Jan 23, 25  

**New Explanations for New Realities: Representative Models**

As new actors, MNCs demand theorization, particularly when existing capital movement theories proved ill-suited to the reality of FDI as the dominant mode of investment. This week surveys and critically evaluates theoretical, conceptual, and analytical attempts to explain the behaviour of MNCs after their rise to prominence in the 1960s.

Part 1: Where do MNCs really come from?
Adam Smith’s Pin factory
The Emergence of Modern Markets:
A Structural Explanation

The parallel existence and mutual interaction of state and market... in the modern world (from Robert Gilpin, *The Political Economy of International Relations*, 1987)
<table>
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<tr>
<th>Nature of economic relations</th>
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<td><strong>Attitude toward MNCs</strong></td>
<td>positive (engines of development)</td>
<td>typically negative (predatory engines of exploitation)</td>
<td>negative (predatory threat to national interest)</td>
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<td><strong>Source of MNCs</strong></td>
<td>natural product of market imperfections</td>
<td>not natural: products and instruments of historically specific class interest &amp; power</td>
<td>not natural: products of permissive policies</td>
</tr>
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<td><strong>Prescriptive response to MNCs</strong></td>
<td>open markets</td>
<td>divided but general preference for national regulation, expropriation/control</td>
<td>national regulation &amp; control</td>
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But is the distinction between states and markets eroding?

• private sector is becoming more public-minded, while the public sector is becoming more business-minded

• emphasis on *partnerships* between business and government (sharing skills and expertise in promoting regional and global stability)

• a new division of labour

• the language of “stability” still there but expressed more in terms of a need among states, MNCs and other actors to avoid “systemic discontinuities”

• e.g. September 11, 2001

• stability of this sort cannot come from governments alone

• structural explanations no longer feasible or enough?

• economic stability giving way to promoting peace (and this an increasingly essential element of successful *business* operations)
Competing models

Spontaneous structural forces Gilplin: IPE

Converging, conscious, and coordinated interest of stakeholders (conscious partnerships)

- IGOs (states)
- NGOs
- MNCs
**Stranger Things**

Four stops on the London Underground will take you from the London Business School in Regent’s Park to the London School of Economics off the Strand. Yet for 30 years the two institutions might have been separated by a Berlin Wall, so minimal was the communication between them, so divergent the matters that interested their professors, so diverse the discourses of their students. Each was openly dismissive, but secretly jealous, of the other.¹
Part 2: Why do MNCs arise?

Representative Theories
Do “new” actors require new theories?

• yes

• MNCs new actors but international investment an old phenomenon

• *Capital movement* theories well established

• *If* FDI were motivated by higher rates of return abroad, these theories would suffice

• But works best for *portfolio* investment

• Motive for FDI not strictly financial
Peasants & Rainbows

- The allure of “grand theory” for MNCs
- The reality: factors, theorems, hypotheses, & models
- Overlapping explanatory devices
- Many (but not all) of these devices generated by economists
Necessary conditions for MNCs (because they can)

- Reduced transaction costs
  - Cheaper, more reliable transportation
  - Improved communications, management & organizational techniques
- “Monopolistic advantages”
  - Financial power, technological or managerial expertise
- Permissive “home” government policies
  - Overseas investment insurance or promotion schemes
  - Official aid policies
  - Tax policy
- NOTE: Gilpin sees latter as sufficient condition
Sufficient Conditions for MNCs (because they should)

• Market saturation in home country coupled with threats to exports abroad

• Rise of tariffs (e.g. huge surge of US FDI in Europe in 1960s; Japanese FDI in US auto markets in 1980s) —“tariff-jumping hypothesis”

• Vulnerabilities to “proprietary knowledge”
• All of the major theories of MNC behaviour stress the *oligopolistic* character of MNCs & industries
Oligopoly defined

oligos=few    polein=to sell

monopoly    (one seller)
monopsony   (one buyer)

Oligopoly: small number of powerful firms affects but does not wholly control a market/industry

