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Multinational Corporations and Development: Changing Perceptions

By

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It is an honour to be giving the Joseph Fisher Lecture this year. I must say also that I am doubly pleased.

The Lecture has been given by international economists whom I much admire. Max Corden, who is Australia's "national treasure" and one of my oldest friends, has given it twice. James Meade who (with Harry Johnson) was the undisputed doyen of international economists has given it also. So has Paul Krugman who was my student and my "discovery" at MIT and from whom I have learnt more than I have taught him. Following in their footsteps is presumptuous but pleasurable.

But I also noticed that Mr. Fisher was a man much to admire. He was for long a successful newspaper man. Today, the power that the media exercise is evident even more than in Mr. Fisher's time. All of us who work in public policy are aware of the need to cultivate the media so that our ideas get attraction and therefore traction. I must tell you that my daughter who once worked as an Intern at the Financial Times in the Weekend Section being edited then by Robert Thomson (then Editor of the London Times and now of the Wall Street Journal), told me how even Luciano Pavarotti wanted to take the phone when she said that she was calling for this influential newspaper. She added: "Now I understand why you would dash out of the shower to take the phone if I said that Peter Passell of the New York Times was calling!"

But Mr. Fisher was also an accomplished businessman who made his money in the apparent belief that economic well-being is hard to sustain unless wealth accumulates. But,

like the Dutch burghers of my colleague Simon Schama's Embarrassment of Riches, and the Jains and Vaishnavs of my native state of Gujarat (from whose tradition Mahatma Gandhi derived his moral sensibility) , he believed that wealth must be deployed, not for self-indulgence, but to do charitable works (of which his endowment of this Lecture is only a small example). I have described such altruism as Personal Social Responsibility.

But it is also apparent from all I have read about Mr. Fisher that he brought a sense of moral rectitude in his business dealings. That he was heavily involved in the Bank of Adelaide and never compromised himself strongly suggests that the current preoccupation of the critics of the financial sector, that it undermines morality, reverses cause and effect. We acquire moral values in all sorts of ways: from our parents, from our schools, and from reading great literature that poses moral questions (as in Fyodor Dostoevsky whose Crime and Punishment has Sofia turning to prostitution to feed her family, posing a moral conflict instead of suggesting absolutes). We bring these values than to where we work. The notion instead that where we work determines our values is for the most part wrong: it is a quasi-Marxist fallacy that argues that where we work, like the means of production, determines our morality. I would suggest also that the fact that the financial sector offers the highest returns to crooked behavior implies that those who are crooked to begin with will be attracted to this sector. The Bernie Madoffs are more likely attracted to finance rather than made by finance.

Since today, the evolving ideas about Multinationals have led to the notion that they ought to practice Corporate Social Responsibility, I can think of no better subject to address in honour of Mr. Joseph than the evolving role of multinationals in development.

The arguments of both the critics and the proponents have gone through significant changes as structural changes in the world economy have occurred and changes in society and governance such as a growing civil society and spread of democracy worldwide have occurred. Equally, it is now clear that, if multinationals are to play a welcoming and beneficial role in the developmental process, they need to re-conceptualize the way they operate in the host countries. If they do so, they will become true friends of the developmental process, and the opponents who charge that they are foes instead will lose political salience.

I: Alternative Views on Impact of Globalization

The earliest arguments as the leaders of the newly independent developing countries began to plan for accelerated growth and resulting reduction of poverty --- what I have called the progressive and activist “pull up” strategy for reducing poverty, in contrast to the conservative characterization of it as a passive “trickle down strategy suggesting that the Earl of Nottingham and his vassals are eating leg of lamb and venison at a high table, with crumbs falling to the dogs and serfs below---, the question that faced them involved answering a basic economic-philosophical question. How would integration into the world economy on dimensions such as trade, equity investment (i.e. multinationals), migration and technology (e.g. intellectual property protection) work? Would, as the opponents argued, integration into the world economy on these different dimensions lead to disintegration of the national economy; or would it help instead?

