A multinational corporation (MNC) is “an enterprise that engages in foreign direct investment (FDI) and that owns or controls value-added activities in more than one country.” A firm is not really multinational if it just engages in overseas trade or serves as a contractor to foreign firms. There are a number of ways of assessing the degree of multinationality of a specific firm. For example, firms are considered to be more multinational if (1) they have many foreign affiliates or subsidiaries in foreign countries; (2) they operate in a wide variety of countries around the globe; (3) the proportion of assets, revenues, or profits accounted for by overseas operations relative to total assets, revenues, or profits is high; (4) their employees, stockholders, owners, and managers are from many different countries; and (5) their overseas operations are much more ambitious than just sales offices, including a full range of manufacturing and research and development activities.

Multinational corporations finance some portion of their overseas operations by transferring funds from the country of the parent firm to the country of the host firm (usually an affiliate or subsidiary, but also possibly a joint venture with another firm). This transfer is called foreign direct investment. The purpose of the transfer is to own or control overseas assets. What precisely constitutes control is somewhat problematic. For practical purposes, most collectors of statistics on FDI consider an overseas investment to involve control only when the investor owns 10 percent or more of the equity (total stock) of the affiliate—on the assumption that investors owning less than 10 percent of equity have no control. Even though a group of smaller investors can band together to control a firm, their investments will not generally be included in statistics on FDI. So
there is a gray area between genuine FDI and foreign portfolio investment—investment that does not involve direct control over overseas assets.\(^5\)

Foreign direct investment is not a new phenomenon.\(^6\) From the time that people began to trade with one another, they set up foreign commercial operations. Mediterranean traders like the Genoese and the Venetians established banking operations in distant locations as early as 1200 CE to finance the trade which their ships carried. Foreign commercial investment reached a high point in the development of the large mercantile trading companies, such as the British East India Company and the Hudson’s Bay Company. Beginning in the eighteenth century, but more importantly in the nineteenth century, there was direct foreign investment in agriculture, mining, and manufacturing as distinct from the earlier forms of commercial investment. By the early 1890s, large U.S. manufacturing firms—like Singer Sewing Machines (the first large multinational corporation), American Bell, General Electric, and Standard Oil, to mention but a few—had large investments abroad. By 1914, according to one study, U.S. direct foreign investment amounted to an estimated $2.65 billion, 7 percent of the U.S. gross national product (GNP) of that time.\(^7\)

In another sense, foreign direct investment is a new phenomenon. The nature and extent of international business changed dramatically after 1945. After World War II and during the period of the Bretton Woods system, there was a major expansion in the investments of U.S. firms abroad. The new investments tended to be in manufacturing, whereas previous investments had been in agriculture, banking, retailing, and raw materials. This expansion of U.S. multinational activity was not seriously questioned until the end of the Bretton Woods period.

The activities of U.S.-owned multinational corporations were the focus of much political debate during the period of interdependence. In Latin America, a response to the growing power of U.S. multinationals was a number of attempts to regulate them. A wave of nationalizations of raw material MNCs occurred in the 1970s in Latin America and on the part of the OPEC countries (see Chapter 8). In Europe, Japan, and the NICs, the main reaction of governments to the growing power of U.S. MNCS was to favor the growth of indigenous MNCS. The growth of FDI flows and the number of MNCs and MNC subsidiaries remained rapid during this period.

One distinct feature of the period of globalization was the spread of MNCs to many countries that had never had their own MNCs and never hosted an MNC subsidiary. The number of home and host countries and the number and variety of multinational firms increased markedly. In 1994, for example, there were 37,000 multinational parent firms controlling over 200,000 foreign affiliates.\(^8\) By 2006, there were 78,000 MNCs with 780,000 overseas affiliates.\(^9\) The formerly communist countries promoted inflows of FDI after 1989. The
result was that globally oriented MNCs of various nationalities were increasingly influential players in the world economy.

During the period of globalization, the controversy over MNCs tended to center around their role as agents of globalization rather than as promoters of U.S. imperial aims. MNCs from Europe and East Asia began to challenge U.S. MNCs in a number of high-technology industries. China and India became much more important as homes and hosts for globally oriented MNCs. MNCs headquartered in Mexico, Brazil, Korea, Taiwan, China, and India began to invest abroad. While the global political system remained largely under the control of the governments of nation-states, as businesses from a variety of regions became more globally oriented, the question of who was to regulate whom and how became an important political issue.

To some extent the globalization of business began with regional expansions and therefore was linked to the construction of stronger regional monetary and trading blocs (see Chapters 2 and 3). If nationally oriented firms could no longer compete successfully with globally oriented ones, then one way for the firms of smaller nation-states to cope with globalization was to promote regional economic integration. However, governments that encouraged regional integration of markets without eventually lowering trade and investment barriers with the rest of the world were promoting regionalization rather than globalization. So, just as in the case of trade, there was some concern about a potential tradeoff between regionalization and globalization.

In this chapter we will concentrate on factors influencing global FDI flows and the expansion of MNC activities. The largest flows occurred primarily between developed countries, so most of this chapter will be devoted primarily to that subset of countries. In Chapter 8, we will discuss how FDI flows from the industrialized countries to the developing countries increased and how the people and governments of the developing world were dealing with this.

**COMMON CHARACTERISTICS OF MNCs**

Multinational corporations range from companies that extract raw materials to those that manufacture high-technology products like wide-body aircraft to those that offer financial services such as insurance or banking. These multinational corporations differ not only in what they do but also in how they do it: their level of technology, their organizational structure, and the structure of the market for their products. Nevertheless, certain common characteristics can be used to identify problems created by the rise of the importance of MNCs.

Multinational corporations are among the world’s largest firms. In 2006, the top 50 multinationals had revenues over $80 billion. The largest—Wal-Mart—had revenues of over $350 billion in that year (see Table 4.1). The revenues of each
## TABLE 4.1 Top 50 MNCs in 2006 Ranked by Revenues in Billions of Dollars

<table>
<thead>
<tr>
<th>Firm</th>
<th>Industry</th>
<th>Home Country</th>
<th>Assets ($Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wal-Mart</td>
<td>Retail</td>
<td>US</td>
<td>352</td>
</tr>
<tr>
<td>Exxon Mobil</td>
<td>Petroleum</td>
<td>US</td>
<td>347</td>
</tr>
<tr>
<td>Royal Dutch Shell</td>
<td>Petroleum</td>
<td>Netherlands</td>
<td>319</td>
</tr>
<tr>
<td>BP</td>
<td>Petroleum</td>
<td>UK</td>
<td>274</td>
</tr>
<tr>
<td>General Motors</td>
<td>Automotive</td>
<td>US</td>
<td>207</td>
</tr>
<tr>
<td>Toyota Motor</td>
<td>Automotive</td>
<td>Japan</td>
<td>205</td>
</tr>
<tr>
<td>Chevron</td>
<td>Petroleum</td>
<td>US</td>
<td>201</td>
</tr>
<tr>
<td>DaimlerChrysler</td>
<td>Automotive</td>
<td>Germany</td>
<td>190</td>
</tr>
<tr>
<td>ConocoPhilips</td>
<td>Petroleum</td>
<td>US</td>
<td>172</td>
</tr>
<tr>
<td>Total</td>
<td>Petroleum</td>
<td>France</td>
<td>168</td>
</tr>
<tr>
<td>General Electric</td>
<td>Heavy Machinery</td>
<td>US</td>
<td>168</td>
</tr>
<tr>
<td>Ford Motor</td>
<td>Automotive</td>
<td>US</td>
<td>160</td>
</tr>
<tr>
<td>ING Group</td>
<td>Insurance</td>
<td>Netherlands</td>
<td>158</td>
</tr>
<tr>
<td>Citigroup</td>
<td>Banking</td>
<td>US</td>
<td>147</td>
</tr>
<tr>
<td>AXA</td>
<td>Insurance</td>
<td>France</td>
<td>140</td>
</tr>
<tr>
<td>Volkswagen</td>
<td>Automotive</td>
<td>Germany</td>
<td>132</td>
</tr>
<tr>
<td>Sinopec</td>
<td>Petroleum</td>
<td>China</td>
<td>132</td>
</tr>
<tr>
<td>Credit Agricole</td>
<td>Banking</td>
<td>France</td>
<td>128</td>
</tr>
<tr>
<td>Allianz</td>
<td>Insurance</td>
<td>Germany</td>
<td>125</td>
</tr>
<tr>
<td>Fortis</td>
<td>Banking</td>
<td>Belgium/Netherlands</td>
<td>121</td>
</tr>
<tr>
<td>Bank of America</td>
<td>Banking</td>
<td>US</td>
<td>117</td>
</tr>
<tr>
<td>HSBC Holdings</td>
<td>Banking</td>
<td>UK</td>
<td>115</td>
</tr>
<tr>
<td>American Intl. Group</td>
<td>Insurance</td>
<td>US</td>
<td>113</td>
</tr>
<tr>
<td>China National Petroleum</td>
<td>Petroleum</td>
<td>China</td>
<td>110</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>Banking</td>
<td>France</td>
<td>109</td>
</tr>
<tr>
<td>ENI</td>
<td>Petroleum</td>
<td>Italy</td>
<td>109</td>
</tr>
<tr>
<td>UBS</td>
<td>Banking</td>
<td>Switzerland</td>
<td>107</td>
</tr>
<tr>
<td>Siemens</td>
<td>Information Tech.</td>
<td>Germany</td>
<td>107</td>
</tr>
<tr>
<td>State Grid</td>
<td>Utilities</td>
<td>China</td>
<td>107</td>
</tr>
<tr>
<td>Assicurazioni Generali</td>
<td>Insurance</td>
<td>Italy</td>
<td>102</td>
</tr>
<tr>
<td>J.P. Morgan Chase</td>
<td>Banking</td>
<td>US</td>
<td>100</td>
</tr>
<tr>
<td>Carrefour</td>
<td>Retail</td>
<td>France</td>
<td>99</td>
</tr>
<tr>
<td>Berkshire Hathaway</td>
<td>Insurance</td>
<td>US</td>
<td>99</td>
</tr>
<tr>
<td>Pemex</td>
<td>Petroleum</td>
<td>Mexico</td>
<td>97</td>
</tr>
</tbody>
</table>
of the top ten multinational corporations in 2006 were over $168 billion, more than the gross domestic product (GDP) of at least 140 countries. Indeed, Wal-Mart’s 2006 revenues were larger than the GDP of all but the 21 largest national economies and well ahead of Denmark, Norway, Saudi Arabia, and Poland. These corporate giants also tended to compete in oligopolistic markets. Some were able to dominate markets because of their sheer size, others (even some small- and medium-sized firms) because of their access to financial resources, control of proprietary technology, and/or possession of a special, differentiated product.

Multinational corporations do not simply market their products abroad; they send abroad a package of capital, technology, managerial talent, and marketing skills to carry out production and marketing in foreign countries. In many cases, the multinational’s production is truly global, with different stages of production carried out in different regions of the world. Marketing also is often global. Goods and services produced by MNCs are often sold throughout the world. Finally, the largest multinational corporations tend to have affiliates or operations

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**TABLE 4.1 (Continued)**

<table>
<thead>
<tr>
<th>Firm</th>
<th>Industry</th>
<th>Home Country</th>
<th>Assets ($Bllions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deutsche Bank</td>
<td>Banking</td>
<td>Germany</td>
<td>96</td>
</tr>
<tr>
<td>Dexia Group</td>
<td>Banking</td>
<td>Belgium</td>
<td>96</td>
</tr>
<tr>
<td>Honda Motor</td>
<td>Automotive</td>
<td>Japan</td>
<td>95</td>
</tr>
<tr>
<td>McKesson</td>
<td>Retail</td>
<td>US</td>
<td>94</td>
</tr>
<tr>
<td>Verizon Communications</td>
<td>Telecommunications</td>
<td>US</td>
<td>93</td>
</tr>
<tr>
<td>NTT</td>
<td>Telecommunications</td>
<td>Japan</td>
<td>92</td>
</tr>
<tr>
<td>Hewlett-Packard</td>
<td>Information Tech.</td>
<td>US</td>
<td>92</td>
</tr>
<tr>
<td>IBM</td>
<td>Information Tech.</td>
<td>US</td>
<td>91</td>
</tr>
<tr>
<td>Valero Energy</td>
<td>Petroleum</td>
<td>US</td>
<td>91</td>
</tr>
<tr>
<td>Home Depot</td>
<td>Retail</td>
<td>US</td>
<td>91</td>
</tr>
<tr>
<td>Nissan Motor</td>
<td>Automotive</td>
<td>Japan</td>
<td>90</td>
</tr>
<tr>
<td>Samsung Electronics</td>
<td>Consumer Electronic</td>
<td>South Korea</td>
<td>89</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>Banking</td>
<td>Switzerland</td>
<td>89</td>
</tr>
<tr>
<td>Hitachi</td>
<td>Information Tech.</td>
<td>Japan</td>
<td>88</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>Banking</td>
<td>France</td>
<td>84</td>
</tr>
<tr>
<td>Aviva</td>
<td>Insurance</td>
<td>UK</td>
<td>83</td>
</tr>
</tbody>
</table>

in a sizeable number of countries. One analyst defines a multinational corporation as one with investments in six or more foreign countries and finds that such firms accounted for 80 percent of all foreign subsidiaries of major U.S. corporations. Joint ventures and licensing are options available to multinationals wanting to do business abroad without being the sole owner of a foreign subsidiary. In a joint venture, the various partners own less than 100 percent of the equity of the joint venture firm. There may be a majority owner with more than 50 percent ownership, or all the owners might be minority owners. The owners typically select a management team made up of representatives of all the owner firms to run the joint venture. Licensing involves the granting of usage rights for intellectual property—for example, patents, copyrights, and trademarks—in exchange for some sort of payment. In certain countries, joint ventures and licensing are the only avenues available to MNCs who wish to participate in the local economy due to the restrictive inward investment policies of host governments.

