dynamic comparative advantage as well as their direct potential impact on economic growth, is being increasingly emphasised in the evaluation of inward FDI.⁴⁹

Dunning has pointed out five main ways in which competitiveness and comparative advantage of countries can be increased.⁵⁰ First, a country's firms may become more efficient in its existing production, possibly through improved quality control, networking with partner

firms, cost-effective sourcing and raising productivity of labour and capital. Second, the innovation of new products, processes and organisational structures is an important aspect. This may be done through making risk capital available for start-up firms, improving national innovatory systems and exploring better the economies of the spatial clustering of related activities. Third, The allocation of a nations resources and capabilities may be improved (switch to activities which are more productive with increasing comparative advantage). Fourth, a host country may also expand its industries to new markets. This requires knowledge about foreign markets, international customer needs and skilled marketing and logistics. Finally, structural aspects may be important in upgrading comparative advantage. Dunning suggests government encouragement of flexible labour markets, retraining programmes of high quality, ensuring of bureaucratic efficiency, appreciating fiscal and other incentives for industrial restructuring and a willingness to accept and adjust to change.

In many ways, these five vectors for upgrading competitiveness and comparative advantage constitute the core of the benefits of foreign direct investment. Inbound FDI by transnational corporations is means highly desired by governments to achieve an upgrade in comparative advantages and economic growth, and thereby an ability to achieve its political goals. Keeping in mind theories set fourth by Dunning and by Porter, it is rather self-evident that transnational corporations are potential bonanza for governments. FDI may interact with the existing competitive advantages of hosts and thus affect future competitive advantages in many ways. TNCs may provide additional resources and capabilities, capital, technology, management skills and access to markets, and may also inject new entrepreneurship, management styles, work cultures, and more dynamic competitive practices. The resource allocation may become more efficient and the TNC may contribute to competitive stimulus and spillover effects on suppliers and customers. Hence, domestic resources and capabilities are upgraded as well as the productivity of indigenous firms and clusters of related activities may arise. Due to the positive contributions above, transnational corporations may add to its host nations' gross domestic product and provide additional tax revenue to governments. The balance of payments may be improved, through import substitution, export generating or efficiency-seeking investments. The host economy will also be likely to become better linked with the global market, and a fostering of a more efficient international division of labour may advance economic growth. Additionally, via TNC activity, the host economy is likely to become more directly exposed to the economic and political systems of other states, the

values and demand structures of foreign households, attitudes to work practices, incentives, industrial relations and foreign workers along with various customs and behavioural norms of foreign societies.⁵¹

POLICY IMPLICATIONS

Gilpin has set out six responsibilities that are crucial for governments to assume for attracting TNCs and thereby gain higher economic activity and welfare:

“...honest and competent government, heavy investments in education at all levels, respect of international property rights, encouragement of entrepreneurship, support of a diversified and excellent national program of R&D, and to pursue sound macroeconomic policies.”⁵²

Dunning asserts that a positive contribution (a net benefit) of inbound foreign direct investment is depending on numerous aspects, including the strategic incentive for the particular FDI project (i.e. whether the investments are resource seeking, market seeking, efficiency seeking or strategic asset seeking) and, consequently, the conditions that prompted it. It is also determined by the economic policies pursued by the host and by other Governments.⁵³ The benefits are critically depending on the type and age of the investment, the economic characteristics of the host country and the macroeconomic and organizational strategies pursued by the Government. The important function of Governments within market economies is, besides various social and strategic responsibilities, to maintain an efficient and up to date legal, financial and commercial infrastructure, an educated labour force, an adequate transportation and telecommunications network, an anti-monopoly policy, a sound macroeconomic policy and a wealth-creating culture. Dunning emphasizes that today's globalised economy forces governments to re-examine their domestic economic strategies since the competitiveness-enhancing assets they are now increasingly competing for has become much more footloose. Traditionally, the macro-organizational policies only affected the domestic allocation of resources, but are now likely to affect foreign direct investment, trade, and cross-border alliances as much as any tariff, exchange-rate change or interest-rate hike. Thus, Governments are now, to much more extent, obliged to realign their domestic economic strategies more closely to the needs of the global market; they need to ensure that the quality of their location-bound resources and capabilities do not fall behind those of their competitors.⁵⁴

Now which, in more detail, policies must Governments pursue? Dunning sets out a variety of characteristics which favour positive contributions of foreign direct investment, including making local resources available at low real cost; minimal structural distortions or institutional impediments to upgrading of indigenous assets; development strategies that help promote dynamic comparative advantage; encouragement of local entrepreneurship, particularly in related activities; efficient capital markets and appropriate market-facilitating policies; efficient administrative regimes and macroeconomic policies; prioritise policies that help upgrade human and technological capabilities and pursuance of suitable tax policies.⁵⁵

A SECOND LOOK AT THE BARGAINING RELATION

The nature and the relative variety of the constraints of the host states, primarily the dependence on foreign direct investment and the degree of competition among countries for the investment, has increasingly intensified the phenomenon of competitive bidding for investment –among states as well as among communities within a certain state.⁵⁶ One indication of this widespread awareness of governments of the importance of attracting FDI is the extensively implementation of investment promoting authorities in states throughout the world.⁵⁷ As Walter has pointed out, in a hypothetical case where a transnational corporation is relatively indifferent between Ireland and another European country as a production site for accessing the European Economic Area, Ireland's special FDI tax rate of 10 percent is likely to be a considerable incentive.⁵⁸ Ireland's low taxes for foreign firms, which has caused many companies to move their finance departments to Dublin, have for a long time irritated The European Union, which has made attempts to stop so-called disloyal taxes, aiming for a tax harmonisation in the EU.⁵⁹ Ireland has been accused for tax discrimination, which, however, did not stop the Irish FDI policy; instead they have now lowered the taxes for domestic firms as well.⁶⁰

A study conducted by UNCTAD in 1995 found that 99 countries out of 103 offered some kind of fiscal (i.e. tax) incentives to inward investors during the early 1990s while financial incentives were offered in 59 out of 83 countries surveyed.⁶¹ However, not only new investment projects are subject to competition. TNCs may also endeavour the obtaining of various state subsidies in order to *keep* a plant in a particular location. One example of this is the plans announced by Ford in 1997 to reduce the labour force at its Halewood plant in

Mereyde, England. Ford unequivocally stated that the future existence of the plant (even the reduced plant) was indeed uncertain, and that the UK Government would do best in coming up with an appropriate deal –which it accordingly did.⁶²

Table 3.1 A selection of some incentive packages in the US and Europe (Source: UNCTAD 1995, Table VI.3)

<i>Location</i>	<i>Company</i>	<i>Company investment (\$ millions)</i>	<i>State investment (\$ millions)</i>	<i>State's financial investment per employee (\$)</i>
Smyrna, TN USA (1983)	Nissan (Japan)	745-848	22 Road access 7.3 Training 33 <i>Total</i>	25,384
Flat Rock, MI USA (1984)	Mazda (Japan)	745-750	19 Training 5 Road improvement 3 On-site works 21 Economic development grant/loan 5 Water system 45.5 <i>Total</i>	13,857
Georgetown, KT USA (1985)	Toyota (Japan)	823.9	12.5 Land purchase 20 Site preparation 47 Road improvement 65 Training 5.2 Toyota families' education 149.7 <i>Total</i>	49,900
Tuscalosa, AL USA (1993)	Mercedes-Benz (Germany)	300	68 Site development 77 Infrastructure 15 Private sector/goodwill 90 Training 250 <i>Total</i>	166,667
Spartenburg, SC USA (1994)	BMW (Germany)	450	130 <i>Total</i>	108,333
Setubal Purtugal (1991)	Auto Europa: Ford/VW (USA/Germany)	2,603	483.5	254,451
West midlands UK (1995)	Ford/Jaguar (USA)	767	128.72	128,720
Northeast England (1994/95)	Samsung (Korea)	690.3	89	29,675
Lorraine France (1995)	Mercedes-Benz (Germany)	370	111	56,923

Table 3.1 illustrates that governments certainly perceive a need to offer these kinds of incentive to attract or keep TNC activity.

