Jan 21, 23 New Explanations for New Realities: Representative Models

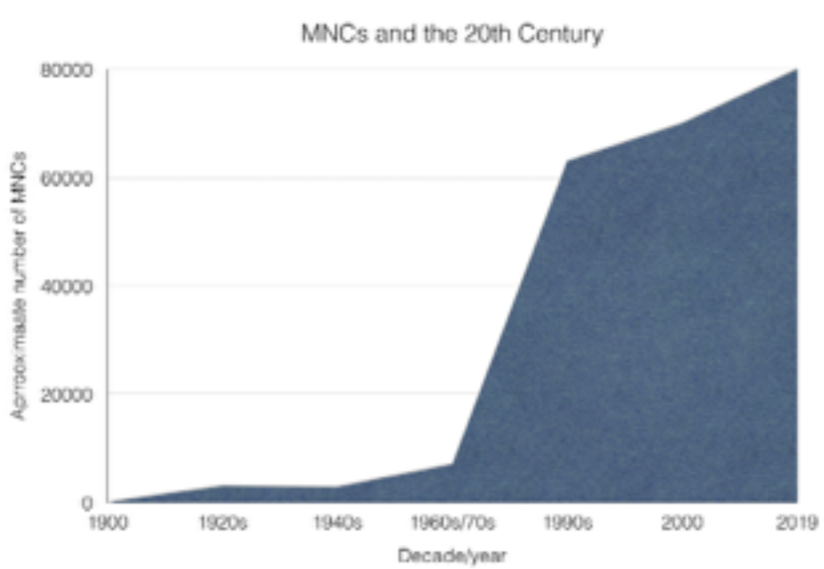
As new actors, MNCs demand theorization, particularly when existing capital movement theories proved ill-suited to the reality of FDI as the dominant mode of investment. This week surveys and critically evaluates theoretical, conceptual, and analytical attempts to explain the behaviour of MNCs after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

Readings

📖 **Joan Spero and Jeffrey Hart (1997) "The Multinational Corporation and the Issue of Management," from *The Politics of International Economic Relations*, New York: St. Martin's.**

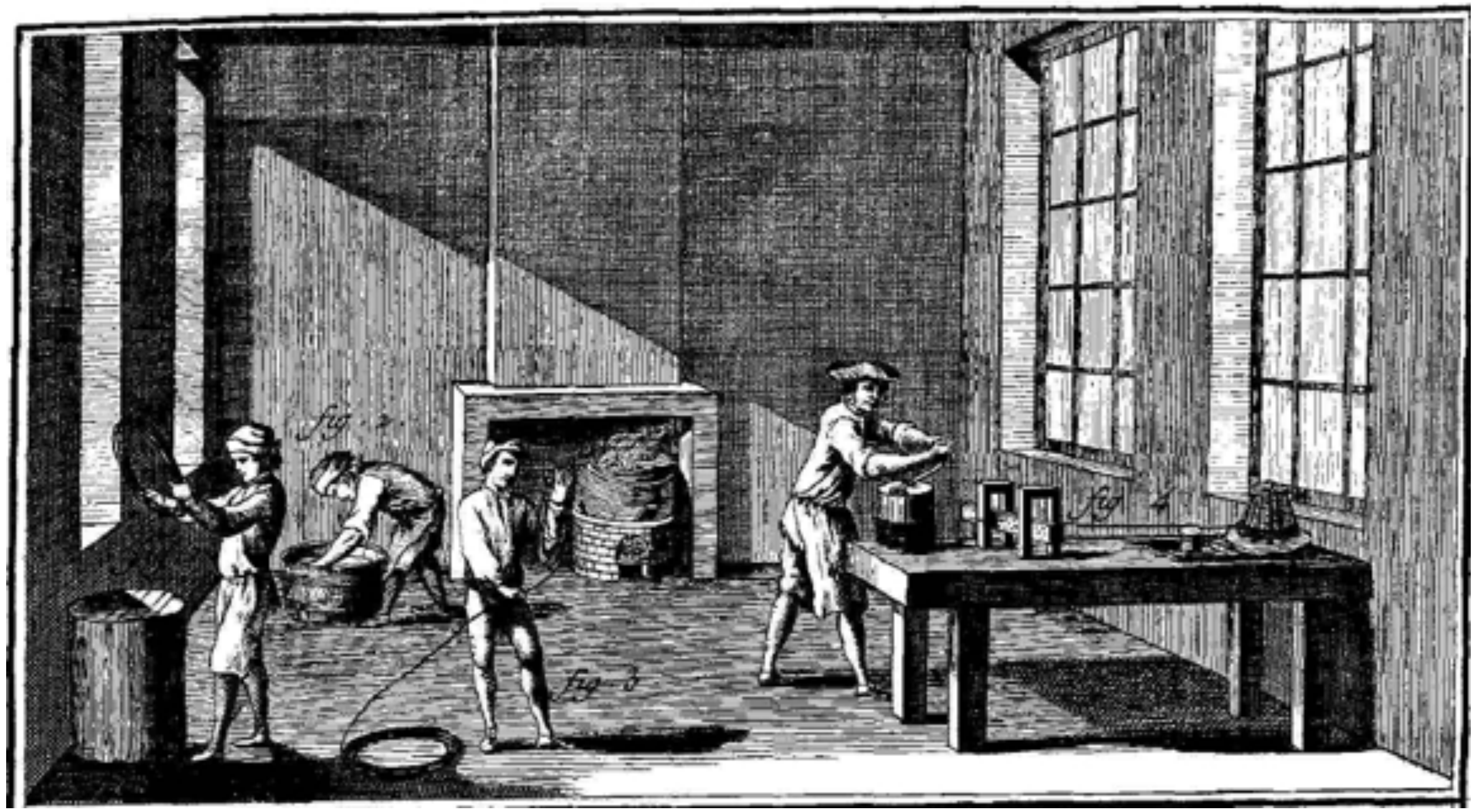
📖 **Susan Strange (1994) "Rethinking Structural Change in the International Political Economy: States, Firms, and Diplomacy," from Richard Stubbs and Geoffrey Underhill, *Political Economy and the Changing Global Order*, Toronto: McLelland and Stewart.**