Another option for MNCs is the strategic alliance. Strategic alliances are partnerships between separate, sometimes competing, companies. When the companies are from different countries, they are called international strategic alliances. The companies are drawn together because each needs the complementary technology, skills, or facilities of the other; nonetheless, the scope of the relationship is strictly defined, leaving the companies free to compete outside the relationship. A strategic alliance may be formally ratified in the form of a joint venture, but companies are increasingly using other ways to work together with other firms. The purposes of these alliances range from joint research and development to designing industry standards to sharing distribution or marketing networks in a way that both benefits the companies and reduces their risks. One of the catalysts for these arrangements has been the rapidity of technological change and the skyrocketing costs of development, especially in high-technology industries. Another has been the perceived need to compensate for disadvantages that individual firms have in competing with larger and more integrated firms or alliances.

Decision making for multinationals tends to be centralized, though management structures vary from company to company, and policy control emanates from the parent company when the international aspects of a firm’s business become important. The classic evolution of international investment has been from semi-independent foreign operations to the integration of international operations within a separate international division to the integration of international operations within the whole company. As a result, although multinational corporations have decentralized many decisions to the local level, key decisions involving foreign activities, such as the location of production facilities, marketing and branding strategies, location of research and development facilities, long-range planning, and especially capital investment, tend to be made by the parent company.

Yet another organizational characteristic is the integration of production and marketing on an international scale. Production may take place in different stages in several different countries, and the final product may be marketed in still other
countries. The European Ford Escort, for example, includes parts from 15 different countries, which are assembled in the United Kingdom and Germany and then sold throughout Europe. The Apple iPod was designed in the United States and is assembled in China; its components come from the United States, Taiwan, South Korea, and Japan. iPods are sold just about everywhere. Central control and management of the geographically dispersed activities of MNCs are facilitated by modern computing and telecommunications technologies.

Multinationals tend to be mobile and flexible. Some are tied to specific countries by the need to get access to specific assets, such as raw materials of a particular kind, or by a large capital commitment that cannot be shifted easily to another location (e.g., oil wells and refineries located near major oil fields). Others, however, are able to shift their operations easily whenever needed for the purpose of maximizing company profits, markets, security, or survival. As part of their effort to transcend national borders, many multinationals try to create global staffs that are drawn from many countries to serve in yet others. As part of their effort to gain and protect their knowledge in strategically important areas, they recruit skilled personnel and make corporate allies wherever they can find them. Mobility and flexibility are thus increasingly an advantage that globally oriented MNCs have over more locally or even nationally oriented firms.

The special characteristics of multinational corporations can cause conflicts with national governments, because governments are territorially bound and politically committed to defending the interests of their citizens, whereas firms are not territorially bound and are legally committed to defending the interests of their stockholders or stakeholders. Most importantly, multinational corporations may seek goals or follow policies that are valid from the firm’s international perspective but are not necessarily desirable from a national perspective. An important contemporary example is the interest of Wal-Mart in obtaining products assembled or manufactured in the low-wage countries like China for sale to consumers in high-wage countries like the United States. Wal-Mart pushes its U.S. suppliers to relocate production to China for this reason, even though the consequences for low-skilled workers in the United States may be quite negative. The policies and goals of multinational corporations may therefore conflict with the policies and goals of the states in which they operate.

There is also a related jurisdictional problem. Multinational corporations operate in many countries and are therefore subject to many different legal jurisdictions. Because no one country is responsible for overall jurisdiction and because jurisdiction can be unclear, a given MNC may have problems deciding what laws it needs to obey and where. Some governments, like the U.S. government, engage in efforts to regulate the activities of U.S. citizens and U.S.-based companies abroad. The U.S. government, for example, has laws against the bribery of foreign officials to secure contracts. The legal name for this kind of regulation is extraterritoriality and it is the subject of much criticism on the part of foreign governments. MNCs are generally opposed to extraterritorial regulation for obvious reasons.
The rapid spread of multinational corporations, and especially of U.S. multinationals, has been characteristic of the contemporary world economy. From 1971 to 2006, the stock of U.S.-owned direct investment abroad measured by book value rose from $86.2 billion to $2.4 trillion. Foreign direct investment by other developed countries, though smaller than U.S. investment, also rose sharply. From 1971 to 2006, the stock of direct investment by Germany rose from $7.3 billion to $1 trillion, that of the United Kingdom from $16.2 billion to $1.5 trillion, and that of Japan from $4.4 billion to $450 billion (see Figure 4.1). The total stock of FDI worldwide was over $12 trillion in 2006.

Total annual outflows of FDI rose from around $12 billion in 1970 to $1.2 trillion in 2006 (see Figure 4.2). Growth in outflows tapered off after the deepening of the world debt crisis in the early 1980s, but resumed after that until 2000 when a major dip in both outflows and inflows occurred that lasted several years. Average annual growth in both outflows and inflows of FDI was over 18 percent in both the 1980s and the 1990s. The aggregate trend in global FDI inflows mirrored that of outflows for the most part (see Figure 4.3). While industrialized nations were by far the main sources of FDI outflows and the main destinations for FDI inflows, developing nations steadily increased their share of both inflows and outflows (see Figures 4.2 and 4.3).

The top 500 MNCs accounted over 90 percent of global FDI and more than half of world trade by the late 1990s. Out of the 500 top MNCs, 441 were headquartered in the developed countries of North America, Western

**Figure 4.1** Outward Stock of Direct Foreign Investment in Billions of Dollars, 1960–2006

Europe, and Japan. Sales of foreign affiliates of MNCs were greater than total world exports, implying that MNCs used FDI as much as or more than they used exports to service overseas demand for their goods and services. In addition, FDI inflows represented 12.6 percent of global gross fixed capital formation in 2006, up from 5 percent in 1990 and 2 percent in 1980, suggesting the growing importance of FDI in world economic growth.
The FDI outflows and inflows of the five largest industrialized economies have fluctuated widely in recent years. All five large industrialized economies experienced rapid increases in outbound FDI in the 1980s. Japanese outflows, in particular, rose very rapidly in the 1980s and then declined rapidly in the early 1990s (see Figure 4.4). Inflows of FDI into Japan remained low relative to those of other large industrialized countries. FDI inflows into the United States increased rapidly during the 1980s, reflecting the efforts of European and Japanese firms to establish economic beachheads in North America in a time of movement toward a more regionalized world trading system. They rose again in the first decade of the twenty-first century, partly a consequence of the weakening dollar (see Figure 4.5).

Canada, which traditionally had widespread and high levels of foreign investment, represented the most extreme case of an industrialized country that was dependent on inflows of FDI. Annual inflows of FDI into Canada averaged $979 million between 1982 and 1987. Inflows increased rapidly from $7.6 billion in 1990 to $69 billion in 2006. Part of the reason for the increase in FDI inflows in the last 15 years was the formation of NAFTA.

Annual inflows of FDI into the European Union averaged $19 billion in 1982–1987. Inflows increased to $109 billion in 1990. In 2006, FDI inflows into the EU reached a level of $566 billion. While the United States was the origin of the largest percentage of non-European FDI inflows, the U.S. share declined steadily in the 1980s and the Japanese share increased rapidly.

Investment in the United States by European and Japanese corporations increased greatly in the 1980s. Whereas, in the early 1960s, the stock of foreign direct investment in the United States was negligible, by 1980 the United States had about $83 billion in foreign direct investment. By 1992 this had grown to $420 billion. In 1970, the inward stock of direct foreign investment...
in the United States was only about 20 percent of the stock of U.S. direct investment abroad. By 1992, that figure was about 86 percent.28 In the early 1980s, the value of foreign assets in the United States began to exceed the value of U.S. assets abroad (see Figure 4.6), a trend that has continued with some variation to the present.29

There were several reasons for the increased interest of foreign corporations in investment opportunities in the United States. One was the increased size and aggressiveness of non-U.S. firms. In the year 2000, for example, of the top 500 MNCs, 148 were based in the European Union and 107 were based in Japan.30 Another reason was that the decline of the dollar in the 1970s, the late 1980s, and the first decade of the twenty-first century brought down the cost
of acquiring U.S. firms, making them more attractive acquisitions for foreign corporations. These circumstances coincided with an uptick in corporate restructuring and downsizing in the United States, which left many companies up for sale, and with the search by U.S. surplus trading partners for safe places to invest their money. A further incentive to invest in the United States was growing trade frictions and protectionist pressures in such vulnerable sectors as electrical equipment and automobiles. Production in the United States guaranteed continued access to the huge U.S. domestic market. And finally, foreign investors were attracted to the U.S. market by the relative political stability of the United States.

One interesting new dimension of foreign investment in the United States was the influx of foreign banks and securities firms, which were attracted to the United States by clients who had already located there, by profits to be made in U.S. financial markets, and by the low cost of acquiring U.S. banks. The growth of Japanese banks was particularly important in the 1980s, keeping pace with the spread of Japanese business and foreign investment. Japan was the world’s leading capital exporter by the end of the 1980s, and the United States was one of its favorite sites for investment.

Japanese financial institutions challenged U.S. supremacy in the banking and securities areas. In 1985, Japanese banks overtook U.S. banks as the world’s biggest lenders. Although only one of the top ten banks in the world measured by assets was Japanese in 1978, twelve of the top fourteen were Japanese by the end of 1986, and four of the top ten securities firms ranked by capital were Japanese. The assets of Japanese banks grew from 25 percent of the total assets of the largest 50 banks in 1980 to 57 percent in 1989. Even after the bursting of the Japanese economic bubble in 1991, Japanese banks continued to dominate the list of the world’s largest banks. Loan activity dropped back, however, especially in important overseas markets like the United States.

Another more recent trend was the growth in private equity financing of mergers and acquisitions connected with foreign direct investment. Private equity involves the issuing of shares of businesses that are not publicly traded on a stock exchange. There are a variety of ways that private equity can be used for financing business operations. One of the older and more familiar ones is venture capital. In venture capital, a wealthy individual or a group of wealthy individuals provides funds to a “start-up” firm in exchange for financial control in the form of equity. Many of the large semiconductor firms of Silicon Valley started with venture capital funding. Because of the high risk associated with start-up enterprises, the investors require high rates of return on their investments. They expect many of the ventures they invest in to fail, so the ones that succeed have to succeed big in order to justify the investment.

Another form of private equity is the leveraged buyout (LBO). The leveraged buyout is a method for converting a publicly traded firm into a privately held firm by purchasing a controlling interest in the firm. A wealthy individual or group may do this on their own or with bank loans. The rationale for doing this has to be that, by taking a public firm private, the purchaser is increasing the overall value of the assets of the firm. There was a boom in leveraged buyouts in
the 1980s stimulated by the successes of LBO-innovators like Warren Buffett. The passage of the Sarbanes-Oxley Act of 2002, which was designed to correct problems in U.S. corporate governance, allowed for the low interest rates made possible by declining inflation rates after 2000, and a general climate of financial deregulation stimulated the growth of a third form of private equity, the private equity fund. Private equity funds were created to pool the risks associated with investments in venture capital and LBO markets. By 2006, $356 billion had been invested in this market, an increase of 25 percent over the previous year. Private equity funds contributed to an uptick in mergers and acquisitions and thereby an increase in flows of FDI internationally between 2000 and 2006.