At the time, I distinguished among four different schools of thought¹. First, there was the benign impact model: this fitted into economists' thinking since they are used to "mutual gain" outcomes. . Thus, multinationals would earn profits but they would also bring funds and technology, for instance, to the host countries. Similarly, freer trade would benefit all. Then, there was also the more pleasing template of benign intent. Multinationals saw themselves as agents of benign change. Aid was given to reflect the white man's burden: it was altruistic. But then there was the malign impact view. President Cardoso, who was earlier an eminent sociologist in Brazil, and Raul Prebisch of Argentina and first Secretary General of UNCTAD, were among those who propounded this bleak view. The former is known for the "dependencia" thesis that the developing countries would wind up in a state of dependency with increased international integration: multinationals were seen as sources of a malign impact. But then there were many, some in the developed countries as well, who thought in terms of malign intent: aid, for instance, was being given to hold the decolonized countries into a neocolonial embrace.

Let me now treat the evolution of thinking about multinationals and their role in development, using this fourfold division of views that characterized different scholars and policymakers in the postwar years.

II: Benign Impact Arguments for Multinational Corporations

At the outset, the benign impact arguments in favor of investing in developing countries came, as one would guess, principally from the mainstream economists. Let me

¹ Cf. Chapter 1 in Bhagwati (ed.), The New International Economic Order, MIT Press: Cambridge, Mass., 1977.

recap just a few of the important ones that led many to argue that there was a “presumption” that multinationals (MNCs) brought good to the developing countries.

(a) Several economists focused on the inflow of funds that MNCs would bring to the host countries.

If MNCs earned a return equaling the value of their contribution to the host country (i.e. there were no uncompensated externalities or other market failures or policy-imposed distortions), one may deduce that there was neither benefit nor loss to the host country: what the MNCs contributed to the host country was what they earned, leaving no “surplus” that would benefit the host country.² But it is obvious that, if MNCs are taxed by the host country as they are, that implies that the MNCs earn less than their contribution to the host country.

Yet another pro-MNC presumption followed from the fact that, if real wages were bounded from below and there was surplus labour available as in the Marx-Lewis model of the reserve army of labour available at a given wage, the social return from funds brought in by the MNC investment would not just be the private return on the investment but also the wages earned by the surplus labour that was hired thanks to the investment influx. Since countries like India and China had abundance of surplus labour at a given wage, the MNC investment would have a social return that exceeded its private return. That reinforced greatly the tax-defined presumption in favour of MNCs.

² This argument applies to “small” inflows. If the flows are large and there are diminishing returns, then inflow of capital will depress the return to capital and generate a “surplus” or gain to the host country.

(b) But, of course, MNCs do not bring in just funds (sometimes they do not even do that, raising all their funds in the host country). They bring in external (marketing) networks and internal diffusion of knowhow.

Thus, we know that MNCs now source their inputs from many sources and they virtually guarantee external sales of the components they manufacture. Again, retailers like Wal-Mart are conduits for purchase in the host country and sales in foreign countries.

Again, economists had long hypothesized that MNCs are the source of new management techniques and of new technologies which diffuse at low cost through the host country. There are now numerous empirical studies of the channels through which such diffusion occurs.

It is not surprising therefore that worldwide the benign impact view of MNCs has come to prevail. Countries such as India (where the pre-reforms policy based on a malign view of MNCs had reduced equity investment by MNCs to almost \$100 million) have come around to increasingly opening their doors to welcoming MNCs. The early view of MNCs in many of these countries that MNCs were foes of development has changed to the benign view that they are friends instead.

In fact, one could even say that there is now a virtual competition among many developing countries for MNCs, pretty much the way states in US compete to attract manufacturing firms to locate in them, granting all kinds of rewards such as tax holidays, subsidized land and other benefits, raising the legitimate question whether, once these giveaways are factored in, the MNCs remain beneficial to the host countries/states. A

legitimate fear is that we may be getting a race to the bottom and the presumption that the taxes on MNCs leave the host country better off may be getting reversed in such a “race to the bottom” in giveaways. Astonishingly, but not surprisingly (given the self-serving lobbying by MNCs, a subject I turn to later in this Lecture), the MNCs have wanted at the OECD to reduce taxes, arguing that they distort allocation of investments among host countries, but have not symmetrically argued that subsidies would do that too!

III: The Malign Impact Arguments

In fact, the specific malign-impact arguments that had provided support for the anti-MNC policies in earlier times have now lost salience. The principal ones related to adverse impact on local entrepreneurship and on the political intrusions. The former has been discredited; the latter is no longer compelling.