The dilemma of governments is that joining a bidding war undoubtedly implies a very weak bargaining position, although not joining may leave them without the desired investments:

“...competition among countries to attract and keep investment through incentives is strong and pervasive. This is partly so because, [*ceteris paribus*], incentives can induce foreign investors towards making a particular locational decision by sweetening the overall package of benefits and hence tilting the balance in investors’ locational choices. Incentives can be justified if they are intended to cover the wedge between the social and private rates of return for FDI undertakings that create positive spillovers. However, incentives also have the potential to introduce economic distortions (especially when they are more than marginal) [...] It is not the public interest that the cost of incentives granted exceeds the value of the benefits to the public. But, as governments compete to attract FDI, they may be tempted to offer more and larger incentives than would be justified, sometimes under pressure from firms that demands incentives to remain in a country.”⁶³

Dicken has pointed out that there is little doubt there has been a shift in the relative power of TNCs and states, but withholds that the position is “far less straightforward than has often been supposed.” Dicken notes that each bargaining process is different and highly contingent on the specific circumstances involved. Stopford and Strange’s view is that the bargaining power has shifted towards TNCs due to state competition for world market shares, but at the same time bargaining power of states towards particular firms may have become more advantageous since competition among corporations has increased:

“Governments *as a group* have indeed lost bargaining power to the multinationals [...] Intensifying competition among states seems to have been a more important force for weakening their bargaining power than have the changes in global competition among firms. This is not to deny that governments can maintain considerable power in their dealings with any one foreign firm. The reasons lie in the competition for world market shares. It seems to us that the changes in the production structure [...] have altered the relative importance of those factors over which firms had most control. [But] does it follow that firms *as a group* have increased their bargaining power over the factors of production? Here, the argument becomes complex, for the power of the individual firm may be regarded as having also fallen as competition has intensified. New entrants have altered the rules and offer government new bargaining advantage. One needs to separate the power to influence general policy from the power to insist on specific bargains.”⁶⁴

NOTES

- ⁴⁸ John H Dunning, "Re-evaluating the Benefits of Foreign Direct Investment", in *Transnational Corporations* (vol.3, No. 1 - February 1994), pp. 24-27.
- ⁴⁹ For empirical examination of growth impact of transnational corporations, see United Nations Conference on Trade and Development: *World Investment Report 1992: Transnational Corporations as Engines of Growth* (New York: United Nations, 1992).
- ⁵⁰ Dunning, *op. cit.*, in note 1, p.32.
- ⁵¹ Dunning, *op. cit.*, in note 1, pp. 46-47.
- ⁵² Gilpin, *Global Political Economy: Understanding the International Economic Order*, p. 304.
- ⁵³ Dunning, *op. cit.*, in note 1, p.35.
- ⁵⁴ Dunning, *op. cit.*, in note 1, pp. 43-45.
- ⁵⁵ Dunning, *op. cit.*, in note 1, pp. 46-47.
- ⁵⁶ See Dicken, *Global Shift: Transforming the World Economy*, pp 271-273.
- ⁵⁷ See Peter Nygård, SOU 2001:109, pp.139-147.
- ⁵⁸ Andrew Walter, "Do They Really Rule The World?" in *New Political Economy* (vol. 3, No. 2 1998), pp. 288-292.
- ⁵⁹ George Parker, "From talking shop to crucible of high politics: Europe's convention is evolving into a historic undertaking" in *Financial Times* (December 31, 2002), p. 7; and Ola Hellblom, "Ingen reavinst på Irland" in *Dagens Industri* (November 10, 2002), p. 18.
- ⁶⁰ Hellblom, *op. cit.* in note 11.
- ⁶¹ United Nations Conference on Trade and Development: *World Investment Report 1995* (New York: United Nations, 1995).
- ⁶² Peter Dicken, *Global Shift: Transforming the World Economy* (London: Paul Chapman Publishing, 2001) pp. 272-273.
- ⁶³ United Nations Conference on Trade and Development: *World Investment Report 1995* (New York: United Nations, 1995), pp. 299.
- ⁶⁴ John Stopford and Susan Strange, *Rival states, rival firms: competition for world market shares* (Cambridge: Cambridge University Press, 1991), pp. 215-216.

PART TWO

EMPIRICAL TESTING

CHAPTER THREE

Empirical Research: Examining the Perceived Policy Implications

This empirical part of the thesis examines how leading decision makers in the political environment perceive the interrelation between transnational corporations and states, and which policy implications they deduce from the development of globally active transnational corporations.

METHOD AND SELECTION OF REPRESENTATIVE RESPONDENTS

In order to conduct a useful research on the perceived interdependency and policy implications of TNC activity, the author considered it to be of central importance that the respondents met a number of distinct requirements, due to validity and reliability of the research. The respondents need to:

- (1) Have significant insight into either the highest political authority of or into the executive power in a large transnational corporation with global presence.*
- (2) Have or have had significant influence on either the political decisions on the highest level in a state within the Triad, or on the strategy in a large transnational corporation with global presence.*
- (3) Hold or have held a position within the political or corporate sphere that involves or has involved substantial contact with the other sphere.*
- (4) Have a strong reputation as experienced, knowledgeable and with high integrity.*

The respondents chosen by the author were:

- (1) Dr. Lars Heikensten, Governor's alternate, First Vice Chairman and Deputy Governor of the Swedish central bank, Riksbanken. Mr. Heikensten is responsible for the preparation of monetary and exchange rate policy and risk management, besides having international functions as the Governor's alternate in the International Monetary Fund, the Group of 10 and the European Central Bank. He has been a Deputy Governor of the Riksbank since 1995. In January 2003, Dr. Heikensten will become Chairman of the Executive Board and Governor of the Riksbank.*