FDI outflows to the developing world were highly concentrated in Latin America and Asia. These two regions accounted for two-thirds of the total FDI outflows of OECD member countries that did not go to other OECD countries. Between 1985 and 2006, there was a major reduction in Latin America’s share of FDI outflows and a major increase in the Asian share (see Figure 4.7). After 2000, FDI began to flow in significant quantities to countries that used to be part of the Soviet Bloc.

To summarize, one of the big changes during the period of interdependence was the increased role of Europe and Japan in generating outflows of FDI. All three major industrialized regions rapidly increased their FDI outflows, but one major industrialized country, Japan, stood out as attracting considerably lower inflows than the others. Europe and the United States considered this to be evidence of significant barriers to FDI inflows in Japan, even though the Japanese government had dismantled most legal barriers. Accordingly, in the 1990s, both the U.S. government and the EU put pressure on the Japanese government and industry groups to open the Japanese economy to inflows of foreign direct investment.
During the period of globalization, the biggest changes in FDI flows were associated with the rapid growth of MNCs from the developing world (especially East Asia), the temporary downturns associated with the Japanese and the dot.com bubbles, and the rise of private equity funds. The generally upward trend in flows was not hindered by the lack of a multilateral investment regime and not helped much by the TRIMs agreement in the Uruguay Round. Something else was driving the trend toward greater flows.

EXPLAINING THE GROWTH IN MNC ACTIVITY

There are a number of theories about the factors that have contributed to the enormous expansion of the MNC activity in the past three decades. Changes in technology and organizational sophistication created the possibility of expansion. The development of new communications technologies, cheaper and more reliable transportation networks, and innovative techniques of management and organization have made possible the kind of centralization, integration, and flexibility that are the hallmark of the successful MNC. But these were merely enabling factors. The question remains as to why we have seen such a great expansion of MNC activity since the end of World War II.

One answer would be to stress the importance of government policies. Some governments—particularly powerful governments like that of the United States—actively encouraged multinational expansion. The progressive elimination of restraints on capital flows made expansion of direct investment possible. The reduction of tariffs made direct investment more attractive. Governments directly subsidized FDI outflows by providing various forms of insurance for international investments. The United States, for example, created the Overseas Private Investment Corporation (OPIC) in 1961 to insure U.S. firms against some of the risks involved in direct investment. Canadians and Europeans created incentives to attract inflows of foreign investment. Although the U.S. federal government has not officially courted foreign investment, in recent years states and local communities have taken the lead, even competing with one another for foreign manufacturing plants.

But, again, government policy changes alone would not have resulted in the expansion of MNC activity described above. Foreign investment, after all, is the result primarily of decisions made by private firms. Theories about FDI that do not take into account the firm-level incentives to invest overseas are not likely to be very helpful in explaining the trends described above. We turn, therefore, to a set of theories that deal with this issue.

Horizontal and Vertical FDI and the KK Model

One key distinction in the economics literature on MNCs is between horizontal and vertical FDI. Horizontal FDI replicates activities that occur in the home country in a variety of host countries. The purpose of horizontal FDI is to gain
access to local markets that might otherwise be inaccessible. **Vertical FDI** fragments production across countries so that different tasks are located according to differences in the relative abundance of factors of production. Thus, skilled-labour-intensive activities would occur in skilled-labour-abundant locations and unskilled-labour-intensive activities would occur in unskilled-labour-intensive locations, and so on. Here the purpose of FDI is to minimize production costs so that the firm can be internationally competitive in multiple markets.\(^4^4\) Horizontal FDI tends to go to relatively wealthy regions of the world, whereas vertical FDI tends to go to developing countries that have abundant labor and low wages or some other factor-based advantage such as an abundance of raw materials or energy.

Since most of the FDI flows are among the industrialized countries and a small proportion of flows are between the industrialized and the developing countries, then one important theoretical question is why there is more horizontal than vertical FDI. A theory that attempts to explain this is James Markusen’s knowledge-capital or KK model.\(^4^5\)

**Internalization Theory**

Internalization theory contends that firms expand abroad through foreign direct investment in order to “internalize” activities in the presence of market imperfections, just as they expand domestically by building multiple plants and offices for similar reasons. The particular market imperfections that create incentives for internalization are represented in the idea of transaction costs. **Transaction costs** arise when markets produce undesirable results because of various imperfections. For example, when the costs of concluding long-term contracts with an external firm are higher than the costs of establishing a new internal unit to accomplish the same purpose, then it can be said that the market for long-term contracts is imperfect and generates high transaction costs.\(^4^6\)

There are both natural and artificial reasons for market imperfections. Long-term contract markets are inherently difficult to organize and prone to high transaction costs. Similarly, it is frequently difficult to put an accurate price on technologies when licensing them or otherwise transferring them to another firm. There are problems of asymmetry of information between the buyer and seller that make such markets notoriously tricky. Often sellers require buyers to sign “nondisclosure agreements” to protect their intellectual property before explaining what the technology does in the first place. It is no wonder that buyers often perceive these transactions to have high costs and that they sometimes try to avoid them by creating their own technologies or by buying companies that own the technologies they need (both forms of internalization). Sellers are equally wary, mainly because they do not wish to lose control over knowledge that may provide them with important competitive advantages.

Market imperfections of this sort may be considered artificial to the extent that they are at least partly the result of government policies. Markets for information are frequently faulty, but trade barriers or lax government enforcement of intellectual property rights may also create higher than normal transaction costs.
for firms considering alternatives to foreign direct investment, and thus may help
to motivate them to internalize those costs by investing abroad.47

The OLI Model

John Dunning has expanded upon internalization theory by suggesting that three
conditions must be met before a firm will be able to compete with local firms
despite the disadvantages of being foreign: (1) it must have market power that
derives from ownership of some specialized knowledge, (2) it must consider the
particular foreign location advantageous for new investments relative to alterna-
tive locations including its home market, and (3) it must prefer FDI over export-
ing and licensing by the usual internalization logic. This expansion on internali-
ization theory is called the OLI model, where OLI stands for ownership, location, and internalization.48

The OLI model is one of the most widely accepted theories of foreign direct
investment.49 Nevertheless, there are other theories that attempt to explain as-
pects of MNC behavior and/or MNC/host country relationships that are some-
what different from and not entirely compatible with the either the KK or the
OLI model.

Product Cycle Theory

The product cycle theory argues that firms expand abroad when their principal
products become “mature” in domestic markets. During the initial or rapid
growth stage of product commercialization the firm attempts mainly to respond
to domestic demand. As growth tapers off, the firm may begin to look for new
sources of demand in export markets. Eventually, domestic demand begins to fall
as the market is saturated, new firms begin to challenge the earlier entrants to the
market, and the firm looks for ways to protect its revenues and profits by estab-
lishing foreign subsidiaries with lower factor costs so as to remain competitive in
the home market and/or gain better access to foreign markets. As overall de-
mand for the product moves toward zero, the firm will try to move on to new
products or attempt to create new advantages by altering the product (see Figure
4.8).50 The product cycle theory was designed to explain changes over time in
FDI on the part of manufacturing firms, and was never put forward as a general
theory of MNCs or FDI. Nevertheless, it adds something to OLI theory by pos-
itng a reason for changes over time in firm-specific ownership advantages.

Obsolescing Bargain Theory

A close relative of product cycle theory is the theory of the obsolescing bargain.
In obsolescing bargain theory, a firm that has invested in a host country starts
with a good bargaining position with the host country’s government because of
firm-specific advantages such as superior technology, access to capital markets,
and access to final product markets. An excellent example of this would be the
initial negotiations between American oil companies and host governments in
the Middle East in the 1920s. U.S. firms were able to win favorable “concessions” for the right to drill for petroleum in the new oil fields. Once the firm has made an investment, however, the bargaining advantage may slowly shift to the host country. The technology may mature and become more easily accessible to the host country’s firms, and the host country may learn how to gain better access to global capital markets and to final product markets. It then attempts to negotiate more favorable terms with the foreign investor.  

**Oligopoly Theory**

The oligopoly theory of foreign investment contends that firms move abroad to exploit the monopoly power they possess through such factors as unique products, marketing expertise, control of technology and managerial skills, or access to capital. In the battle for profits and market share, firms engaged in oligopolistic competition may move abroad as part of their overall competitive strategy. They may move aggressively to exploit a new foreign market in the hope that this action will give them a permanent advantage over their competitors. Conversely, a company whose competitors have just entered a foreign market might be forced to go international defensively, in order to block their opponent’s move or at least prevent the competitor from gaining a survival-threatening advantage.

The oligopoly theory is consistent with the OLI model in that the OLI model asserts that a firm must have some sort of market power derived from firm-specific advantages (usually based on the firm’s special knowledge). Many oligopolistic industries are populated with precisely this type of firm. What oligopoly theory adds to the OLI model is the idea that the timing of entry into specific foreign markets may depend upon the timing of entry of a given firm’s competitors.
The Tariff-Jumping Hypothesis

Another important hypothesis about FDI flows deals with the attempt by MNCs to jump over tariff or non-tariff barriers by establishing foreign subsidiaries. The tariff-jumping hypothesis has been used recently to explain the increased willingness of Japanese and U.S. MNCs to invest in Ireland and the United Kingdom to gain access to markets in Western Europe. Because Ireland and the UK are members of the European Union, investing in those two countries may provide improved access to all the members of the EU. As a result, the data appear to indicate that non-European MNCs seem more than usually interested in investing in those two countries. The tariff-jumping hypothesis, again, is consistent with the OLI model because, for example, the existence of the European Union, with its high external tariffs and low internal ones, gives a locational advantage to relatively low-wage countries within the EU.53

Barrier jumping is also posited as an explanation for the rapid increase in FDI flows from Japan to the United States. This is particularly true of Japanese investments in automobile production in the United States. The first big jump in Japanese FDI in autos occurred in 1981, the year in which a VER was negotiated to limit Japanese exports. Investments continued during the 1980s on the assumption that the U.S. market would be closed to Japanese imports unless they were replaced with local production. As a result, Japanese production capacity in the United States increased from zero in 1980 to approximately 2.8 million units per year in 2004.54

The Importance of the Home Country

More recent theorizing about the behavior of MNCs stresses the importance of the home country. Marked differences in the behavior of MNCs from different home countries—for example, U.S. firms versus Japanese firms—suggest that the way in which the home country structures its domestic economy has an important impact on the way in which domestic firms internationalize their business activities, despite the fact that most economic theories of MNC behavior seem to imply that the home country context should be largely irrelevant. While there is a certain convergence in the behavior of firms from different home countries over time in terms of the way they deal with questions of organizing export activities, local production, R&D, and marketing,55 firms of different nationalities retain important distinctive characteristics that are strongly affected by the home environment.