(a) Albert Hirschman was the most articulate proponent of the view that MNCs would stifle local entrepreneurship. This fueled the attempts at imposing the requirement that only joint ventures with local partners would be acceptable. But it became pretty clear that MNCs could be conduits for increased competitiveness of local firms: as noted above, diffusion of technology and “best practices” often follows, improving the competitiveness of domestic rivals. This happens, for the most part, by example; but it also happens because the host country nationals who are typically employed by the MNCs often acquire the skills and

knowhow which lead to their setting up their own new forms (e.g. Uday Kotak, who represented Goldman Sachs in India, has now set up his own Kotak bank and become the most important financial entrepreneur in India).

Besides, where local knowhow (typically in the shape of contacts and networking which enable the MNC to function more efficiently in the host country) matters, joint ventures often follow. Moreover, forcing MNCs into marriage with some local firm/investor, is more likely to imply profit-sharing with the lucky firm chosen to meet the host-country requirement, creating rentiers rather than true entrepreneurs.

(b) The question of political intrusion has been one of the greatest concern. Just think of how Pepsi and AT&T got involved with Kissinger and the CIA in facilitating the destabilization of the Allende regime and the military takeover by Pinochet. [Ironically, no one remembers the Pepsi story and the beverage firm smells like roses to many who know no history.] Or of the Katanga intervention and assassination of Patrick Lumumba by Union Meuniere. Today, with massively increased transparency and the growth of civil society groups that monitor and agitate against such practices by MNCs, it is far less feasible for the MNCs to behave in these reprehensible ways.

1. Recently, however, new malign-impact arguments have come from the civil Society and from labour unions in the developed countries. They are also misplaced, however.

The most astonishing argument has come from groups that argue that MNCs “exploit” local workers by paying them “low wages”. Of course, poor countries have low incomes and

low wages! Instead of comparing the wages paid by MNCs with local wages in non-MNC firms --- here the MNCs win hands down, for the most part, as there is an observed premium if you are employed in an MC which many scholars have tried to explain in terms of the efficiency-wage and other models---, the comparison is made with wages back home. And when you ask workers: should you be paid higher wages, it is not surprising that they say “yes” just as I and my distinguished Discussants would likely say to our Deans also. As we say in jargon, income has a positive marginal utility. [I am not sure about the Brits who seem sometimes to put conditions on proposed increases in their wages like: “provided” others get wage increases also.]

Specious assertions in support of the exploitation argument are also made by saying that MNCs earn high profits and can “afford” to pay higher wages. This supposes that MNCs are earning abnormal profits. But in industries like apparel, which are often the object of agitation by our unions and NGOs charging exploitation, the competition is fierce and I have never seen evidence of abnormal profits.

Again, I have been in debates where a union leader would flamboyantly violate the rules and wave a sweatshirt, saying that it costs \$10.00 in New York but the wage paid in Guatemala is only 50 cents. Quite respectable economists at the pro-labor Economic Policy Institute have argued this way also. Typically, for instance, a \$100 jacket in an Ann Klein store would be contrasted with a wage of \$2.00 per hour in Nicaragua in the Export Processing Zone. But this is not sensible. For one thing, out of ten coats designed, nine will probably bomb out, leaving the effective sale in New York at \$10 instead of \$100. Again, you have to

add transport costs and tariffs (which are high on apparel) which push up the retail price but not profits in New York: so, we are probably down to \$5 and then things look far less melodramatic. Again, the gross value of the retail sale in New York is no index of the value added in Zambia to which the wage paid in Zambia might be related: Zambia may be adding only \$100 worth of value to unpolished diamonds that sell, after being polished, for \$10,000 in New York.³

While many NGOs are simply confused about all this, the bottom line is that unions in the developed countries are agitated about competition from the developing countries and, hiding behind the façade of altruistic concern with exploitation of workers abroad, they seek to prevent the outflow of DFI to developing countries abroad and the resulting addition to competition for themselves.