Old Singer building,
Manhattan, 1930s



This unit emphasizes the reality that MNCs are genuinely new actors in international political economic relations (IPE) and thus require new theorization. Existing capital movement theories focused on portfolio investment. MNCs are revolutionary in making foreign direct investments. MNCs, while superficially similar to the large mercantile trading companies of the 1600s (e.g. HBC, East India company) cannot reasonably be compared to these dinosaurs. Like dinosaurs, these companies are extinct, and for similar reasons. MNCs are private actors operating arms length from home governments (places where they are headquartered) and do not officially or legally serve home state interests. The mercantile traders by contrast only exist because of government charters which were abrogated when the company served its purpose and/or challenged the control of the home government. For example, the British government passed the Government of India Act 1858 taking over all of the East India Company's possessions thus dissolving the company. The actual origins of the MNC lay in the capitalist not mercantile period, and these modern giants do not emerge until the early part of the 20th century. Curiously, Mira Wilkins in her book *The Emergence of Multinational Enterprise,* claims that Singer Sewing became the first MNC in 1914. It is very doubtful that their birth can be traced with such precision, but the first companies emerged in this era, were almost entirely American, and had become national industry giants. As the graph on the left shows, MNCs do not become a major phenomenon until the post WW II period, and by the 1970s were being theorized, though mostly by economists rather than political scientists, a trend that continues. This unit explains and contextualizes this reality, provides an overview of IPE theory in general, and develops the most important Liberals contributions and especially Raymond Vernon's "Product Cycle model."