Perfect Competition (infinite # of buyers & Sellers)

Exxon (was Standard Oil of New Jersey, then Esso)
Mobil (was Standard Oil of New York, which merged with Vacuum Oil)
Chevron (was Standard Oil of California)
Texaco
Gulf Oil (controlled by the Mellons)
Shell (Royal Dutch Petroleum)
British Petroleum (Anglo-Iranian)
Representative Theories

1. The Product Cycle Model
2. OLI Theory (Ownership, Location, & Internalization)
3. Global Reach perspective
The PCM

• Associated closely with Raymond Vernon

• Behavioural theory focused on technology rather than firm *per se*

• Best seen visually
The Product Cycle visualized

Phase 1—1948
Introduction

Phase 2—1950s
Growth

Phase 3—late 1950s
Maturity

Phase 4—mid-1960s to 1970
Decline
Assumptions

• MNCs generally positive & beneficial
  • Strong emphasis on “trickle down” benefits
  • Also enhances host state power over time

• MNCs market-induced
  • Efficient responses to “market imperfections”

• MNCs defensive (market-protecting)
Strengths & limitations

• Suited well to early manufacturing behaviour of US MNCs

• Good explanation of technology transfer

• Good explanation of integration of trade & production strategies
OLI Model

- Associated closely with John Dunning
- Reverses focus of PCM (to firm rather than product)
- Strong emphasis on market imperfections & vulnerabilities to *propriety knowledge*
- Strong emphasis on competitive technological advantages
- These factors together create a strong incentive to internalize markets
What exactly does this mean?

• Technology is very expensive & bound to diffuse to competitors in a market-place

• But markets can be *internalized* through acquisitions of other firms

• Technology now diffuses through subsidiaries rather than a market
But a would-be MNC must meet three requirements

1. It must own a specialized (undiffused) knowledge

2. Particular foreign location must be more advantageous to new investment than home market

3. Export & licensing agreements must be less attractive than FDI
Assumptions

• MNCs market-induced actors
• MNCs largely market protecting & defensive
Strengths & Weaknesses (OLI)

• Works well for many high-tech firms

• Nicely complements PCM

• Increase in the variety of investments (e.g. LDC MNCs) challenges FDI theories based on ownership-specific advantages

• Cannot account for the aggressive, market-seeking behaviour of many firms
The Global Reach Perspective

- Associated loosely with Barnet/Muller, *Global Reach* 1976; Stephen Hymer, *The Multinational Corporation: A Radical Approach*, 1979
- Not a theory per se but group of assumptions
- Marxists (e.g. Hymer) emphasize structural features of monopoly capitalism
- Non-Marxists (e.g. Gilpin) stress semi-autonomous power of MNCs
- MNCs not simply market creations
- They are strategic, political actors that utilize subsidiaries as weapons
- MNCs use firm-specific advantages (as per PCM & OLI) BUT also seek to remove competition
- MNCs viewed as institutions with strategies, tactics, & discretionary powers
Assumptions

• MNC behaviour generally undesirable

• Leads to “uneven development”

• MNCs the cause (not cure) of market imperfections

• MNCs supplant (rather than complement) local factors

• MNCs aggressive market-seekers
Prescriptions

• MNCs should be monitored & controlled unilaterally or multilaterally

• Especially critical of “transfer pricing”

• State should intervene in bargaining process

• FDI should be “unbundled”

• States should give preferential treatment to national capital
Strengths & Weaknesses

- conceives of MNCs in strategic terms
- Nice complement to liberal-economic models
- Does not work for all MNC types (e.g. works best for very large, vertically integrated manufacturing firms)
- prescriptions seem increasingly unrealistic
Summary

- Theories of MNCs remain partial and tend to be isolated from each other (conflicting disciplinary biases)

- Are MNCs institutions? Economic phenomena? Driven by technology & market forces or internal agendas?

- Each of these samples biased toward oligopolistic firms and increasingly dated (outdated?)

- Narrow & limited explanatory capacities