I must also add that the claim that MNCs exploit and hence harm foreign workers by paying them “low” wages is in fact the opposite of what MNCs manage to achieve for these workers. By increasing the demand for workers, MNCs generally will increase employment and/or improve the wages of the workers: that is the only successful way to help the workers in a sustainable fashion. Take China, for example. The rapid growth in the Guangdong provinces, aided immensely by MNCs spearheading an unprecedented export boom, greatly increased the demand for workers. As long as workers were in elastic supply (the “reserve army of labour” was kicking in), the added demand for labour led to increased employment. But then the supply of labour began to increase at a much slower rate because the one-child

³ See the extended discussion of this specific form of anti-MNC argument in Chapter 12 of my [In Defense of Globalization](#), Oxford University Press: UK, 2004.

policy kicked in and the inflow of new labour from the hinterland (as distinct from availability of surplus labour in the Guangdong provinces themselves) became difficult because of infrastructure problems. The result was that wages began to rise. This also meant that working conditions improved in a market where labour began to be scarce rather than abundant.

A Caveat: The foregoing arguments then suggest that MNCs and Development are generally speaking friends, not foes. But one caveat must be entered. If the host country is not smart about the policy framework within which the MNCs come in, it can turn MNCs into foes of development. As Ian Little of Oxford has wisely remarked: Direct Foreign Investment (DFI) into a country is as good or bad as its own policies. This is best illustrated by the classic contrast between “Import substituting” (IS) and “Export Promoting” (EP) variety of DFI, the argument being that the former is likely to be bad for the host country the way that the IS strategy yields little returns from domestic resources, whereas the latter is beneficial like the EP strategy which uses domestic resources well.

That an IS strategy has been generally counterproductive, except for an early phase of development, is now conceded by many development-and-trade scholars, except for a handful of prominent economists, chief among them Dani Rodrik of Kennedy School at Harvard and Joe Stiglitz at Columbia. There is far too much empirical evidence now from many economists such as Arvind Panagariya of Columbia that simply cannot be ignored. There is also compelling evidence that the resulting growth, once outward orientation was embraced and growth enhanced, the resulting growth did pull up over 200 million above the

poverty line: in short, the growth has been “inclusive” contrary to popular assertions. The revenues generated by the enhanced growth are also enabling direct expenditures finally to be undertaken, not just promised, that will (if properly managed) lead to improved healthcare and education for the poor.

What Ian Little says is that if the IS strategy is a bad framework to get a lot out of your own resources, it will be bad for the use of foreign resources as well. This sounds like commonsense, of course. But it has also been demonstrated theoretically by many economists including myself, Koichi Hamada, Richard Brecher and Carlos Diaz Alejandro. While India had discouraged DFI prior to the reforms, so we can test for Little’s proposition, China certainly was into IS strategy and allowed for more IS-variety DFI inflow; and its DFI in the Guangdong provinces was certainly based on outward orientation. Where the earlier IS variety of (what is sometimes described as “tariff-jumping” DFI policy where you attract DFI by closing the market to imports as against domestic assembly in China) DFI was a failure --- Jim Mann has documented beautifully why and how the Beijing Jeep DFI by Chrysler failed --, the EP variety was a huge success.

I might add as an aside that, now that the Chinese market has become uniquely gigantic, the Chinese are into reverting to the old-style IS variety of DFI policy again, but now to great advantage. China is now saying again to foreign firms, as at the time of the Beijing Jeep, if they will not produce in China, enabling the Chinese then to pick up their technology on the cheap, China will simply turn to their rivals. Faced with the choice of losing a huge market to its rivals (e.g. GE versus Siemens) by resisting the Chinese tactic and surrendering

to it by investing instead and having the Chinese pick up its technology on the cheap, the foreign firm can do little but choose the latter option. I see no way, short of infeasible collusion among the foreign firms, that this Chinese tactic can be countered. The Chinese, thanks to this tactic of technology-extraction which has become possible how because of the enormous growth of its market, have thus provided a new and favourable twist to the IS type of investment from the viewpoint of the host government: but it applies only when the host country's market is immense.

IV: MNCs and Rule Setting: A Problem Area

So far, I have been dealing with the question of MNCs and Development in terms of the outcomes within the framework of their operation in a policy framework that they did not themselves manage to define. But once we drop this assumption, as we must, then the benign view of MNCs which now prevails begins to change and the need for international governance to minimize possible malign effects from rules reflecting lobbying interests becomes more evident.