For example, Japanese firms belong to confederations of allied firms called keiretsu. When Japanese firms go abroad, they try to sustain their ties with other keiretsu firms at home and abroad, even when this might not be entirely rational from a short-term economic perspective.56 U.S. firms, in contrast, are not as likely to develop long-term relationships with other firms, even though they are quite willing to nurture short-term partnerships. Other systematic differences between U.S. and Asian firms include different average rates of
return on foreign assets and debt/equity ratios. For example, Japanese and
Korean firms tend to have lower returns on foreign assets and higher debt/equity
ratios than U.S. firms.57

**THE CONSEQUENCES OF MNC ACTIVITY**

Modern governments have given high priority to the public policy goals of eco-
nomic efficiency, growth, and improvement in the standard of living. In evalu-
ating the impact of multinational corporations on developed market economies
and determining the governance problems raised by multinationals, one must
examine the effect of those firms on economic performance. This is not a simple
task, however, because it is somewhat difficult to separate out the effects of FDI
and other MNC activities from those of other variables on a given country’s
economic performance. For most macroeconomists, for example, capital invest-
ment is capital investment no matter who owns it or where it comes from. It is
clear that FDI flows add to the pool of capital available for investment on a
global basis. Many empirical studies have demonstrated that there is a positive
relationship between increases in FDI flows and economic growth rates in a
wide variety of countries.58 Empirical studies of the impact of increases in FDI
inflows, nevertheless, have to consider what might have happened to domestic
investment levels in the absence of increased FDI inflows. Similar points could
be made about transfers of new technology or efforts to raise the skill levels of
local MNC employees.59

Proponents of multinational corporations argue that FDI is a mechanism for
increasing productivity and stimulating growth. By transferring capital, technol-
ogy, and know-how and by mobilizing idle domestic resources, multinational
corporations (argue their advocates) increase productivity, foster growth, and
thereby improve welfare.60 To be more specific, the potential gains from
FDI fall into three main categories. First, FDI may facilitate trade in goods
and services by allowing firms to compensate for market imperfections by
engaging in international **intrafirm trade**. Second, FDI may increase the
productivity of firms that are directly engaged in FDI, especially those that
are the recipients of FDI inflows. Third, FDI may generate positive **external
economies** that benefit firms and other economic actors that are not directly
engaged in FDI.61

There are strong indications that increases in FDI flows are associated with
rising levels of trade—that FDI is not a substitute for trade but actually helps to
generate trade. Even when MNCs invest in overseas production facilities to service
foreign markets, for example, some of that overseas investment generates demand
for exports from the home country. A hypothetical example would be the estab-
ishment of an automobile assembly plant by a U.S. MNC in Belgium. Until the
firm locates Belgian (or European) suppliers of automobile components, it is quite
likely the firm will continue to purchase components from U.S. companies for its
Belgian operations. Even when local suppliers are substituted for initially imported
components, there will continue to be a demand for goods and services that the firm thinks it can get only from the home country.

In other words, the same factors that create incentives for FDI also create incentives for intrafirm trade. In 1988, for example, Japanese subsidiaries in the United States purchased over four-fifths of their imports from their parent companies in Japan and exported over three-fifths of their exports to the same companies. In the same year, intracompany trade between U.S. parent firms and U.S.-owned foreign affiliates accounted for over two-fifths of total U.S. imports and over one-third of total U.S. exports. As a result of the increase in FDI flows and MNC activity, a large and growing proportion of world trade in manufactures, perhaps as much as 50 percent, is accounted for by intrafirm trade.

It is possible, however, that external economies are more important than gains from trade, since FDI tends to generate more rapid growth in overseas production and sales than in exports (with some notable exceptions). Measuring the extent of external economies is difficult, and therefore not much research has been undertaken in this area. One method that has been used is to examine changes in productivity, export performance, and research effort of locally oriented domestic firms after the entry of foreign firms. Some additional clues about externality gains can be obtained from analyses of inflows of FDI into specific countries and industries.

For example, suppose that there had never been any Japanese investment in local production of automobiles in the United States and that U.S. auto firms had succeeded in getting higher trade barriers against Japanese firms to reduce competition from Japan. Then consumers would have lost by not being able to purchase the relatively inexpensive but high quality automobiles produced by Japanese firms, and U.S. firms would not have been forced to upgrade the quality of their products and the efficiency of their plants to match those of Japanese producers. The end result would have been a decline in the overall international competitiveness of the U.S. auto industry. Thus Japanese inflows of FDI in automobiles in the 1980s may have been good for U.S. competitiveness. This is called a demonstration effect of FDI because the presence of foreign firms demonstrates the advantages of organizing production in a different way.

It is important to remember, however, that the United States generally has low barriers to trade. As a result, incentives for firms located there to become internationally competitive are higher than those for firms located in countries with high barriers to trade. Thus one would not expect FDI inflows into the latter to have positive effects on their international competitiveness. Similarly, one would not expect the externality-based benefits of FDI inflows to be as great in countries with relatively low levels of human capital development as in countries, like the United States, with relatively high levels of human capital. This suggests that there may be a stronger basis for concern about the possible negative effects of FDI inflows in developing countries than in industrialized countries (see Chapter 8). Nevertheless, even in industrialized countries there are important concerns about the effects of MNC activities.

Critics of multinational corporations believe that inflows of FDI may reduce efficiency and stifle growth in host countries. Because MNCs tend to be
oligopolistic, they may be able to predate domestic firms, limit their own production, maintain artificially high prices, and thus earn oligopoly rents. If the rents are not reinvested locally, but rather are extracted via profit repatriation, then the country might have been better off limiting the entry of MNCs or limiting the repatriation of profits, because domestic firms would have been more likely to reinvest such rents domestically. In addition, critics argue that MNCs may actually hinder national growth and economic prosperity by absorbing local capital instead of providing new capital, by applying inappropriate technology, by creating “bad” (low-skill and low-wage) jobs instead of “good” (high-skill and high-wage) jobs, by doing research in the home country instead of in the host country, and by employing expatriate, not indigenous, managers. Most of these criticisms have been tested empirically and most of the available evidence suggests that they are not correct, but there are a few areas where the criticisms seem to have some validity.67

Over the years, much research has been devoted to the question of the effects of FDI on economic performance on specific countries or regions.68 Most studies of the economic impact of multinational corporations on their host developed market economies conclude that their overall effect is positive. The 1981 Caborn report adopted by the Parliament of the European Community, which called for greater regulation of multinational corporations, found that multinational enterprises raise the level of world economic activity and have “favorable impacts on productivity, growth rates and overall level of employment, on the dissemination of new products and processes and also of managerial know-how.”69 Other benefits cited in studies of individual European economies include improvements in balance of payments, research and development, the level of technology, and increased dynamism.70

**Possible Negative Effects of MNCs**

Despite indications of overall benefits from multinational corporations, such investment is not without costs for the host state. Costs are incurred because behavior that is rational for the corporation may be less beneficial to the host country. Several concerns have been revealed in public and private studies.71 The fear of technological dependence is one. Although access to advanced technology is one of the primary economic benefits of multinational corporations for the host developed countries, that access may stifle domestic research and development. The concentration of research and development in the home state may discourage research and development activities in the host state and result in the subordination of the host to technology controlled from abroad. There is a related concern that host states may pay excessive costs for imported technology, because the control of technology by a multinational enables the parent to charge a monopoly rent for its use.72 A similar concern arises concerning management skills. The transfer of managerial talent to host countries can be a source of efficiency and growth, but the use of foreign managers may also deny nationals opportunities to use and develop their skills.

Yet another concern grows out of the multinational corporations’ oligopolistic character. The entrance of foreign competitors may stimulate domestic
competition and thus encourage efficiency, but it may also reduce competition and threaten existing domestic industries. Even such market dominance by multinational corporations may be beneficial if it brings with it new technologies and other economic efficiencies. But if it does not introduce such improvements, it may decrease efficiency. Special concern is voiced by states when multinational corporations acquire existing national firms. Acquisition may give the firm access to capital, technology, and other resources and thereby improve its performance, but it may simply indicate a transfer of ownership, adding no new efficiencies.

Some concern has been expressed regarding the import orientation of multinational corporations. An official Canadian study, known as the Gray report, found that subsidiaries in Canada preferred to seek supplies and services within the company, as opposed to within the country. This preference for importing from the parent may provide the highest-quality goods and services, but it may retard the development of Canadian manufacturing and service sectors and thus limit the spillover effect that foreign investment has on the rest of the Canadian economy. Other concerns have been voiced regarding export policy. Although the evidence suggests that multinational corporations have an equal or better export record than their domestic counterparts do, the practice of restricting exports and limiting markets of individual subsidiaries is not unknown in multinational corporations. Finally, there is concern connected with the multinational corporations’ balance-of-payments impact. The consensus of economists is that balance-of-payments effects of MNCs are minor in comparison with macroeconomic factors such as the growth rate of the economy, changes in exchange rates, and the like; but critics continue to argue that MNCs contribute to trade deficits because of their greater propensity than domestic firms to import needed inputs.

The multinationals’ economic impact on host economies is generally positive, and the public generally perceives that positive impact. Yet there are real economic concerns in specific areas. The most important issue for the developed host countries is not whether foreign investment is economically worthwhile but whether it is possible to increase the benefits and decrease the costs associated with foreign direct investment.

For much of the 1960s and 1970s, examination of the effects of multinational corporations focused on the host states, with the implicit assumption that the home state was always the recipient of economic benefits. In the last two decades, however, that assumption has come under fire. Some analysts and influential interest groups in the United States, particularly labor union representatives, believe that U.S. direct foreign investment had a negative effect on the U.S. economy by favoring foreign investment over foreign trade and production in the United States, exporting jobs instead of goods, allowing tax revenues to escape, and impairing domestic economic development by sending capital abroad instead of using it at home. Although these arguments had increasing political significance, several studies of the impact of foreign investment on the U.S. economy revealed that investment had not taken place at the expense of domestic investment, trade, or employment.

Indeed, the politics of multinational corporations within the industrialized countries increasingly involves debates over what should be done to assist
domestically owned MNCs to become more internationally competitive. Some political actors favor extensive interventions on the part of the government to promote specific firms and industries—sometimes called industrial policy, but also referred to as technology policy when it involves more focused assistance for the creation and commercialization of new technologies. These proponents often argue in favor of interventions to counter the industrial policies of others, especially Japan and the Asian NICs. Others oppose such interventions as being contrary to the norms of the multilateral trading system, difficult to carry out in the new globalized world economy because the national identity of MNCs is becoming somewhat less clear, and generally ineffective in promoting the interests of the nation.

National Economic Control

A second area of potential conflict between MNCs and governments in developed countries is the interference of multinational corporations in the national control of the economy. As developed states have sought to manage their economies to improve economic efficiency, growth, and welfare, concern about external constraints on that control by multinational corporations has emerged.

The concern with national control is clearly revealed in studies of elite and public attitudes toward foreign investment. In a survey of European public opinion, most of the negative views on multinationals centered on fears that they might erode the national control of the economy. Many respondents saw major differences between U.S. and European multinationals: corporations based in the United States were viewed as typically powerful, dynamic, and well organized but also uncontrollable and morally suspect; whereas multinationals based in Europe were seen as socially committed, humane, and loyal as business partners. Various studies of Canadian attitudes reveal that the most adverse feeling toward multinational corporations involved the loss of control. Canadians generally believe that there is a trade-off between the economic benefit of multinational corporations and their adverse effect on control over national affairs.

The sense of lost control reflects, in part, an intangible feeling that, as a result of foreign investment, decisions crucial to the national economy are made outside the nation. The perception is not that these decisions are adverse, just that they are made elsewhere. The tendency of multinational corporations to centralize decisions in the parent suggests that the fears that decision making shifts from host to investing country are often justified. Interestingly, the intangible fear of loss of decision making may not be related to the level of foreign investment. Canadians, who have a vast amount of foreign investment, are no more concerned than are the English, who have much less. The French, with a low level of investment, on the other hand, evidence a high level of concern. The fear of lost control seems to be related more to different national expectations regarding the need for independence than to the actual threat to that independence.

The fear of lost control of sensitive industries is particularly acute. Countries, including the United States, have always been concerned about foreign ownership of such sectors as communications, transportation, and finance. Increasingly, public
officials feel that industries with a large influence on the economy, such as the automotive or petroleum industries, or those in the vanguard of scientific and technological development, such as computers or electronics, should remain under national control. Such concern emerged in the United States in 1987 when the Japanese company, Fujitsu Ltd., tried to acquire an 80-percent share in Fairchild Semiconductor Corporation, a pioneering firm in the industry and a large supplier of computer chips for the U.S. military that had fallen upon bad times. Various U.S. government officials argued strongly that the sale ought to be blocked on national security grounds. Ironically, Fujitsu was proposing to buy the 80-percent share that already belonged to another foreign firm, the French company Schlumberger, Ltd. Apparently the concern of government officials was not simply that it was foreigners who wanted to buy Fairchild, but that it was the Japanese in particular, with whom U.S. semiconductor competition has been particularly fierce. In this case, the issue never came to decision because Fujitsu withdrew its offer as a result of the controversy. Since that time, however, as foreign investment in the United States has increased, public opinion has been wary of foreign investors, especially in the sensitive high-technology industries.

Whereas multinational corporations have often played an important role in achieving national goals, there is a concern that they are less responsive to national economic planning than are domestically owned firms operating primarily in the national market. The concern is, first, that activity rational for an international firm may not be in tune with that planned for the national economy and, second, that the multinational has the capacity to circumvent mechanisms for implementing national plans. Because multinational corporations have access to outside financing, they are not as dependent as domestic industry is on national governmental finance and thus may not respond to governmental incentives to invest in certain industries or certain regions. Because they have fewer links with the national economy and polity, it is feared, multinational corporations are less likely to cooperate voluntarily with national planning goals.