- (2) *Mr. Sven Hegelund*, state secretary at the Ministry of Finance. Mr. Hegelund has been a state secretary with responsibility for economic policy, international economy and financial markets since 1999. Before that, he held the position as chief economist at Landstingsförbundet, and has also worked with economic analysis and economic policy at LO (the blue-collar trade-union confederation) and TCO.
- (3) *Ms. Lotta Fogde*, state secretary at the Ministry for Foreign Affairs. Ms. Fogde has been a state secretary for Leif Pagrotsky, Minister for Trade⁶⁵, since 2000, and was also, together with Mr. Pagrotsky, responsible for the compilation of the government's statement on the overall Swedish globalisation policy in 2002⁶⁶. Before that, she was a political adviser and press secretary at the Ministry for Trade, Industry, Employment and Communications, and has also worked as a journalist.
- (4) *Mr. Anders Sundström*, former Minister for Industry, Employment and Communications. Mr. Sundström was the Minister for Industry, Employment and Communications between 1996 and 1998. Before that, between 1994 and 1996, he was Minister for Labour Market. He is currently a member of the Swedish parliament and holds a position as chairman of the board at Pitedalens Sparbank, a banking group in northern Sweden.
- (5) *Mr. Kurt Hellström*, chief executive officer, Telefonaktiebolaget LM Ericsson, Stockholm. Mr. Hellström has held the position as CEO of Ericsson since 1999. Before that, he has held various senior positions in the mobile business, with focus on marketing and sales. From 1989 to 1990 he was head of Radio Systems Sweden AB. From 1990 to the end of 1998 he was head of Ericsson Business Area Radio Communication and President of Ericsson Radio Systems AB. In 1999 he was appointed Executive Vice President of Telefonaktiebolaget LM Ericsson and President of Ericsson Asia Pacific Limited in Hong Kong. He holds a Master of Science degree from the Royal Institute of Technology in Stockholm and a Master of Management degree from the Stockholm School of Economics.
- (6) *Ms. Malin Persson* is Head of Corporate Strategy & Business Development, AB Volvo, Gothenburg. She has previously held positions at Volvo as Group Coordinator and Logistics Manager.

The interviews were carried out in the form of rather open discussions between the author and the interviewee, in which the author had a role of merely a moderator, giving the interviewee

significant freedom to openly discuss the interrelation between transnational corporations and states in a global economy, as well as the wider implications of this relation. Thus, the respondents were able to extensively influence the angles and subtopics brought up to discussion. The reason why the author chose this form of interviewing was to strengthen the reliability of the research, through not influencing the perception of the respondents. The variety of respondents, representing both different political institutions, but also the TNC side of the relation, is also due to an aim to strengthen the reliability and validity of the thesis.

The interviews took place in the respondents' offices and lasted between 25 and 40 minutes. The discussions were recorded with a small tape-recorder in order to achieve the highest possible accuracy in the summary and analysis of the interviews.

The discussions were organized around a few, for the thesis central, topics. These were (1) the priority of economic growth on the political agenda; (2) the political ambition to attract foreign direct investment; (3) the implications for the interdependency between transnational corporations and states of (a) globalisation of markets (b) global location strategy among TNCs, and (c) the economic benefits of FDI.

INTERVIEW RESULTS SUMMARY

This summary of the interviews is arranged by topic. However, one should note that this division is primarily a pedagogical one, and that the discussions under each topic do not necessarily reflect a distinction between their *implications*.

The Politics of Economic Growth

The most apparent conclusion that can be made from the interviews was the consensus on the central position of economic growth as a political objective. Ms. Fogde, Mr. Hegelund and Mr. Sundström all agreed that economic growth was indeed a considerably central objective for state policy, partly due to their view that growth is of vital importance in the *to be or not to be* dimension for a government: economic growth is assumed to be, if not fundamental, then at least of enormous importance for public opinion and thus the ability to be re-elected. Mr. Sundström emphasized that investigations had implied that the primary cause for a forming of a certain government after any general election was indeed the voters' faith in this

government's ability to provide a good economic growth for the nation as a whole. Ms. Fogde reminded the author of the US president Clinton's motto from 1992; "it's the economy, stupid". Additionally, Ms. Fogde, Mr. Hegelund and Mr. Sundström stressed that economic growth is indeed the fundament for a central ideological ambition of the Swedish government; re-allocation of resources in the society. These interviewees also maintained that economic growth was necessary for providing the government with the ability to implement an ideologically determined policy in the society: it creates scope for reform in the budget. According to Ms. Fogde, economic growth may also help preventing social conflict, due to lower rate of unemployment. Mr. Sundström also argued that it is uncertain whether democracy itself would be able to survive in a society without economic growth. "It is uncertain whether people will vote for democratic parties if welfare is not delivered in the long term", he continued, referring to the development that brought Hitler and the national socialist party to a government position in Germany.

The Political Role of Foreign Direct Investment

In the matter of the political importance of attracting foreign direct investment, there was also a broad consensus. Dr. Heikensten, Mr. Hegelund, Ms. Fogde and Mr. Sundström all emphasized the importance of FDI, and the two latter pointed out that this importance had indeed resulted in the Invest in Sweden Agency (ISA), a government authority with the only purpose of attracting foreign direct investment to Sweden. Both Ms. Fogde and Mr. Sundström emphasized the balance of payment effects of FDI, arguing that Sweden is dependent on an inflow of investment since there is also a substantial outflow of investments from Sweden. As Ms. Fogde put it, "it is essential that the flows of FDI does not simply form a draining of investments from the country." She also adds that it is the government's view that FDI is very important for the vitality of the Swedish economy. This is, according to Ms. Fogde, due to the importance of taking part of external impulses, such as new technology and methods of production. Mr. Sundström emphasised that transnational corporations not only generate economic growth, but also have a positive impact due to increasing demands on societies to deliver knowledge and competence through education and research, functioning financial environments and the fundaments for a healthy economy; a functioning democracy; rules and regulations in order to keep the market economy from degenerating; and information and knowledge. Dr. Heikensten said that: "it is of considerable importance for a country to attract transnational corporations, and also to be able to keep the domestic

transnational corporations from moving their headquarters abroad, since the most skilled labour is in the headquarter functions. Losing these is problematic, since it leads to a generally weaker labour market and risks lead to a self-strengthening process that may cause an undermining of the national competence since it becomes less attractive to study and less interesting to do research in the country. Hence, it is indeed an immense problem if large corporations are not willing to establish themselves in your country, or if the present corporations are leaving.” Mr. Hellström emphasized that “Ericsson, as well a number of other large international corporations, have played significant roles in generating Sweden’s present economic welfare.” Additionally, Mr. Hellström added that: “many of the small and medium sized enterprises are depending on the larger firms, so the spillover effects are also beneficial for the economy.” Ms. Persson said that: “most certainly, a country, or a region, which succeeds in attracting transnational corporations, tend to, additionally, attract even more capital and even more firms due to spillover effects.” Mr. Hellström also noted that, due to the variety of positive impacts of TNC activity in a country, governments need to be sensitive about the needs of transnational corporations. “The Swedish government have traditionally been very keen on implementing decisions that favour these large industries, and have even been criticised for listening too much to the large enterprises”, he noted. Ms Persson added to this by saying that “In a sense, it is a benefit for the large corporation that it is economically important to the governments.”