Adam Smith's Pin factory

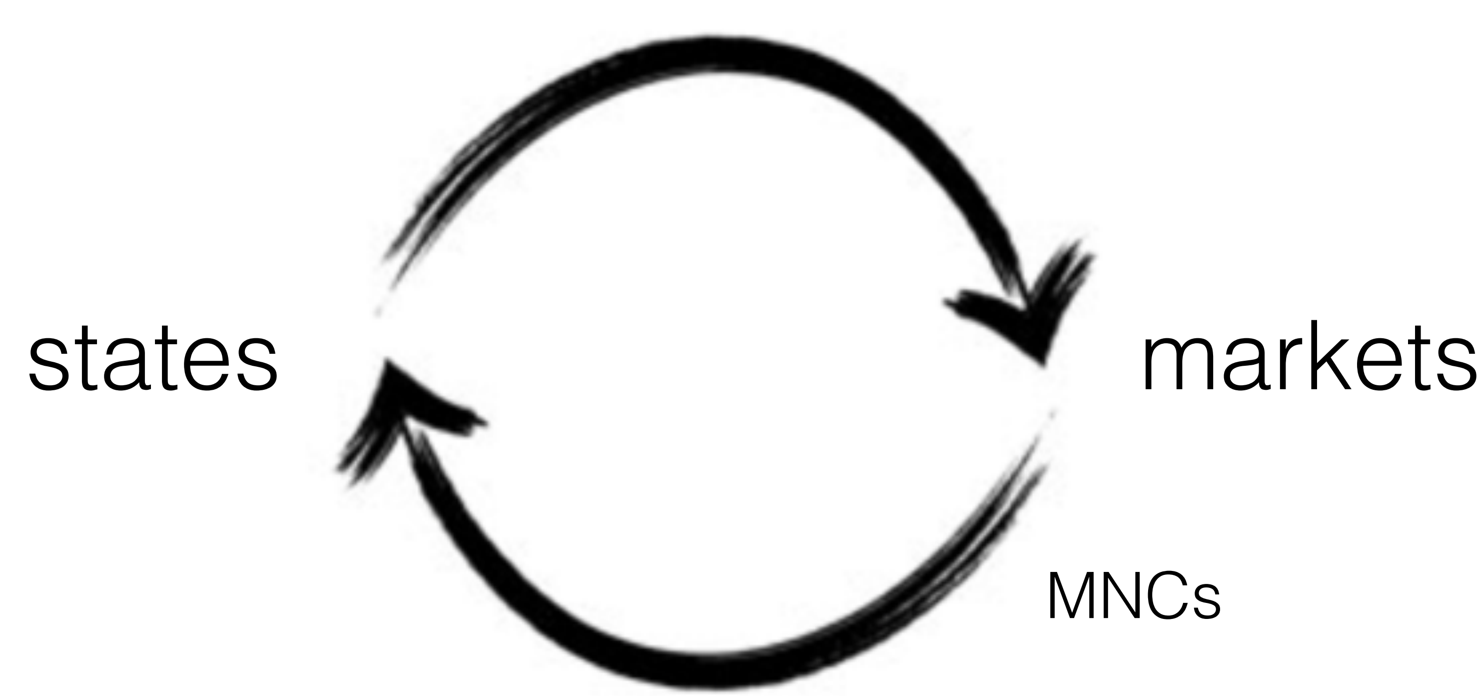


Wealth creation comes from the division of labor

"One man draws out the wire, another straights it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations …. I have seen a small manufactory of this kind where ten men only were employed . . . [who] could make among them upwards of forty-eight thousand pins a day"

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)



	Liberalism	Marxism	Mercantilism (Realism)
Nature of economic relations	harmonious	conflictual	conflictual
Nature of the actors	household and firms	economic classes	nation-states
Goal of economic activity	max. of global welfare	max. of class interest	max. of national interest
Relationship between economics and politics	economics *should* determine politics	economics *does* determine politics	politics determine economics
Theory of change	dynamic equilibrium	tendency toward disequilibrium	shifts in the distribution of power

source: Robert Gilpin, *US Power & The Multinational Corporation*, 1975, p. 27

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Theory of change	dynamic equilibrium	tendency toward disequilibrium	shifts in the distribution of power
Attitude toward MNCs	positive (engines of development)	typically negative (predatory engines of exploitation)	negative (predatory threat to national interest)
Source of MNCs	natural product of market imperfections	not natural: products and instruments of historically specific class interest & power	not natural: products of permissive policies
Prescriptive response to MNCs	open markets	divided but general preference for national regulation, expropriation/control	national regulation & control