The Gray report, for example, expressed a concern that multinational corporations might interfere with the Canadian government’s goal of increasing investment in manufacturing and discouraging overdevelopment of resource extraction. The report pointed out that foreign fabricating and manufacturing firms that integrate vertically backward to obtain secure supplies of natural resources are less likely to respond to Canadian needs and economic capabilities because their raison d’être is shaped heavily by their committed investment elsewhere.

A greater concern is that multinational corporations may evade national taxation. Through its central control of pricing, the multinational corporation can take profits in countries where taxes are low and avoid showing profits and paying taxes in those countries where taxes are high. Because transactions of subsidiaries of the same multinational are not arm’s length transactions—that is, not determined by free-market prices—the central decision-making unit can artificially fix the prices of those transactions. These so-called transfer prices can be manipulated to minimize taxes. A multinational can, for example,
inflate the price of imports or decrease the value of exports among affiliated companies in order to minimize the earnings of a subsidiary in a high-tax country. This issue emerged in the United States when certain states proposed using a unitary tax formula for computing state taxes of multinational corporations. The purpose of the unitary tax is to prevent multinationals from manipulating transfer prices to their own benefit. Rather than taxing the company on its state revenues, the state would tax it according to a complex formula based on its world-wide earnings. This provoked a strong reaction, particularly from Japanese and British corporations, who threatened to stop investing in states that used unitary tax formulas.

A controversy over California’s unitary tax led to the U.S. Supreme Court’s 1994 decision on a lawsuit filed by Barclays Bank of the United Kingdom in 1984 and another by Colgate-Palmolive in 1986 arguing that the California system was unconstitutional. On June 20, 1994, the Court voted 7–2 in favor of California’s right to keep the unitary tax. If the Court had voted against California, the state would have had to refund approximately $2 to $4 billion in taxes already collected under the law and return to a system of taxation based on the assumption of “arms length” relationships between MNC parents and local subsidiaries.

The California legislature decided in 1986 and 1993 to modify the unitary tax law to make it elective. State authorities realized that the system was creating disincentives for inflows of new FDI and recognized that it was quite difficult to administer because of wide variations in national accounting practices, fluctuations in international exchange rates, and lack of full cooperation from foreign MNCs in tax audits. So while the ruling of the U.S. Supreme Court paved the way for other states to adopt unitary taxes, California was slowly but surely jettisoning the idea.

Another dimension of interference in national control is in what one author called the “national order.” Multinational corporations, it is charged, are less bound by national social codes and economic relationships. Thus the links between business and government that exist in Europe and in Japan and that are a tool for national economic management may be more tenuous and less effective between national governments and foreign multinationals.

Another aspect of the national order is labor-business relations. It has been argued that foreign multinationals have followed labor policies inimical to national labor policies. It has been charged that they are more willing than national firms, for example, to discharge employees and are less willing to consult employees in making decisions that will affect them. Europe is particularly sensitive to this because of its commitment to labor rights and employment protection, but these concerns have also surfaced in the United States. In 1988, the British construction company Beazer tried to buy Koppers, a Pittsburgh-based construction materials and chemicals company. In order to stir up public opposition to the takeover, Koppers’ management successfully played up fears that Beazer, as an allegedly insensitive foreign company, would close the plant or fire workers.
Interference by Home Governments of Multinationals

Another dimension of the problem of control is not the threat from the multinational itself but from the multinational’s home government to the host country, primarily the threat from the United States to the host countries of U.S. multinational corporations. Such extraterritorial interference occurs when U.S. laws are applied beyond U.S. borders through subsidiaries of the multinational corporation (MNC). 89

One area of U.S. extraterritorial interference has been through application of U.S. export controls. The Trading with the Enemy Act of 1917, the Export Control Act of 1949, and its successors, the Export Administration Acts of 1969 and 1979, were used by the U.S. government to control dealings of foreign affiliates of U.S. corporations. 90 The Trading with the Enemy Act empowered the president to regulate all commercial and financial transactions by U.S. citizens with foreign countries or nationals in time of war or national emergency. The act was invoked to prohibit all trade with Cuba, North Korea, North Vietnam, and, until recently, China. The Export Control and Export Administration acts gave the executive branch the authority to “prohibit or curtail” all commercial exports, including technical know-how, to communist or other specified countries from U.S. companies or their foreign subsidiaries on the basis of national security, foreign policy, or short supply. Because U.S. courts held the parent firm criminally liable for the acts of its foreign affiliates, there was a great incentive for multinational corporations to cooperate with these U.S. regulations.

There have been cases in which the United States has blocked U.S. subsidiaries’ transactions abroad that were legal under the laws of the host country. In 1982, in a highly politicized episode, the United States ordered U.S. multinational corporations operating abroad to comply with a U.S. embargo on the export of high-technology products to the Soviet Union for use in the construction of a natural gas pipeline from the Soviet Union to Western Europe. The sanctions, originally promulgated in December 1981, following the imposition of martial law in Poland, were extended in June 1982 to subsidiaries of U.S. companies abroad and foreign companies working under U.S. license. The embargo applied to technology that had been purchased when there were no controls on exports from the United States. The incident provoked a serious conflict between the United States and its European allies, who saw the U.S. action as a unilateral and retroactive application of extraterritorial jurisdiction. Some European governments issued formal orders requiring the resident companies to honor the contracts, and when the companies complied, the United States imposed penalties on them, including the revocation of all export licenses. 91

The U.S. government, however, has not always prevailed. Resistance by the French government and courts led the United States to withdraw its restriction on the sale of trucks made in France by a U.S. firm to the People’s Republic of China. And after five months, the U.S. decision to extend the pipeline embargo to foreign subsidiaries of U.S. corporations and licenses was reversed following an agreement by the North Atlantic Treaty Organization (NATO) allies to study
East-West trade. Numerous other cases suggest that the U.S. government is often willing to back down when foreign governments insist.92

Another area of U.S. (as well as EC and West German) extraterritorial interference has been through antitrust legislation. The Sherman and Clayton acts seek to prevent restraint of competition both within the United States and in U.S. import and export trade. The U.S. courts have asserted a wide-ranging extraterritorial jurisdiction of these laws, including application to the subsidiaries of U.S. multinational corporations. The fact that a U.S. corporation is a parent of a foreign subsidiary has been held sufficient for jurisdiction by U.S. courts. On this basis, the U.S. government has attempted to force, not always with success, disclosure of information by foreign subsidiaries. It has forced U.S. parents to divest themselves of foreign affiliates or to alter the behavior of their affiliates, even though that ownership or behavior was legal under the host country’s laws. United States courts, for example, forced a U.S. beer company to divest itself of a subsidiary in Canada and obliged American parents to order their subsidiaries to cease to operate in a radio cartel in Canada, even though this cartel had been approved by the Canadian government.

In another case, U.S. courts claimed jurisdiction in a private antitrust claim against foreign companies joining in a uranium cartel outside the United States and with the expressed consent of their governments. But instead of the defendant firms, the relevant governments, including Canada and the United Kingdom, appeared in court and argued that the United States could not exercise jurisdiction because it had provoked the cartel by embargoing the use of foreign-origin uranium in U.S. nuclear reactors; because the cartel was, as a result, created as a matter of government policy; and because laws outside the United States do not regard cartel formation as unlawful. The court not only rejected these arguments but also criticized the governments for appearing in place of the firms. Largely in reaction to the uranium case, the United Kingdom enacted legislation to block such action by foreign governments.93

Finally, there has been intervention through U.S. balance-of-payments policies. In the 1960s, the U.S. government tried to improve its balance of payments by asking U.S. corporations to limit their new foreign investment in developed countries, to increase the amount of foreign investment financed by borrowing abroad, and to increase the return of earnings and short-term assets from their foreign affiliates. This had a serious impact on investment abroad, particularly in Europe, where the policy threatened to dampen economic growth, hurt the balance of payments, and dry up local capital markets when U.S. corporations borrowed on local capital markets instead of borrowing in the United States. The capital restraints were ended in the 1970s following the emergence of the float and the improvement in the U.S. balance-of-payments position. Given the internationalization of capital markets in the 1980s, it is unlikely that similar controls could be imposed today.94

The U.S. government also used U.S. multinational affiliates to pressure South Africa to end its apartheid policy. The Comprehensive Anti-Apartheid Act of 1986 prevented U.S. companies and their foreign branches from providing new loans to the South African government or engaging in new investment
in South Africa. Canada, the European Community, the Commonwealth nations, and the Nordic nations passed similar laws prohibiting new investment, and the Nordic countries and Australia and Canada did not allow new bank loans. Congress considered but did not enact stricter legislation, such as requiring mandatory disinvestment by U.S. multinationals or imposing a full-trade boycott on South Africa.

In addition to federal actions directed at ending apartheid, many U.S. state and local governments took a strong stance against apartheid by enacting partial or total disinvestment policies, prohibiting investment of state-run funds in companies that did business in South Africa, or refusing to make purchases from or give contracts to firms that did business in South Africa. Although the state and local governments were not in a position to mandate that U.S. companies withdraw from South Africa, their laws forced multinationals to choose between their U.S. business and their South African business.

Federal, state, and local laws were successful in inducing U.S. corporations to leave South Africa. From 1984 to 1988, for example, 141 U.S. companies withdrew their equity investments from South Africa (although some of these maintained other economic links). It is unlikely that the actions of the United States or those of the other countries that supported the economic embargo against the South African apartheid regime were responsible by themselves for bringing about the end of apartheid, but it is significant that Nelson Mandela was quick to acknowledge its importance after his election to the presidency of the post-apartheid regime. Also, it is noteworthy that so many governments considered manipulation of their multinationals to be a legitimate means of undermining apartheid in South Africa.

In conclusion, the potential for the home country to interfere with MNC activities abroad is very real. If one considers the volume of transactions carried out by multinational corporations, however, the number of actual threats of home country interference is relatively small. Home governments of industrialized nations appear to have adopted a policy of avoiding interference in the activities of MNC affiliates, except in unusual circumstances.

Multinationals and the National Political Process

One final but important area in which multinational corporations may interfere is in the politics of the home and host states. As with any corporation in the home or host country, the multinational is a potentially powerful political actor that can, and at times does, seek to influence law, public policy, and the political environment. The nature and significance of the multinational corporation’s effect on national politics in developed countries are areas that have not been sufficiently examined and about which little is known.

There are several ways in which multinational corporations might attempt to influence politics in host countries. In the most extreme case, they might overthrow an unfriendly government or keep a friendly regime in power. They might intervene in elections through legal or illegal campaign contributions or take action to support or oppose particular public policies. Finally, multinational
corporations might influence the national political culture—that is, shape public political values and attitudes. In all of these actions, the firm may act on its own, at the instigation or with the support of the home government.96

In the case of Canada, the Gray report, which considered these possibilities, concluded that multinational corporations have little direct impact on Canadian public policy. The influence of foreign investment, according to that study, was in shaping alternatives available to Canadian decision makers. For example, because of the structure of Canadian industry and the fact that some firms are foreign controlled, public policy is limited in its efforts to rationalize industry.97 The U.S. Senate Subcommittee on Multinational Corporations found that multinational corporations have engaged in legal and illegal payments in developed countries, but the subcommittee did not suggest just how such payments influenced public policy.98

Multinational corporations may also affect public policy in the home state. One study of U.S. foreign policy found that the direct influence of any particular corporation is likely to be balanced by countervailing powers, even though corporate groups may shape policy. The most important influence, the study concluded, was the ability of business generally to influence the political consensus from which U.S. foreign policy is drawn. The predominance of the liberal approach to international economic relations is an example of this intangible yet significant influence.99

A somewhat different view emerged from the hearings of the Senate Subcommittee on Multinational Corporations held in 1975. These hearings suggested that multinational corporations at times become an important part of the dynamic of U.S. foreign policymaking by initiating demands, providing information, and at times cooperating in the execution of policy. Another impression is that multinational corporations at times follow policies independent of, and perhaps in contradiction to, official governmental policy.100

Another effect of multinational corporations on national politics is through their influence on social structure. One study suggested that multinational corporations are altering both national and international class structures, creating new social, economic, and political divisions. According to the study, there is a new class structure emerging that consists of a transnational managerial class favoring a liberal international economic order; a large class of established labor with secure employment and status in their local communities, which has been the primary object and beneficiary of social legislation and economic management; and a group of social marginals that has not been integrated into the new industrial society and that suffers the system’s social costs. The study found that this new class structure, shaped by the multinational enterprise, will create new social conflicts not suited to control by presently established institutions.101

In conclusion, there has been concern and conflict regarding the multinational corporation. However, the regulation of multinational corporations was not as highly politicized and controversial an issue in the Western system as it was in the Third World, especially after the end of the Bretton Woods period. One reason for this was the adoption of policies to encourage the growth of domestically owned MNCs in Western Europe, Japan, and the NICs. Although
some in the West believed that multinational corporations should be managed to maximize benefits, there was a general perception of the importance of international investment and the need to remain competitive with other industrialized nations. The former prime minister of Canada, Pierre Trudeau, offered this explanation:

I don’t worry over something which is somewhat inevitable, and I think the problem of economic domination is somewhat inevitable, not only of the United States over Canada but perhaps over countries of Europe as well … These are facts of life, and they don’t worry me. I would want to make sure that this economic presence does not result as I say in a real weakening of our national identity. I use that general expression too. The way in which I do that is to try and balance the benefits against the disadvantages. It is obvious if we keep out capital and keep out technology, we won’t be able to develop our resources and we would have to cut our standard of consumption in order to generate the savings to invest ourselves and so on. … Each country wants to keep its identity or its sovereignty, to speak in legal terms. It has to instantly make assessments, and when we make assessments it is to try and select those areas which are important for our independence, for our identity.102

During the period of globalization, however, leftists and environmentalists in the West would take another look at the MNCs and make them part of their objections to the evils of globalization.