The Task of Attracting Direct Investment

Contrasting the policies of many other states, the Swedish government is reluctant to offer any specific incentives packages (such as tax reduction or grants) to attract foreign direct investment. According to Ms. Fogde, this is due to a belief that such incentives programmes are short-term thinking. She claimed that FDI incentives policies may bring TNCs to the country, but as soon as their perceived beneficial treatment is over, they will consequently leave the country. She pointed out that some other countries have chosen to pursue a diametrically different FDI policy, and among them is Ireland, whose policies she commented as short-term thinking and irresponsible. Mr. Hegelund considered the competitive Irish FDI policy “unacceptable”, and mentioned the on-going work in the EU to prevent such competition. Both Ms. Persson and Mr. Hellström confirmed that states do contact Volvo and Ericsson in order to encourage the company to invest in production sites in their country. Ms. Persson maintained that incentives such as tax rebates of Irish model would certainly be

considered by Volvo before an establishment of a production site, especially if the corporation is relatively indifferent between two countries in the location choice. Mr. Hellström, however, agreed with Ms. Fogde's view that specific time-limited incentives packages are short-term thinking: "many developing countries try to attract foreign direct investments through subsidies and other, less sound methods, which are seldom fortunate since these countries replace other, more important, fundamentals with direct grants and so on." Mr. Hellström also commented Ireland's policy: "Ireland has stimulated foreign direct investment through very low taxes and corporate tax liberties for a limited time. This attracts corporations, but when these companies, after some time, suddenly needs to start paying taxes comes the question 'should we stay or not?' However, Ireland has combined this policy with good education, which is positive."

Ms. Fogde pointed out that the Swedish government has been very reluctant to provide ISA with any financial instruments to attract TNC investments, and said that the terms must be the same for foreign as well as for domestic companies. "Thus, in the matter of financial incentives, the Swedish government is pursuing a very different policy in comparison with many other states, which really do work hard to give advantages to foreign firms in order to attract FDI", Ms. Fogde said. Instead the respondents emphasized the Swedish long-term policies for attracting FDI. Ms. Fogde said that the government certainly wants to do everything it can to facilitate a good economic climate for trade and industry. Mr. Hegelund stressed the importance of macroeconomic stability and generally good fundamentals such as advantageous rules and regulations, good financial system and indeed high quality education at all levels. Mr. Sundström noted that the tax reduction for foreign experts working a limited time in Sweden is an expression for an ambition of the state to defend its competitive position in international knowledge-intensive industry and benefit transnational corporations, but underlined that the long-term government investments in education and research is even more important. Mr. Hellström shared the view that governments need to invest in education and research, emphasizing that most of Ericsson's research centres are located near strong universities. Mr. Sundström furthermore laid emphasis on that a state needs to be aware of which competitive advantages it has, and accordingly focus on maintaining a strong position in these areas. The Swedish competitive advantage, he said, is indeed in knowledge intensive industries, and, hence, the Swedish government invests extensively in upholding a high quality educational and research system, but also good infrastructures. "There is also a good

deal of market-seeking investment for whom Sweden is a prospective location choice”, Mr. Sundström added. This is due to Sweden’s location in the Baltic region, as a country from which the markets of Finland, Sweden, Germany, the Baltic States and Russia can be accessed. Therefore, a good infrastructure is essential for Sweden.

The competitive financial incentive-policies of states were extensively discussed, and the respondents commented a possible future situation where Sweden would ultimately be forced to pursue an offensive FDI policy as a daunting prospect. “It would feel like an enormous defeat”, Ms. Fogde said, and Mr. Hegelund agreed: “Obviously, a situation where TNCs play off states against each other is very unfortunate, and there are work in progress in the EU, on rules and regulations, aiming to counteract such inconvenience through coordination of FDI policies.” Such coordination was also heavily emphasized by Ms. Fogde, who underlined that “the Swedish government frequently, in such organisations as OECD and the EU, urges the developed countries to harmonize FDI policies, and make agreements not to be involved in FDI competition, to make rules and policy outlines, since we are aware of the fact that this situation is damaging for all states.” Dr. Heikensten also noted that: “in the perspective of state competition for transnational corporations, there is certainly a risk that these large firms may play off states against each other and in various ways coerce better conditions for themselves. This problem could be neutralised through international agreements, e.g. in the European Union, ensuring conditions of more similar kind, if that is considered important. However, some countries, trying to use this development as a positive force, do not regard the competition as harmful, but as a positive occurrence.”

The Interdependency Relation

An interdependency situation between transnational corporations and states was widely recognised by the respondents. Ms. Fogde pointed out that “today’s large, global transnational corporations’ demands certainly need to be considered since so much employment and income are depending on them”. She further commented that: “There is an interdependency relation between states and transnational corporations, and this interrelation is different from the old relation between a state and its large domestic industries since there, in the latter case, was a clear question of give-and-take. However, in the new scenario, there is a potential risk for a case where the state is the primary giver, since *transnational* corporations have a stronger bargaining position due to the variety of optional locations for their investments.

Thus, their dependency on a certain states has indeed lessened. Both Ms. Persson and Mr. Hellström also agreed that today's large, transnational corporations have become significantly less dependent on states and that the *geographical* aspect of where they produce is of trivial importance. The localization of economic activity provided by transnational corporations is determined by where the conditions are beneficial, they said.

“Additionally...” Ms. Fogde said, “...it is very interesting to note that, despite every country being so dependent on the world around them, a very nationalist thinking remains in the EU, concerning the EU policies on such issues as trade and industry. Country after country recommends decisions, which will favour specific corporations or industries in their own country. One may think such acting would be history by now but evidently it is not. This is indeed a substantial feature in trade politics in the European Union; we have not progressed as far as one would wish. It would certainly be difficult to maintain that the interdependence is not asymmetric, and that this asymmetry does not benefit the TNCs. The general conception is indeed that there is an asymmetry, and I think so too, but it is, naturally, difficult to measure the level of asymmetry.” Ms. Fogde also said that: “the major problem is that there are not enough political will, among enough states, today, to agree on common rules and regulations concerning the activities of transnational corporations. One must understand that neither globalisation nor the transnational corporations are responsible for this unfortunate development. This is a result of a number of governments, which for the moment do not understand that a coordinated policy is in their interest, but lets their short-term self-interest precede our common best.”