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

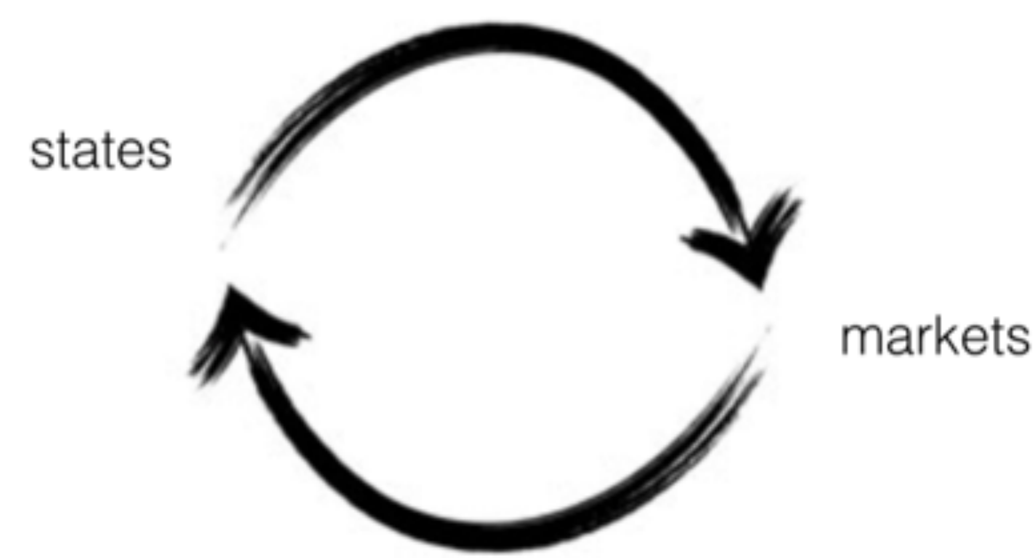
- the language of “stability” still there but expressed more in terms of a need among states, MNCs and other actors to avoid “systemic discontinuities”

- e.g. September 11, 2001

- stability of this sort cannot come from governments alone

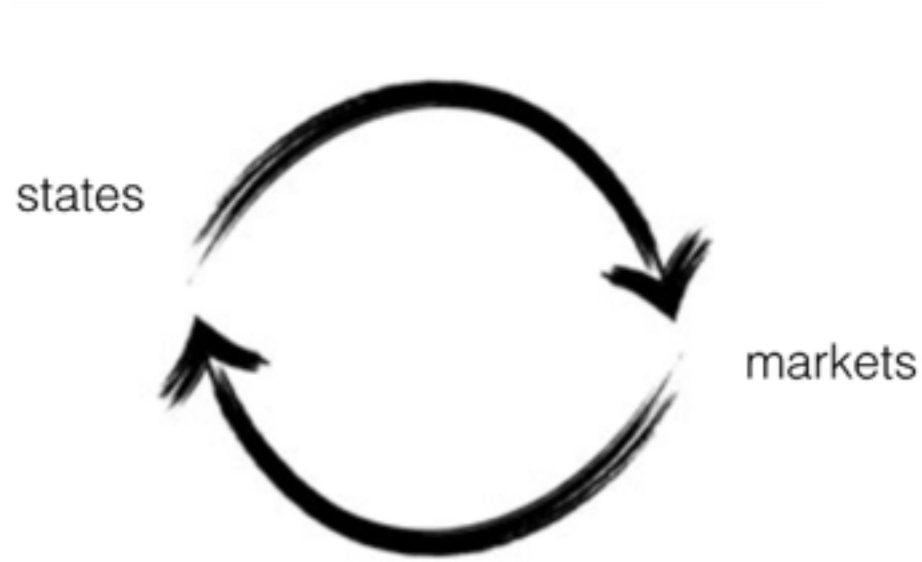
- economic stability giving way to promoting peace (and this an increasingly essential element of successful *business* operations)

- “they must construct global political and economic scenarios which do not ignore the potential for systemic discontinuities….”

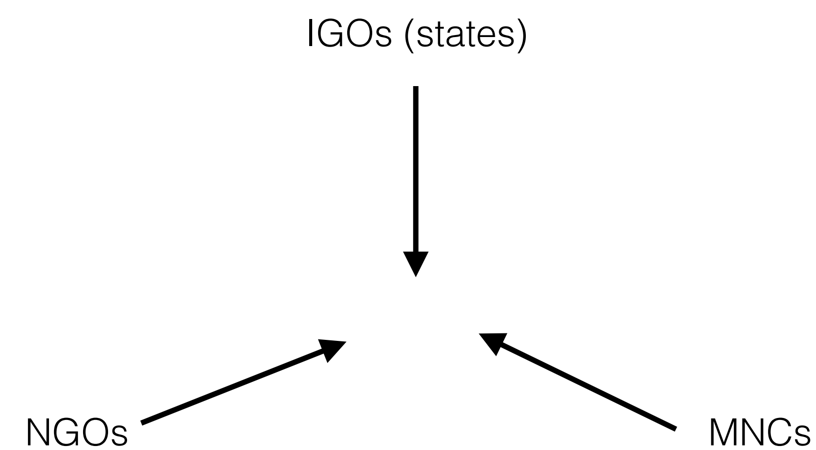


Competing models

Spontaneous structural forces Gilplin: IPE



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



Susan Strange(1923-1998)

Established the academic field of international political economy (IPE) and co-founded the British International Studies Association. World-leading thinker on IPE. Her most influential books include *Casino Capitalism* (1986), *States and Markets* (1988), *The Retreat of the State* (1996) and *Mad Money* (1998).