INTERNATIONAL REGIMES FOR FOREIGN DIRECT INVESTMENT

Compared with the control of money and trade, the international governance of FDI has been extremely limited and relatively informal.103 One reason is that constructing international regimes for FDI has only recently become an issue in international economic relations. The need for monetary and trade orders became clear as a result of the crisis of the 1930s, a crucial impetus for the establishment of the postwar economic regimes. In foreign direct investment, however, no such international crisis and no consensus have arisen in the West. It was not until the 1960s that MNCs became an issue in international politics and even then, they were more important for North-South politics than for relations among the industrialized countries (see Chapter 8). The fear of economic costs and loss of national control caused by the growth in FDI in the industrialized countries has been balanced for the most part by the perception of economic benefits.

One factor shaping these generally positive perceptions of multinational corporations is the dominant liberal philosophy of the governments and globally oriented business interests in the industrialized world. FDI, like other international financial flows and trade, is viewed by these individuals as economically
rational and beneficial. The role of large corporations in politics is not seen as dangerous in countries where domestic corporations play such roles. This general receptivity to international capital affects reactions to multinational corporations. The principal dissent comes from labor leaders and from the governments of France and Japan, two countries that were slow to embrace the idea of foreign direct investment and which actively fostered partnerships between the government and domestic firms in the pursuit of national economic development.104

Another reason for the limited perceived threat has been the power relationship between the multinational corporations and the governments of the developed countries. In the developed countries, the multinational corporation is not perceived as a major threat to governmental power. Whereas firms can influence economic performance and interfere with a nation’s economic management, they cannot undermine the authority of powerful, sophisticated governments. Although multinational corporations control sensitive sectors, they do not, except in Canada, loom so large in the national economy that governments feel they must acquiesce to their strength. Furthermore, Western governments possess not only the expertise—lawyers, accountants, economists, business experts—to regulate multinational corporations but also the confidence that they can devise means for control.

Yet another reason for the limited perception of threat in the West is that virtually all industrialized regions have their own multinational corporations. The position of the governments of the developed market economies as both home and host moderates their desires to restrict multinational corporations, for any restriction would limit the expansion of their own MNCs. Reinforcing this limited concern over foreign investment in the late 1970s and early 1980s was the troubled economic scene in the West, one of the more prominent features of which was a decline in new capital formation. There has thus been a reluctance to question the source of any new capital investment.

A final dimension of the limited threat and lack of international control of multinational corporations is the absence of U.S. interest in such management. Concern about foreign investment in the United States, especially by the Japanese, has been rising. Nevertheless, U.S. perception of a need for management, crucial to the development of a formal regime, has not existed in the field of international investment. The lack of perceived problems for U.S. political and economic systems, the dominant liberal ideology, and the political significance of the large multinational corporations in U.S. politics has made U.S. leadership more interested in promoting than controlling foreign investment.

As multinationals have become more important and better understood, the trend toward liberalizing regulations on multinationals has been echoed throughout the Northern states, as we will see in the following discussions of national, regional, and international management.

**National Governance**

Most efforts to control multinational corporations in the present international system occur within the host country. Although policy in developed market economies has been receptive to foreign investment, there have been some...
tempts to regulate foreign corporations to maximize economic benefits and to minimize the loss of control.

The most important form of regulation is the control of initial capital investment. States have sought to restrict key sectors for national investment and to regulate the degree of foreign ownership or control in sectors open to foreign investment. Although all countries have some form of key sector control—transportation, communications, and defense industries are commonly restricted industries—few of the developed market economies have comprehensive regulations or even a clear national policy regarding foreign investment.105

For many years, Japan followed a comprehensive, restrictive policy.106 In investment as well as trade, Japan’s public philosophy and governmental policy differ from those of other Western countries. Postwar policy was originally based on the Foreign Exchange Control Law of 1949 and the Foreign Investment Law of 1950, which provided governmental authority to screen all new foreign investment, with a view to limiting that investment, and to prevent the repatriation of earnings and capital of foreign investors. Government policy was highly restrictive. New foreign investment was limited to a few industries, and within those industries, foreign ownership was limited to no more than 49 percent. When purchasing existing industry, foreigners were limited at most to a 20 percent ownership of unrestricted industries and a 15 percent interest in the many restricted industries.

While restricting direct foreign investment, Japan tried to obtain the benefits of multinational corporations by purchasing advanced technology through licensing agreements instead of acquiring technology through foreign control. As a result of these comprehensive, restrictive policies, FDI inflows into Japan have been quite low (see again Figure 4.5). Also, most foreign MNC affiliates are joint ventures in which the foreign partner owns 50 percent or less of the venture.

Starting in 1967, as Japan’s balance of payments strengthened and foreign pressure for liberalization increased, Japanese policy changed somewhat. The number of restricted industries was reduced, and 100-percent foreign ownership was permitted in many industries in May 1973. In 1980, the Japanese government passed a new Foreign Exchange Control Law. This legislation liberalized foreign exchange controls, removed formal entry restrictions on foreign direct investment (with the exception of 22 industries, including agriculture, forestry, fisheries, mining, petroleum, leather, and leather manufactures) and permitted 100-percent foreign control through new investment or acquisition.

In the mid-1980s, Japan relaxed controls in the financial services sector, allowing foreign institutions to obtain securities and trust bank licenses and encouraging the Tokyo Stock Exchange to open membership to foreigners. There remained a review process through the Committee on Foreign Exchange and Other Transactions in the Ministry of Finance, which evaluated foreign investment according to criteria such as effects on national security, impacts on domestic enterprise in the same or related business, smooth performance of the national economy, reciprocity with the home country of the investor, and the need for approval for capital export transactions. One of the most effective barriers to foreign investment was the keiretsu system, which can effectively
restrict inward foreign investment. Many Japanese financial and industrial firms hold each other’s stock as part of their *keiretsu* obligations, a policy promoted by the Japanese government since World War II to prevent hostile takeovers of any sort, including foreign acquisitions.107 Finally, though the Japanese government has allowed some liberalization, it has always retained the power to restrict foreign investment at any time at its own discretion.

On the other hand, the Japan External Trade Organization (JETRO), once an export-promoting organization, has been turned into an investment-attracting organization; and the Japan Development Bank is now providing favorable rates on loans to foreign investors. As a result of liberalization, foreign investment in Japan has risen, although Japan still has very low levels of foreign investment inflow in comparison with those of other OECD countries (see again Figure 4.5).108 Similarly, the Ministry of Economy, Trade, and Industry (METI) has become a defender of the “internationalization” of the Japanese economy, even while it remains a promoter of the interests of Japanese firms in world trade. METI understands that in order for Japanese exports and outbound foreign investments to expand in the long run, Japan will have to become more open to imports and inbound FDI. Thus METI pushes Japanese business and the rest of the Japanese government in the direction of making it easier for non-Japanese firms and individuals to set up business in Japan.109

There is some evidence in recent years that the efforts of JETRO and METI to encourage investment in Japan are succeeding. FDI inflows into Japan increased from zero in 1995 to a peak of $12.7 billion in 1999, only to fall back a bit in 2000 to $8.2 billion.110 Inflows averaged about $6 billion from 2001 to 2005. When Nissan got into financial difficulties in 1999, the French car maker Renault upped its stake in the Japanese firm to 36.8 percent through a share-swapping arrangement and negotiated an alliance with Nissan that included new investment in Japan for the production and sales of Renault models with marketing support from Nissan. In 1999, Salomon Smith Barney bought a 20-percent stake in Nikko Securities, Japan’s third largest securities firm, and also formed a joint venture with Nikko called Nikko Salomon Smith Barney combining the Tokyo operations of Salomon with the Equities, Fixed Income, Research and Investment Banking Divisions of Nikko; and a U.S. firm named Ripplewood organized a consortium to purchase the Long-Term Credit Bank, a bank that had failed as a result of bad loans.111 DaimlerChrysler purchased a one-third equity share in Mitsubishi Motors in March 2000 when the latter experienced some debt-servicing problems. Boots (the British drugstore chain) and Carrefour (the French department store chain) first entered the Japanese retail marketplace also during this period. Thus, Japan was becoming more open to foreign investment by the end of the 1990s partly as a result of the bubble economy.

Canada also drew up a policy for regulating the inflow of foreign investment in the seventies. The Canadian Foreign Investment Review Act of 1972 established the *Foreign Investment Review Agency* (FIRA) to screen virtually all new direct foreign investment in Canada. Its coverage was comprehensive (including new businesses), most acquisitions, the expansion of existing
foreign-owned firms into nonrelated businesses, and change of foreign ownership. As a matter of national policy, FIRA refused takeovers in the fields of broadcasting, rail and air transportation, newspapers, nuclear energy, and banking. Evaluation of the benefit to Canada of foreign investment was determined by criteria such as contribution to employment, new investment, exports, processing of raw materials, purchase of supplies in Canada, access to sophisticated technology, improved productivity, and competition, as well as the degree of Canadian equity participation.

FIRA also insisted that foreign investors fulfill performance requirements in return for permission to invest in Canada. These commitments included import substitution requirements, export targets, research and development expenditures to be made in Canada, local equity participation guarantees, and exclusive production-in-Canada arrangements. Many investors were deterred by such requirements from making application to FIRA. Others complied. But FIRA’s restrictions brought a negative reaction from the United States, which in 1982 filed a complaint with the GATT, charging that FIRA’s performance requirements were illegal. In 1983, a GATT panel found that Canadian requirements forcing companies investing in Canada to buy a certain proportion of their goods and services in Canada were illegal under GATT but that its export performance requirements were compatible with GATT.

In 1984, the Foreign Investment Review Act was replaced by the Investment Canada Act, which was designed to promote, rather than discourage, foreign investment. Foreign investment is still screened, but only those investments exceeding C$5 million and C$50 million for direct and indirect investments, respectively, are subject to the screening procedure, greatly decreasing the number of foreign investments subject to review. The stated purpose of the review is to ensure that the investment be “of net benefit to Canada.”

Under the U.S.–Canada Free Trade Agreement signed by the two countries in 1989, U.S. firms were given even greater opportunities for Canadian investment, because indirect acquisitions would eventually be exempted from any review, and the threshold for review of direct acquisitions would be raised. U.S. firms wishing to make major investments in Canada still must have their proposals reviewed (which is not the case for Canadian firms investing in the United States), but the likelihood of rejection has continued to decrease. These developments were reinforced and generalized to include Mexico with the signing of the North American Free Trade Agreement (NAFTA) in 1992.