Dr. Heikensten, Mr. Hegelund and Mr. Sundström all shared Ms. Fogde's perception that transnational corporations have become increasingly less dependent on national governments. Mr. Sunström's view was that this relative independence was due to the “global” nature of today's large transnational corporations. His emphasis was on the importance of harmonised rules and regulations within and between the Triad economies, in order to prevent transnational corporations to play off states against each other. His view was however a bit more optimistic: he recognised the desire of countries to attract TNCs, and but that: “Sweden would certainly be interested in improving the situation for transnational corporations located in Sweden, although such policies are regulated on an international level in the EU and the World Trade Organisation (WTO) and, thus, our freedom of action is limited, and we are not

to full extent able to ‘steal’ these corporations from each other.” He also said that the general pressure of taxation in a single state could not vary too much from the taxation in states in the world around it. According to Mr. Sundström, globalisation increasingly implies that taxation of mobile assets becomes difficult. Therefore, he noted, real estates and labour (income tax) is basically what the state in a sovereign fashion can tax, and said that: “no state can have neither wage costs nor welfare costs which significantly diverges from other states whom are equal to it in the matter of industrial development, since there is a competition situation between them.” Dr. Heikensten pointed out that “Several large corporations, which have been located in Sweden, have moved their headquarters to other states with lower taxes. This can be seen as an expression for Sweden not being able to keep them within the states territory, and simultaneously an expression for other states being able to attract them. Earlier, corporations were more nationally bounded, but this situation has changed; home market bias has considerably weakened and a situation of competition for foreign direct investment between states has arisen.” Mr. Hellström added to this discussion by stressing that “long-term incentives are important; it is the pressure of taxation in Sweden that has led to a drain of corporations from the country”, a situation that Mr. Hellström held the Swedish government responsible for.

NOTES

⁶⁵ After the general election in Sweden 2002, Pagrotsky became Minister for Trade and Industry, but at the time when the interviews were conducted, he was Minister of Trade at the Ministry for Foreign Affairs.

⁶⁶ Government of Sweden, *En samlad svensk globaliseringspolitik* (Stockholm: Tryckeriet Åsbrink 2002).

PART THREE

ASYMMETRIC INTERDEPENDENCE

CHAPTER FOUR

Final Analysis and Discussion of Results

In this chapter, the interdependence between the state actor and the TNC actor in the political system will be furthermore analysed. The contribution that the author wish to provide is being outlined through the construction of a theoretical model for viewing the power relation between transnational corporations and states in a global political economy.

As has been pointed out in the thesis, transnational corporations now play a central role in creating values in the states in which they perform FDI projects. In many respects, this can be said to be a result of the globalisation of the world economy, and most distinctly from the globalisation of markets, making possible for these large transnational corporations to with ease shift production between increasingly similar national markets. This development has also given the transnational corporation the advantage of being able to shift activity in response to changing factor endowments or government policy and exploit differences between countries on a global scale.

RECONSIDERING THE BARGAIN

Traditionally, the bargaining relationship between transnational corporations and states have been considered an obsolescing one. Even though TNCs initially had the upper hand in the bargain, the investment would eventually lead to a commitment by the firm to the production site, with a resulting power shift advantageous for the host. However, due to the theoretical reasoning and the empirical evidence in this thesis, the author asserts an altered structure of the interdependence between these two main actors in the global political economy.

Given that the transnational corporation now to much extent pursue global strategies for their activities, and given the earlier discussed process of globalisation of the world economy, the bargain does not obsolesce, since the firm becomes increasingly less bounded to the state it invests in. Additionally, the development has made it possible for the corporation to keep the host, more or less, dependent on it and thus maintain the upper hand in the bargain. Given that there is a relative scarcity of the major FDI projects, state competition for these has also increased, furthermore leaving the state with less ability to renegotiate the bargain in its

advantage, since the relative importance of the specific FDI project increases and, thus, the cost of losing it. An anomaly in this context may be in industries that are dependent on a certain natural resource (controlled by the government of the state in which it is located), such as in mining, where there is a relative scarcity of the resources sought by the firm. However, in the industries dominating worldwide foreign direct investment flows, the mobility of the investments has increased considerably, and eroded the ability of states to shift the power in the bargain. In other words, the *obsolescing* bargain model may very well be increasingly inaccurate.

The interrelation in the long term, between the TNC and the states as actors in the international political arena may be better explained as a function of the relative scarcities which both these actors faces. Therefore, the author suggests a model for explaining the symmetry in this interdependence, which we will now turn to.

ASYMMETRIC INTERDEPENDENCE: A FUNCTION OF RELATIVE SCARCITY

The task of evaluating the power relation between states as a group and transnational corporations as a group is indeed a difficult one. However, the astute reader may already have realised that the common denominator for the reasoning in this thesis is scarcity. Indeed, scarcity determines the power relation between transnational corporations and states both in the short term, as in the case of bargaining strength due to a specific proposed localisation of an affiliate, but also in the long term. “Power” in this context is defined, according to Goldman’s characterization, as the ability of actor A to influence the actions of actor B, so that the nature of the actions of actor B potentially could considerably alter from the nature of his hypothetical actions, if he would have acted without the influence of actor A.⁶⁷ If actor B is completely independent from A, actor A will not be able to make B do anything that actor B is unwilling to do. Thus, the power of actor A increases with his ability to make B act in a way that conflicts with the preferences, or values, of actor B.

The suggestion of this thesis is that the interdependence between transnational corporations and states is asymmetric. This asymmetry is fundamentally a function of scarcity, since the power of each actor is determined by the scarcity of the goods sought by the other actor. In the present situation, as presented in the theoretical as well as empirical parts of this thesis,

transnational corporations have a structural advantage, since (1) they control resources generating economic strength; (2) they can easily shift these resources between different locations; (3) states are depending on these resources for reaching their objectives; (4) there is a scarcity of these resources and of the actors controlling them.

To make this perfectly clear, one may ask under which circumstances the states would have a structural advantage? The answer is that states, in order to have a structural power advantage over transnational corporations, must control scarce resources extensively sought by these corporations, and that the perceived scarcity of the resources controlled by the states at least counterbalance the scarcity of the resources controlled by transnational corporations. This is because the *relative scarcity* is the key to the advantage. Let us once more turn to our friends, actor A and actor B. We assume that actor A and actor B are dependent on two different goods for their survival. Both actor A and actor B have access to only one of these goods. However: actor A has access to the good which actor B is depending on, and vice versa. The problem for actor B is that even though actor A has none at all access to the good which actor B has access to (and which actor A is depending on), their surroundings are virtually swarming with other actors who has access to that same good, and from whom actor A can obtain this good. Unfortunately, that is not the case with the good which actor B is depending on. Consequently, actor B needs to obtain this good from actor A. Needless to say, in a situation where actor A and actor B are trading these goods, the interdependence between these two actors is considerably asymmetric. Due to the relative scarcity of the good controlled by actor A, actor A has substantial power to influence, perhaps even dominate, the actions of actor B.

The same principle should apply to the power structure between transnational corporations and states. The power relation derives as a function of the relative scarcities of the sought goods, or resources, by each set of actors in the system observed. Figure 4.1 suggests a model for viewing the interdependency between transnational corporations and states as a function of the relative scarcities. The asymmetry, and thus the power, increases to the advantage of transnational corporations given the balance of relative scarcities between states, and between corporations. For example: if states extensively demand a good controlled by transnational corporations, and if this good constitutes a scarcity due to the imbalance of supply and demand for this good, the transnational corporations will have an advantage due to the relative

scarcity. The relative scarcity is also, as is illustrated in the figure, determined by the interactions on state-state, and TNC-TNC level. In regard to the TNC-TNC determinant, the variables are the availability of transnational corporations, but also the degree of competition between transnational corporations for the attracted resources used to reach their objectives (e.g. access to natural resources, markets, or skilled labour; factors for maximizing profits).