*Strange*r 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]

States, Firms, & Diplomacy

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. surge of US FDI in Europe in 1960s; surge of 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

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)

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)

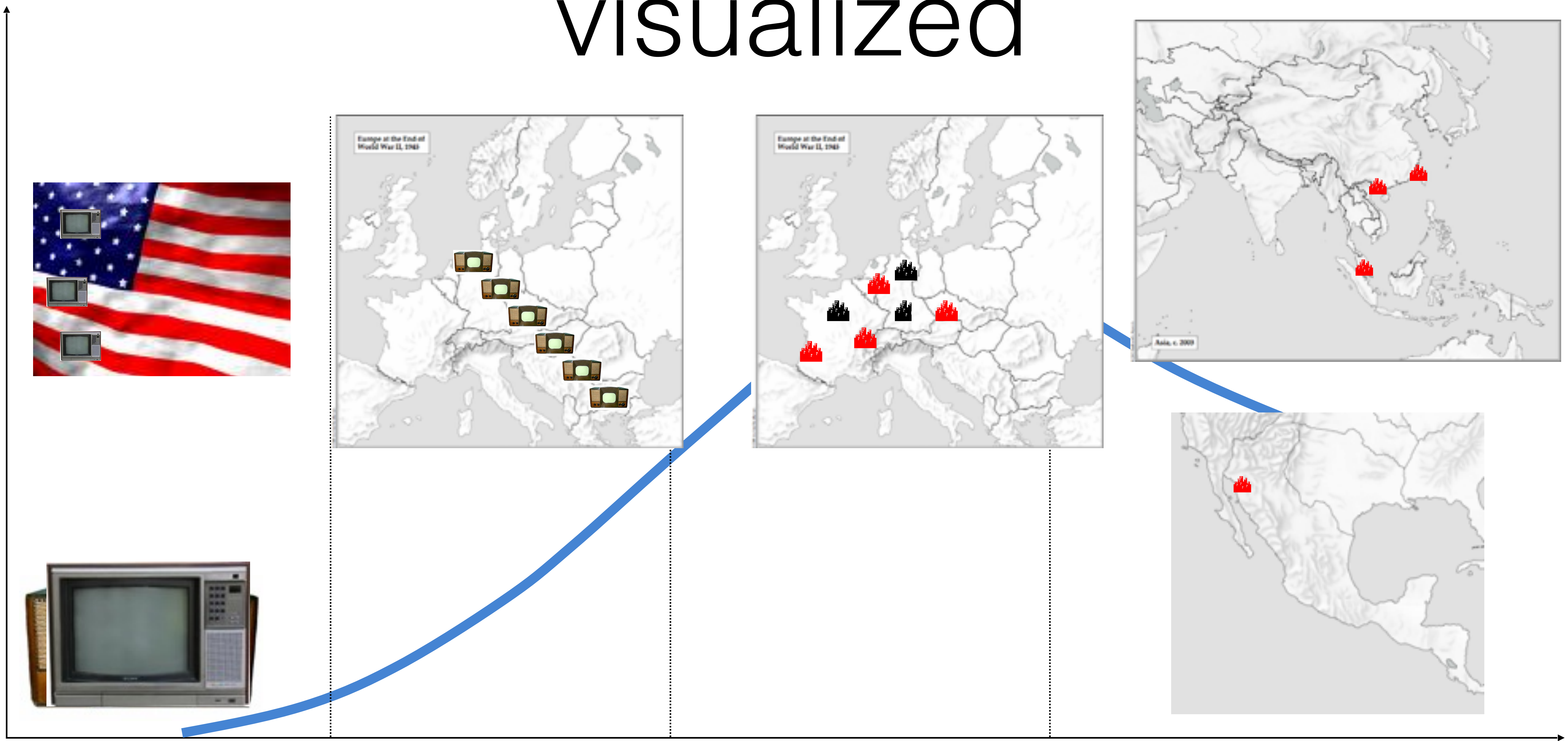
Representative Theories

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 | Phase 2— 1950s | Phase 3 — late 1950s | Phase 4 — mid-1960s to 1970

Introduction | Growth | Maturity | 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