Other states also screen inbound investment. Britain and France rely on an ad hoc consideration of applications for new direct foreign investment. Investments that might create foreign dominance of an important economic sector, damage national research and development, interfere with official plans for industrial rationalization, or create excessive concentration are reviewed by the appropriate ministries or agencies. There are no formal statutory guidelines for evaluating foreign investment, other than national antitrust and competition laws, but in practice, judgments tend to favor investments that benefit employment, balance of payments, research and development, and exports; create new enterprises instead of acquiring existing firms; encourage national management at both
the national and the parent level; and fit in with governmental plans for industrial reorganization.

In general, investment policy in the mid-1960s was restrictive, but since then many countries have become highly receptive to foreign investment. The United Kingdom, for example, has been traditionally favorable to foreign investment, and, under Conservative government after 1979, Britain abandoned any government planning role, preferring to leave investment decisions to the operation of a free market. In 1985 the British government permitted a merger between Westland, a helicopter manufacturer, and the U.S. company United Technologies, despite strong pressure to favor the development of a European consortium to strengthen European air industry cooperation. In 1988, the Swiss chocolate company, Nestlé, was allowed to buy Rowntree (a British candy producer) despite strong nationalistic protests. Nonetheless, even in a fundamentally liberal environment, such as Great Britain’s, the desire for a national presence, or even a national champion in certain industries, has occasionally prevailed. When British Caledonian Airways was up for sale in 1987, both the Scandinavian carrier SAS and British Air made a bid for control. The government subtly discouraged SAS by declining to guarantee retention of route licenses; the British Air bid succeeded, allowing it to expand significantly its size and route capacity, providing England with a strong national airline carrier to compete in the post-1992 internal market.

U.S. controls on foreign investment have traditionally been limited to the International Investment and Trade in Services Act (IITSA) of 1976, which established a mechanism to monitor foreign investment, and the International Emergency Economic Powers Act of 1977, which empowers the president to block foreign acquisitions of U.S. companies or compel divestiture of an already acquired domestic company if he or she determines there is an extraordinary threat to the national security, foreign policy, or economy. Various other sectoral controls limit foreign investments in areas such as aviation, atomic energy, and communications.

As foreign investment in the United States increased dramatically in the 1980s, more attention was given to regulation. The Bryant Amendment to the Omnibus Trade Bill of 1988, which was defeated, would have required foreign investors to file certain proprietary information with the Department of Commerce for public disclosure. In that same year, an amendment to the Defense Production Act of 1950 (known as the Exxon-Florio amendment after its sponsors Senator J. James Exon and Representative James J. Florio) extended the scope of the IITSA to prohibit mergers, acquisitions, or takeovers of U.S. firms by foreign interests when such actions are deemed a threat to the national security of the United States. After lapsing for technical reasons in the fall of 1990, the Exxon-Florio authority was reinstated in August 1991 and made a permanent part of U.S. law.

The job of implementing the Exxon-Florio amendment was given to an interagency committee called the Committee on Foreign Investment in the United States (CFIUS), which is chaired by the Secretary of the Treasury and includes representatives from the departments of State, Defense, Commerce, and
Justice, as well as the Office of Management and Budget, the Office of the U.S. Trade Representative, and the Council of Economic Advisers. CFIUS investigates any transaction that falls under the statute and then makes a recommendation to the president, who then makes the final decision on whether to invoke the law.

The first CFIUS investigation under the Exon-Florio amendment was conducted in late 1988 and early 1989. It involved the proposed takeover of the silicon wafer division of the Monsanto Corporation by a German chemical firm, Hüls AG. While some members of the committee wanted to bar the purchase, the government negotiated an agreement with Hüls whereby the purchase would be approved if the company agreed to maintain production of wafers and continue research and development in the United States.

Between 1988 and 2005, CFIUS received 1,500 notifications of transactions, but conducted only 25 investigations. Thirteen proposals were withdrawn during review, including a proposed acquisition of a U.S. machine tool manufacturer by a major Japanese firm called FANUC, and twelve were sent to the President for final determination. The President ordered divestiture in only one instance. A particularly contentious case was the takeover of a U.S. firm called Semi-Gas, which produced ultrapure industrial gases used in semiconductor manufacturing, by Nippon Sanso, a Japanese firm. This deal was particularly sensitive because Semi-Gas had been a collaborator with U.S. semiconductor and electronics firms in an R&D consortium called Sematech (short for semiconductor manufacturing technology). Sematech had been part of a U.S. effort to reestablish technological leadership in semiconductors, having lost out in some key semiconductor areas to Japan in the early 1980s. What bothered many people was that U.S. tax dollars had been spent to raise the technological capabilities of firms like Semi-Gas, and it did not seem to make sense, therefore, to allow Japanese firms to reap the benefits.

The Exon-Florio amendment was amended further in 1993 to prevent (1) foreign acquisition of U.S. firms with contracts with the U.S. Departments of Defense and Energy worth more than $500 million and (2) awarding of U.S. government contracts involving “top secret” information to firms controlled by foreign governments. The new amendment also empowered CFIUS and other government agencies to review proposals for investments in high-technology areas deemed “critical” not just for national security reasons but also for U.S. competitiveness. The open-ended nature of these provisions made it possible for the U.S. government to begin screening a much broader range of inward flows of FDI.

In June 2005, China National Offshore Oil Company (CNOOC) made an unsolicited bid of $18.5 billion for the acquisition of Unocal, an American oil company with oil properties in Central Asia. The deal was strongly opposed by members of Congress from both parties, because CNOOC was largely controlled by the government of China and because China had major restrictions on inflows of U.S. foreign investment. As a result, CNOOC chose to withdraw its bid.

In February 2006, Dubai Ports World (DPW) attempted to purchase six major port facilities in the United States including the port of Newark, New Jersey. Despite the fact that CFIUS approved the deal, again it was opposed vigorously
by members of Congress from both parties. This time the objections were based on the fear that DPW, a company headquartered in the United Arab Emirates, could be infiltrated by terrorists intent on smuggling weapons of mass destruction into the United States. The president personally supported the merger, but legislation proposed to block it convinced DPW to scrap the deal and sell its U.S. holdings to AIG, an American insurance company.\textsuperscript{123}

As a result of the controversies over the CNOOC and DPW acquisition attempts, the Congress passed the Foreign Investment and National Security Act (FINSA) of 2007. Besides codifying preexisting practices, FINSA expanded the concept of national security to include mergers that involved critical infrastructure and technologies. It also mandated closer scrutiny of mergers involving state-owned enterprises. In addition, CFIUS was empowered to negotiate arrangements with acquiring firms that would mitigate any threat to U.S. national security arising from a merger.\textsuperscript{124}

Motivating these recent efforts was increasing economic nationalism. There is a growing concern in the United States over excessive dependence on foreign capital to finance growth, and a vocal minority would like to see even stricter limits on foreign investment.\textsuperscript{125} Nonetheless, the prevailing view still defends the benefits of foreign investment for the United States and would like to see a more liberal economic environment for foreign investment here and abroad. Judging by the actions of most U.S. states, one would assume that foreign investment is highly desirable. State governors are competing, intensely at times, to attract new foreign manufacturing plants. In return for the jobs and the economic stimulus of the new plants, they are willing to offer tax incentives, regulatory breaks, and other inducements. This has been taken to such a degree that a backlash has developed, in which U.S. companies argue that they are being discriminated against by their own local governments, which favor foreign companies and allow them to produce in the United States much less expensively than U.S. companies. It remains to be seen which of these two opposing points of view will prevail; but there is no doubt that the United States is facing an important new wave of protectionism and economic nationalism that is not likely to disappear in the near future.

Aside from imposing entry requirements, countries may also attempt to manage the behavior of multinational corporations once established in their state. The ability to control the multinational corporations’ behavior is crucial to management, because it involves activities that affect national economic performance and national control, such as taxation, labor policy, capital movements, and competition policy. Indeed, governments in the developed countries closely regulate the operations of those firms—both national and multinational—operating within their borders. However, with some exceptions, the developed countries’ governments have not sought to impose special or differential regulation on the operation of multinational corporations. Controls on intracorporate capital flows and intracompany charges, for example, would be difficult to apply, could provoke retaliation, and could act as a deterrent to foreign investment, which is viewed positively in the developed market economies. Furthermore, governments in the developed countries have the administrative and legal capacity to
control the MNCs through legislation, regulation, and administrative practice, which applies to domestic as well as foreign corporations. Finally, the principle of national treatment—a GATT rule specifying that foreign-owned enterprises are to be treated no less favorably than are domestically owned enterprises—acts as a deterrent to discrimination against MNCs. Although national treatment is not universally accepted and is inconsistently applied, it is embodied in certain bilateral treaties such as the friendship, commerce, and navigation treaties with the United States and in the multilateral codes of the OECD and thus serves as a constraint on government policy. Exceptions to national treatment do exist in the areas of government subsidies, government purchasing, work permits and immigration policy, and participation in industry groups that set sectoral policy.

Governments have also applied informal pressure on firms to fulfill certain performance requirements in areas such as plant or export expansion and to adhere to national labor practices. They have carefully monitored foreign investors’ adherence to national tax legislation and foreign exchange laws. As governments, especially in Europe, have expanded their intervention in the national economy through law and regulation, foreign investors have been increasingly obliged to adopt practices—for example, labor relations policies—consistent with those of the host country. Finally, where there has been a conflict of law or policy between the host and the home state, as in the case of the U.S. extraterritorial application of export controls, the governments of the host countries have insisted on asserting their jurisdiction over the resident MNCs. As we have already discussed, several European countries required resident companies to ignore U.S. restraints on pipeline exports to the Soviet Union.

Finally, there have been increasing attempts in the major home country, the United States, to regulate home country MNCs. Concerns with balance-of-payments deficits led to capital controls; organized labor expressed concern over export of jobs and the tax “loopholes” enjoyed by multinational corporations; and the Senate Subcommittee on MNCs in the mid-1970s revealed a broad range of potential foreign policy problems posed by multinationals. In 1977, Congress enacted legislation to prohibit the use of bribery and illicit payments for political purposes by U.S. corporations operating abroad. And in the late 1970s and early 1980s, several U.S. states, in an effort to raise new revenues and to offset the ability of multinational corporations to select the state or country of lowest taxation, enacted unitary tax legislation that taxed both foreign and domestic corporations on their worldwide income instead of on income earned in that particular state. The result was an outcry from Japan and Europe, alleging violation of tax treaties that eliminated double taxation.

Because the industrialized nations have been unwilling to restrict too severely the multinational corporations, many have tried to minimize their costs in other ways. Many industrialized countries have tried to strengthen their domestic firms in order to make them more competitive with foreign MNCs. Such policies, as part of broader industrial policies, include governmental encouragement and support of industrial concentration and rationalization of national industry, research and development, maintenance of key industries or companies, and development of national capital markets and national managerial skills.
Methods include governmental financial assistance, tax preferences, government participation in industry, encouragement of mergers, financing of research and training programs, and “buy national” procurement policies. Within the European Union, many of these policies are illegal, thus discouraging the growth of national champions. Nonetheless, in certain industries, such as defense, strong domestic suppliers have been directly subsidized and/or sheltered from international competition (e.g., GEC-Marconi in the United Kingdom or Matra in France). The more usual practice is to permit mergers among European firms to make them more internationally competitive without losing their essentially national or regional character. The Spanish government, for example, encouraged mergers of Spanish banks in order to prevent local market dominance by non-Spanish banks after 1992. But the main emphasis within the European Union is on promoting competitive pan-European “sunrise” industries to fight U.S. and Japanese dominance (see section on regional governance below).

Regional Governance

Regional common markets and free-trade areas have provided new opportunities for regional governance of multinational corporations. Within the context of such agreements there is room for substantial control or liberalization of investment policies. One potentially important regional forum for the multilateral governance of multinational corporations is the EU. Two approaches to regional policy have been suggested. One approach, prevalent in the 1970s, was to develop European Union regulations to limit the autonomy of MNCs in areas of frequent national conflict such as labor relations. The other approach has been the Union’s encouragement of large European corporations, capable of competing globally with U.S. and Japanese corporations in high-technology sectors. The control function has not been developed as far as expected, in part because of the liberal, pro-business climate of Europe in the 1980s. Instead, the emphasis has been on the second approach in an effort to close the high-technology gap before the internal market is completed in 1992. However, it is possible that the control issues will reemerge as a priority, especially if the political left grows stronger in Europe.