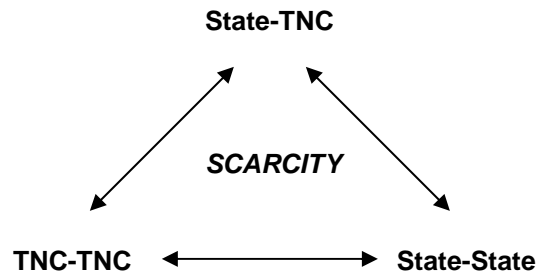


Figure 4.1 A model of the symmetry of the interdependency between TNCs and states as a function of scarcity

Competition is a keyword in the context, since it is both an expression for, and a generator of, scarcity. Obviously, competition between two actors would be the natural outcome if their mutually attracted resource were scarce. But competition may also arise from an attempt of one actor to maximise its outcome, so that the amount is perceived as scarcer than it necessarily is. This phenomenon can be said to constitute an artificial scarcity; it is an inflating of the perceived scarcity and thus the advantage of the party controlling the resource; that party may easier gain advantages on the cost of another party, playing off the parties competing for his good against each other.

In regard to the relative scarcities determined on state-state level, the variables are basically the same: the availability of attractive locations for investing - controlled by states - and the degree of competition between states for investments.

Considering the Strategic Incentives of States for Competitive Bidding

The matrix below (Figure 4.2) provides a description of the logics of outcome maximising behaviour, and illustrates the strategic game that competitive FDI-bidding among states constitutes. Even though states as a group would benefit significantly more from running a

coordinated policy on investment incentives for attracting FDI, there are still incentives to break the “cartel”, and thus benefit from increased inward investment. In the game below, two states (A and B) have agreed not to engage in competitive bidding for investment. Even though the model is a simplification, it still applies as a central explanatory variable for competitive bidding among states, but also as an explanation of the difficulties of imposing restrictions on foreign direct investment.

	Cooperate	Defect
	X	(Y)
Cooperate	3, 3	1, 4
	(Y)	Z
Defect	4, 1	2, 2

Figure 4.2 Competition for foreign direct investment

Clearly, states as a group would be best off being loyal to the common strategy, but on the other hand, individual states have incentives to engage in bidding in order to increase their share of overall FDI benefits. An offensive decision of one state will therefore be likely to immediately trigger a competitive bidding for investments, with a resulting loss in bargaining power for all states. Thus, if we have an initial equilibrium to cooperate and a common good at the arbitrary sum 6 (position X in the matrix), and state B chooses to pursue an offensive strategy in order to capture a larger share of the benefits through an incentives package (attempting to move to an allocation Y in the figure), state A would also be forced to offer incentives in order to prevent investments from moving abroad and maintain a relatively equal allocation of economic activity. Under conditions of pure rationality, the 2, 2 (defection) payoff would be the result. This outcome is commonly referred to as a Nash-equilibrium, where all actors play their best strategy, given the strategy played by the other actors: if state A would choose to cooperate, then state B would be best off to defect and gain more at the expense of state A. In the case where state A defects, state B is best off to defect also. Thus, to defect is the dominant strategy, and the equilibrium ends up in position Z in the matrix. It is

interesting to note that despite rational actions of both states, they have put themselves in a situation where they are worse off than they were before.

Hence, it is rather self-evident that competitive bidding in the long term is destructive for states as a group, as well as for individual states, since it undermines the bargaining situation for all states, providing a greater extent of power to transnational corporations, since they can play off states against each other in order to gain better conditions, and push the upper limit of the bargaining range for their investments.

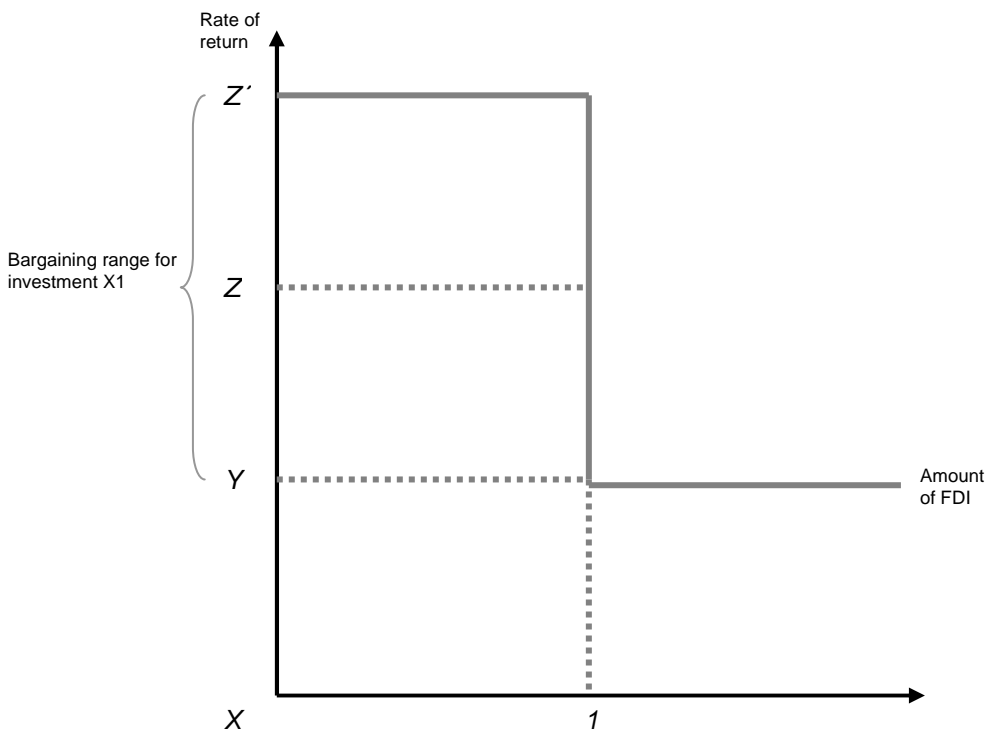


Figure 4.3 A model of the bargaining relationship between TNCs and states in a situation of competitive bidding

Figure 4.1 illustrates the bargaining relationship between transnational corporations and host states, which engage in competitive bidding for investment. As before, the vertical axis indicates the rate of return, which a firm may seek for the $X1$ amount of direct investment (as indicated on the horizontal axis). The range within which the bargain may vary is now between XY and XZ' , instead of, as was the case earlier, between XY and XZ . XZ'

constitutes a new upper limit, indicating the maximum rate of return that the TNC can obtain, given the X_1 amount of proposed investment.

One might object to this by saying that the states should realise this dilemma, and in the long term agree on international rules for competitive FDI policies. This is an adequate objection, which deserves interest, and indeed studies show that people playing the similar game “prisoners dilemma” against one another eventually work out an agreement on the cooperative strategy.⁶⁸ However, such an international regime on foreign direct investment may not necessarily lead to an egalitarian allocation of the investments, since the countries have varied natural conditions in terms of comparative advantages, which may leave some countries with a significantly less amount of TNC activity. The question therefore is: what incentives do these countries have to agree on the common strategy of neglecting competitive acts for attracting investments? The author’s answer is: none. Although it is indeed, from a state perspective, beneficial to attempt imposing such restrictions on FDI policy mentioned by the respondents, it is difficult to actually realise them. This may only be possible if the perceived disadvantage of facing sanctions from other states outweighs the advantage of attracting foreign direct investment through policies that are not accepted by the other states.