I am afraid that the track record of MNCs in defining rules is not exactly exemplary. Well-known examples include the lobbying by American MNCs against the International Code of Marketing of Breast-Milk Substitutes which had been approved by nearly all nations, with the lobbying going so far as to get the USTR to threaten smaller countries into not enforcing the Code. Similarly, cigarette firms in the US insisted on their being granted the ability to advertise their cigarette brands in Thailand even though it was clear that such a concession

would increase sharply the total amount of cigarette consumption, not just increase their share. Again, American firms have lobbied fiercely to prevent the automatic extension of FDA bans in the US on hazardous drugs to sales abroad on the argument that it is up to these governments to prevent such sales if they care to do so, ignoring the fact that these governments may be ignorant or, more likely, captured/bribed into not enacting such bans by these very firms.

Recent examples would include the damage that US multinationals have done to the cause of multilateral free trade. They have been pushing for Free Trade Agreements, which are Preferential Trade Agreements (PTAs) because they free trade only for members of the FTA. As such, they undermine the principle of non-discrimination and, as I have pointed out in my 2009 book, Termites in the Trading System: How Preferential Agreements Undermine Free Trade (Oxford) lead to a veritable flood of FTAs which have now become a “systemic” issue, creating a maze of criss-crossing discriminatory tariffs depending on source and to arbitrary rules of origin that I have called a “spaghetti bowl” phenomenon and affliction. The FTAs also have led to a variety of trade-unrelated and self-serving requirements to be imposed on weaker countries in one-on-one negotiations by the lobbies (including Corporate lobbies) of the hegemonic powers such as the US and the EU, turning the trade game into a shell game. At the same time the US MNCs have put their weight behind undermining the Doha Round of multilateral trade negotiations, greedily asking for ever more concessions from other countries when the crying need after ten years of negotiations is to settle with what we have and then to go on to another Round for “unfinished business”.

V: Corporate Social Responsibility

But if MNCs have occasionally behaved less than responsibly in defining the rules and institutions that relate to international governance, they now face demands from civil society to step up to what has come to be known as Corporate Social Responsibility (CSR).

It is well-known that economists such as Milton Friedman have opposed this by arguing that altruism should be left to the shareholders. The shareholders can spend moneys earned by way of dividends and capital gains from their ownership of stocks in the Corporation on doing good in ways they like: there should be no role for the Corporation to do altruism. To put it differently, Management should be out of doing CSR except insofar as CSR is undertaken like advertising expenditures, with CSR programs being undertaken with a view to protecting the corporation from unscrupulous attacks on them by NGOs advancing their own agendas.⁴

This is an issue that did not exist when there were family firms since ownership and management were flip sides of the family. Now that Management and Shareholding are divorced in the case of most Corporations, the question of CSR by Management on behalf of the Corporation as such becomes pertinent.

My own view is that Corporations are legal persons. Besides, society today sees them as having an identity that extends beyond ownership. So there is a widespread perception that Corporations should act on altruism as if they were legal persons with an identity of their

⁴ Unscrupulous NGOs in fact will zero in on even good firms which have a big visibility simply because that makes the campaign more “effective”! Naomi Klein once suggested this to me, when I was deploring the campaign against Nike, implying that ends justified the means. For an interesting discussion of this tactic, see Art Kleiner’s brilliant book, The Age of Heretics, Doubleday: New York, 1996, pp. 108-109.

own. Once this is conceded, it is inevitable that Management will take a central role in defining CSR. Legitimacy will then require that CSR be not the sole prerogative of the CEO or the Board of Directors but should require that voices of the workers and lower-level management be heard before any decisions are taken on what the content of the Corporation's CSR program should be.

I should add that one of the "efficiency" effects of CSR by Management, which makes CSR a matter of "enlightened self-interest" is almost certainly in attracting staff that feels more enthused about the firm. There is much evidence that many lower-level executives want to work for firms that are ethical and seen to be altruistic.

Nor should one forget that such CSR by MNCs must reflect some commitment to expenditures on programs in the host, not just the home, countries. Nor do I think that CSR must be uniform, following the dictates of some zealous activists. Altruism must allow for diversity: let a hundred flowers bloom, not that Maoists can cut them down but so that they fill Spring with their splendor.

Mind you, this corporate altruism by MNCs is not to be seen as atonement for the harm that they do to Development . As argued above, I believe that MNCs, by and large, do a lot of good. I see CSR by MNCs as essentially adding to the good they do.