OUTCOME OF THE THEORY

Since there is indeed a scarcity of the value generating, mobile investments controlled by transnational corporations, and since economic growth is a superior political objective for states, which additionally compete for the investments, the states are not able to in a sovereign fashion pursue policies that affect their inflow of foreign direct investment. The only way for actor B, in our example above, to prevent actor A from using his influence to force actor B to act in a way that conflicts with actor B’s values would be to either (1) wholly or partly substitute the good controlled by A with another good, in order to reduce the relative scarcity or; (2) agree with the surrounding actors not to trade goods with A, leaving A with the same relative scarcity as is the case for B. Obviously, this is not to say that states should disallow transnational corporations to operate, but it helps to explain the structure and nature of the interdependency. The ways states may decrease the asymmetry in the interdependence, and thus (1) gain a better outcome in separate bargains and (2) increase the long-term ability to pursue more sovereign policies in matters determining location of activities of transnational

corporations, are to either, to some extent, substitute the economic benefits of transnational corporations with other value generating mechanisms, such as domestic firms, or in some way alter the relative scarcity of the firms through creating a real equilibrium between the scarcities, i.e. wholly or partly remove the competition between states for foreign direct investment and coordinate policies on such issues that may be used in a competitive way for attracting TNC activity. Such acting would place the equilibrium in the position X in the matrix (figure 4.2) and reduce the relative scarcity generating a power advantage of transnational corporations in the interdependency between transnational corporations and states. Therefore, one might say that there is a *potential* for a long-term structural advantage for states but it is determined by the common actions by the states and the governing dynamics in the interstate relations as illustrated in the matrix in figure 4.2.

However, as we have seen, states seem to be far from reaching such a remedy. First, as is shown by the empirical study, the perceived dependence on, and perceived benefits of, foreign direct investment is extensive, implying that it is more than unlikely that governments would attempt to pursue policies aiming to restrict the activities of transnational corporations, which control such enormous flows of world investments, trade, capital, and technology. Such policy would be directly counter the widespread process of liberalisation and deregulations of national markets. Additionally, it would be directly financially harmful for single states attempting to act in such way, given the globalised economy of today. The other way forward, a coordination of policies constituting a form of international regulation of national policies on FDI, is also problematic to realise. Even though competitive bidding is a destructive occurrence from the perspective of states as a group, we have learned that it nonetheless is a reality. Attempts have been made by the Swedish government to encourage policy coordination in the EU and OECD, but very little has actually happened. It may be theoretically possible, but in practice doubtful, that the X position in the matrix can be maintained in the long term. On the other hand, this may very well be the only option at hand for states as a group to reduce the asymmetry in the interdependence and counteract the structural advantage of transnational corporations.

WIDER IMPLICATIONS OF THE ASYMMETRY

Do transnational corporations rule the world?⁶⁹ The author's answer to the question would be: no, but their influence and the nature of the structure determining this certainly deserves attention. One must make a distinction between, on the one hand, the phenomenon that states as a group are more dependent on transnational corporations than vice versa, and, on the other hand, the *kind* of power this asymmetry implies. It is sometimes said that the degree of interdependence can fall in one of two degree categories: "vulnerability" interdependence, which is a tie that is costly to break, while "sensitivity" interdependence refers to a tie which either party easily can cast aside, since it may be unnecessary or since the underlying reason for the attraction to the good or service may be obtained elsewhere.⁷⁰ The state of the interdependence between states and transnational corporations can be described as vulnerability interdependence from the states' perspective, although it has the character of sensibility interdependence from the perspective of the TNCs. However, that the interdependence is more costly to break for the states, does not mean that the power of the transnational corporations as a group, which derives from the asymmetry, is unlimited or universal. After all, transnational corporations are bound by the rules and regulations of the states in which they operate. It is the states that are determining the conditions under which transnational corporations operate. The problem, which this thesis aims to elucidate, is that the outcome of the international relations between states, i.e. the competition for foreign direct investment and inability to coordinate FDI policy, considerably undermines the structural power of the states.

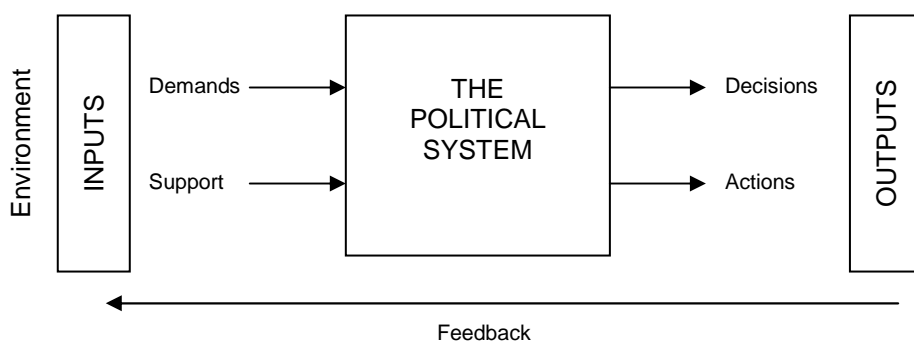


Figure 4.4 A model of the political system

A potential problem with an asymmetry is the possible consequences for the national political system in democratic states. Since the states become vulnerability interdependent vis-à-vis transnational corporations, the ultimate long term consequences is, as has been previously mentioned, that they are unable to in a sovereign (whereas the term “sovereign” denominates the ability to act according to one’s own preferences without considering the preferences of other) way pursue policies that affect foreign direct investment. In this situation it is highly likely to expect an asymmetry in the policy process of the national political system. Figure 4.4 illustrates the national political system.⁷¹ The problem lies in the probability that the perceived magnitude of demands and support of transnational corporations may outweigh the perceived importance of other parts of the political environment, resulting in an asymmetric input in the policy process. This is both a potential problem for the people, since their demands may be partly circumvented by government, as a lower priority, but also a problem for democratic governments since it may undermine the legitimacy of their regime, if the people’s perception is that their preferences are not channelled well enough into the political process.

NOTES

⁶⁷ K. Goldmann, “The International Power Structure: Traditional Theory and New Reality” in K. Goldmann and G. Sjöstedt (eds.), *Power, Capabilities Interdependence: Problems in the Study of International Influence* (Beverly Hills/London; Sage Publications 1979), pp. 7-36.

⁶⁸ Joel Krieger, *The Oxford Companion to Politics of the World* (New York: Oxford University Press, 1993), p. 431.

⁶⁹ A contemporary question, which is often asked by various contributors. See for example Andrew Walter, “Do They Really Rule The World?” in *New Political Economy* (vol. 3, No. 2 1998), pp. 288-292.

⁷⁰ Krieger, op. cit. in note 1, p. 430.

⁷¹ Figure source as modified by the author: David Easton, *A Framework for Political Analysis* (New Jersey: Prentice Hall, 1965), p. 112.

References

Bibliography

Boyer, Richard and Drache, Daniel, eds (1996). *State, Against Markets: The Limits of Globalization*. London: Routledge

Chandler, Alfred (1962). *Strategy and Structure: Chapters in the History of the American Industrial Enterprise*. Cambridge, Mass: MIT Press.

Coase, R. H. (1937). "The Nature of the Firm", in *Economica* (vol. 4, 1937), pp. 386-405.

Cohn, Theodore H. (2000). *Global Political Economy –Theory and Practice*. Addison Wesley Longman.

Dicken, Peter (1998). *Global Shift: Transforming the World Economy*. London: Paul Chapman Publishing.

Doz, Yves (1986). *Strategic Management in Multinational Enterprises*. Oxford: Pergamon Press.

Dunning, John H (1973). "The Determinants of International Production", in *Oxford Economic Papers* (vol. 25, 1973), pp 289-325.

Dunning, John H (1988). *Explaining International Production*. Boston, MA: Unwin Hyman.

Dunning, John H (1994) "Re-evaluating the Benefits of Foreign Direct Investment", in *Transnational Corporations* (vol.3, No. 1 - February 1994), pp. 23-51.

Dunning, John H and Mucchielli, Jean-Luis (2002). *Multinational Firms: The Global-Local Dilemma*. London and New York: Routledge.

Easton, David (1965). *A Framework for Political Analysis*. New Jersey: Prentice Hall.

Eden, Lorraine (1991). "Bringing the Firm Back In: Multinationals in International Political Economy", in *Millennium: Journal of International Studies* (vol. 20, No. 2 1991), pp.197-224.

Gilpin, Robert (1987). *The Political Economy of International Relations*. New Jersey: Princeton University Press.

Gilpin, Robert (2000). *The Challenge of Global Capitalism: The World Economy in the 21st Century*. New Jersey: Princeton University Press

Gilpin, Robert (2001). *Global Political Economy: Understanding the International Economic Order*. New Jersey: Princeton University Press.

K. Goldmann and G. Sjöstedt (1979). *Power, Capabilities Interdependence: Problems in the Study of International Influence*. Beverly Hills/London: Sage Publications.

Government of Sweden (2002). *En samlad svensk globaliseringspolitik*. Stockholm: Tryckeriet Åsbrink.

Grimwalde, Nigel (1989). *International Trade: New Patterns of Trade, Production and Investment*. London, New York: Routledge.

Hellblom, Ola (2002). "Ingen reavinst på Irland" in *Dagens Industri*. (November 10), p. 18.

Investment Canada (1990) "The Business Implications of Globalisation", *Investment Canada Working Paper Series* (No. 1990-V). Ottawa: Government of Canada.

Julius, DeAnne (1990). *Global Companies and Public Policy: The Growing Challenge of Foreign Direct Investment*. London: Pinter

Jönsson, Christer (1992). *Internationell Politik*. Lund: Studentlitteratur.

Kobrin, S. J (1987). "Testing the bargaining hypothesis in the manufacturing sector in developing countries", in *International Organisation* (vol. 41), pp. 609-638.

Krieger, Joel (1993). *The Oxford Companion to Politics of the World*. New York: Oxford University Press.

McGrew, Anthony G and Lewis, Paul G (1992). *Global Politics: Globalisation and the Nation-State*. Cambridge: Polity Press

Nixon, F (1988). "The political economy of bargaining with transnational corporations: some preliminary observations", in *Manchester Papers in Development* (vol. IV), pp. 377-390.

O' Hara, Phillip Anthony (2001). *Encyclopedia of Political Economy*. London: Routledge.

Parker, George (2002) "From talking shop to crucible of high politics: Europe's convention is evolving into a historic undertaking" in *Financial Times* (December 31), p. 7.

Porter, Michael (1986). *Competition in Global Industries*. Cambridge, Mass: Harvard Business School Press.

Porter, Michael (1990). *The Competitive Advantage of Nations*. New York: Free Press.

Salehi-Sangari, Esmail & Foster, Tim (1999). Curriculum Internationalisation, in *European Journal of Marketing* (vol. 33, 7/8 1999), pp. 760-771.

Schneider, Friedrich and Frey, Bruno (1985). "Economic and Political Determinants of Foreign Direct Investment", in *World Development* (vol. 13, No. 2 1985), pp. 1-26.

Stopford, John and Strange, Susan (1991). *Rival states, rival firms: competition for world market shares*. Cambridge: Cambridge University Press.

Tung, Rosalie L (1999). *The IEBM Handbook of International Business*. Cornwall: International Thomson Business Press.

United Nations Centre for Transnational Corporations (1988). *Transnational Corporations in World Development*. New York: United Nations.

United Nations Conference on Trade and Development (1992): *World Investment Report 1992*. New York: United Nations.

United Nations Conference on Trade and Development (1995): *World Investment Report 1995*. New York: United Nations.

United Nations Conference on Trade and Development (1996): *World Investment Report 1996*. New York: United Nations.

United Nations Conference on Trade and Development (2001): *World Investment Report 2001*. New York: United Nations.

Vernon, Raymond (1971). *Sovereignty at Bay: The Multinational Spread of US Enterprises*. New York: Basic Books

Vernon, Raymond (1977). *Storm Over the Multinationals*. Cambridge, MA: Harvard University Press.

Walter, Andrew (1998). "Do They Really Rule The World?", in *New Political Economy* (vol. 3, No. 2), pp. 288-292.

Winters, L Alan (1991). *International Economics* London: Routledge.

Interviews

Interview with Mr. Kurt Hellström, chief executive officer, Telefonaktiebolaget LM Ericsson: Stockholm: July 16, 2002, at LM Ericsson, Head Office (Telefonvägen 30, Hägersten). The interview was carried out between 14:00 and 15:00.

Interview with Mr. Anders Sundström, former Minister for Industry, Employment and Communications:

Piteå: August 8, 2002, at Pitedalens Sparbank (Storgatan 43). The interview was carried out between 09:15 and 09:45.

Interview with Ms. Lotta Fogde, state secretary at the Ministry for Foreign Affairs:

Stockholm: August 12, 2002, at the Ministry for Foreign Affairs (Gustav Adolfs Torg 1). The interview was carried out between 10:00 and 10:40.

Interview with Dr. Lars Heikensten, Governor's alternate, First Vice Chairman and Deputy Governor of the Swedish central bank, Riksbanken:

Stockholm: August 13, 2002, at Riksbanken (Brunkebergstorg 11). The interview was carried out between 14:00 and 14:40.

Interview with Mr. Sven Hegelund, state secretary at the Ministry of Finance:

Stockholm: August 13, 2002, at the Ministry of Finance (Drottninggatan 21). The interview was carried out between 15:20 and 15:45.

Interview with Ms. Malin Persson Head of Corporate Strategy & Business Development, AB Volvo, Gothenburg:

Gothenburg: August 14, 2002, at Volvo AB, Head Office (Bergegårdsvägen, Torslanda). The interview was carried out between 08:00 and 08:20.