European regional governance faces major obstacles. In addition to political opposition on some of these issues, a more basic problem concerns the authority of the EU to impose binding regulations on its member countries. Members of the community have consistently refused to delegate to the EU any national authority for regulation of industrial policy. A French proposal in 1965 for community regulation of foreign investment was rejected by other members who opposed a restrictive policy. In 1973, the European Commission proposed a number of community regulations regarding MNCs, including the protection of employees in event of a takeover and cooperation in monitoring MNC activities. The Caborn report, adopted by the European Parliament in 1981, called for maximizing the positive effects of multinational corporations and minimizing their negative effects by “the establishment of an appropriate framework of countervailing power at the international level through legislation, guidelines, codes, and multilateral agreements, and...
through greater cooperation and exchange between states.” Specifically, it recommended binding EU regulations in the areas of information disclosure, transfer pricing, and merger controls.

Although no specific directives aimed at non-EU investment were passed until 1993 (see below), the European Union moved ahead on several directives that would shape foreign as well as EU corporations’ practices and address some of the concerns mentioned in the Caborn report. The most important areas were accounting and information disclosure and antitrust policy, especially merger control. A number of directives—the EU form of legislation—in the area of company law were designed to increase the transparency of the activities of large conglomerates. The Seventh Company Law Directive, adopted in 1983, called for the consolidation of financial reporting to enable a fair review of the business as a whole. The First and Fourth Directives had already specified the type of information to be published in public companies’ accounts. The draft of the Ninth Directive would oblige groups of companies to define and publish the relationships between parents and subsidiaries and increase the rights of subsidiaries against the parent. The draft of the Thirteenth Directive would lay down rules for the conduct of takeover bids, particularly with regard to information disclosure.

Another area of concern was the promotion of greater participation and consultation rights for employees. The proposed Fifth Company Law Directive, to harmonize the structure of EU public companies, includes a provision for employee participation at the board level. Another proposed directive, known as the Vredeling proposal, called for greater consultation between management and labor regarding company policy and plans. Though interest in these proposed laws stagnated because of liberalization and deregulation in the early 1980s, they were revived after 1993.

The European Union’s industrial policy was considerably strengthened in the 1980s. Industrial policy was designed initially to build EU industrial champions to counter U.S. and Japanese industrial and technological dominance. The Single European Act, signed in 1986, added a chapter to the Treaty of Rome entitled “research and technological development,” which stated that “the Community’s aim shall be to strengthen the scientific and technological basis of European industry and encourage it to become more competitive at [sic] international level.” This was to be realized through EU financial support for basic R&D, the opening up of national public sector procurement contracts, technical standardization, and the removal of fiscal and legal barriers to joint ventures and other forms of cooperation. A number of jointly funded research consortia were established in the areas of telecommunications, manufacturing technology, and information technologies and a steady increase in the number of intra-European mergers and joint ventures occurred. It soon became evident, however, that European MNCs needed to be able to construct alliances with non-European firms in certain important areas in order to be globally competitive. European laws and practices tended to reflect that reality in the 1990s.

The EU made it clear that, while it wished to maintain a liberal policy toward trade and inward investment, it did not intend to allow foreign companies to reap the greatest benefit from the unified internal market. This meant that a
degree of EU preference for European firms would continue to prevail and that foreign-based multinationals would not have the same access to EU programs as local companies, unless some reciprocity was recognized in the multinationals’ home countries. This policy was taken up by the United States in the late 1980s and early 1990s with the establishment of such R&D consortia as Sematech, the HDTV Grand Alliance, and the U.S. Display Consortium. Even Japan began to invite the participation of foreign MNCs in its advanced R&D efforts during this period.\textsuperscript{133}

There was no EU policy specifically to regulate inward foreign investment, although individual EU states had their own regulations. However, Union action could be taken to disallow state financial inducements that acted as subsidies for foreign investors or to refuse to allow goods produced with less than an acceptable local content to circulate freely in the Union. This would curtail the operations of so-called “screwdriver plants,” which simply assembled foreign-made components within the EU and thereby avoid external tariffs. In 1988, for example, France received permission from the EU to block the import of 300,000 television sets that were produced by Japanese companies but assembled in the EU. France claimed that these televisions did not qualify as European because of the high foreign content.

Mergers and joint ventures were permitted under European competition laws. After 1989, two separate laws governed joint ventures: Article 58 of the Treaty of Rome and the Merger Regulation of 1989. The Merger Regulation governed joint ventures that affected market structure significantly, while Article 58 covered all other joint ventures. Until the passage of the Merger Regulation, MNCs were not legally restricted in their decisions on European joint ventures. After 1989, however, all new joint ventures, including those that involved non-European MNCs, had to be approved by the European Commission.\textsuperscript{134}

Another regional management issue in Europe was a directive of the European Commission concerning European works councils. Under this directive, all MNCs operating in Europe with 1,000 or more workers in more than one EU country were required to set up pan-European works councils to inform and consult their employees on key decisions. When the Maastricht Treaty came into effect on November 1, 1993, European legislation could no longer be vetoed by a single member state in the European Council, requiring instead three governments to be opposed. Until that time, Britain had blocked the directive by exercising its veto power. According to a study published by the European Employers’ Union (UNICE), about 1,200 companies would be affected. Most foreign and some European MNCs opposed the legislation on the grounds of increased cost and reduced managerial flexibility. European unions and some MNCs supported the measure. Compagnie des Machines Bull, Thomson CSF, Grundig AG, Digital Equipment Corporation, Xerox Corporation, and IBM all set up some form of information and consultation procedure in anticipation of the new law.\textsuperscript{135}

In addition to regional management through the EU, which is the best known and most complex regional internal market existing today, recent steps have been taken to create other regional areas for trade and investment liberalization. New Zealand and Australia have had a free-trade area for many years,
and have just strengthened it through the **Closer Economic Relationship** agreement to include substantial liberalization of investment and harmonization of regulatory barriers.\(^\text{136}\) NAFTA and the U.S.–Canada Free Trade Agreement have similar provisions, which increase cross-border competition in manufacturing by eliminating most tariffs and enable service industries, such as banks and insurance companies, to compete directly for business in the three countries. Previously, for example, U.S. financial institutions were not allowed to own more than 25 percent of federally regulated Canadian-controlled financial institutions, and Canadian companies were not allowed to offer Canadian government securities in the United States. Both of these policies have been changed under the U.S.–Canada Free Trade Agreement.

### International Governance

International regulations and agreements encouraged the growth of foreign direct investment and the scope of operations of multinational corporations. Western international law enacted before World War II offered some protection for foreign investment. The traditional law of prompt, adequate, and effective compensation in the case of nationalization and various patent and copyright conventions was designed for this purpose, and the postwar agreements reinforced this general trend.\(^\text{137}\) The IMF’s provisions regarding currency convertibility allowed the repatriation of capital and earnings and thus facilitated the international flow of capital. The GATT’s tariff reductions smoothed international production and transfers within the multinationals. In addition, the OECD’s Codes on Liberalization of Capital Movements and of Current Invisible Operations established the norms of nondiscrimination between foreign and domestic investors within a country, freedom of establishment, and freedom of transfer of funds.

Although there were some attempts to regulate the activities of multinational corporations,\(^\text{138}\) until the 1970s there were few attempts to create governance structures for multinational corporations at an international level, and most of those attempts failed. One such effort died with the Havana Charter.\(^\text{139}\) The management of international investment had not been a part of the U.S. scheme for a new postwar economic order. Ironically, in response to strong pressure from U.S. business groups, the U.S. delegation at Geneva in 1947 proposed a draft article on foreign investment. The article, intended to codify the prevailing Western liberal attitude toward foreign investment and the rights of capital-exporting countries, provided for protection against nationalization and discrimination. Once the matter was placed on the negotiating agenda, however, its character quickly changed. The less-developed countries, led by the Latin American states, were able to redefine the proposed article to protect not capital exporters but capital importers. Provisions of the Havana Charter allowed capital-importing countries to establish national requirements for the ownership of existing and future foreign investment and to determine the conditions for further investments. The inclusion of the investment provisions was a major reason for the opposition of U.S. business to the Havana Charter and for its eventual failure. The GATT, its successor, contained no provisions for investment.
However, an agreement on trade-related investment measures (TRIMs) was part of the Uruguay Round (see Chapter 3). Throughout the 1950s and early 1960s, a do-nothing attitude prevailed. Attempts to write international foreign investment laws, such as the United Nations’ Economic and Social Council efforts in the 1950s and those of GATT in 1960 on restrictive business practices, surfaced but led nowhere. In the late 1960s, as concern increased, more comprehensive proposals for a system of international control were drawn up. The most far-reaching proposals called for a body of international law under which multinational corporations would be chartered and regulated and for an international organization to administer these regulations. Other proposals advocate the development of a GATT for investment. This intergovernmental general agreement would consist of a few fundamental concepts of substance and procedure on which there might be a general international consensus and would establish an agency to investigate and make recommendations about the creation or infringement of rules (much as the GATT organization has done). Such an agency would not have compulsory authority, but it would have the power to publicize its findings and thus appeal to public opinion.

Although such a comprehensive, self-sufficient supranational body or even GATT-like Code for Investment seem unlikely, other options are available. These include amending existing WTO agreements, drawing up a separate agreement committing its signatories to apply WTO principles to investment, or prosecuting investment issues that are trade related through the WTO dispute resolution framework in order to set precedents covering investment. The United States participated in the Uruguay Round agreements that dealt with trade-related investment measures (TRIMS) (see Chapter 3). Although limited, the TRIMs agreement was a landmark in multilateral investment management, both because it integrated investment into the new WTO and because its emphasis was on encouraging investment flows. These included local content requirements, local equity requirements, technology transfer or export requirements, remittance restrictions, and incentives.

**Governance in the OECD**

The OECD has been another forum for devising a regime for international investment. In 1961, In the Codes of Liberalization of Capital Movements and of Current Invisible Operations, established in 1961, member countries agreed to “reduce or abolish obstacles to the exchange of goods and services and current payments and maintain and extend the liberalization of capital movements.” Signatories of the Code of Liberalization of Capital Movements pledged themselves not to establish any new restrictions on capital movement, to notify the OECD of existing measures restricting capital movements, and to work toward reducing restrictions in a nondiscriminatory manner. The Code covered all capital movements, from daily currency trading to long-term foreign direct investments. In the Code of Liberalization of Current Invisible Operations, OECD members agreed to liberalize trade in services (also called invisibles).
At first, OECD members liberalized only long-term capital movements. It was not until the 1980s that they began to relax restrictions on short-term capital flows. The United Kingdom led the way by liberalizing all short-term capital movements in 1979. By the early 1990s, no OECD member maintained capital controls of any significance.\textsuperscript{143}

In 1976, OECD members adopted a Declaration on International Investment and Multinational Enterprises. This declaration consisted of four elements:

- \textit{Guidelines for Multinational Enterprises}: A voluntary code of conduct for multinational corporations.
- \textit{National Treatment}: Under this principle, OECD members would “accord to foreign-controlled enterprises on their territories treatment no less favorable than that accorded in like situations to domestic enterprises.”
- \textit{Conflicting Requirements}: Members pledged themselves to cooperate to avoid the imposition of conflicting requirements on multinational corporations.
- \textit{International Investment Incentives and Disincentives}: Members recognized the right to consider the interests of other OECD members in creating investment incentives and disincentives and pledged to make such measures “as transparent as possible.”\textsuperscript{144}

One factor leading to the Declaration was the new interest of the U.S. government and U.S. business in creating such an international code. Public revelations of corporate bribery and illegal political activity resulted in domestic pressures for regulating U.S. corporations. U.S. firms sought to deter, through an international agreement, congressional legislation and to internationalize any constraints placed on them.

The stated goal of the Declaration was to maximize international investment. It suggested guidelines for corporate behavior, such as greater disclosure of information, cooperation with the laws and policies of host governments, less anticompetitive behavior and fewer improper political activities, respect for the right of employees to unionize, and cooperation with governments in drawing up voluntary guidelines for corporate behavior. As part of the Declaration, the OECD countries further agreed on guidelines for government policy regarding multinational corporations, including nondiscrimination against foreign corporations, equitable treatment under international law, respect for contracts, and government cooperation to avoid beggar-thy-neighbor investment policies. Finally, the OECD countries agreed to establish consultative procedures to monitor and review the agreed-upon guidelines. Although the OECD code was voluntary and its guidelines were often deliberately vague, it was a step toward the development and implementation of international norms.\textsuperscript{145}

The OECD agreed in 1979 on a Model Tax Convention, which dealt with transfer pricing. This convention attempted to establish an “arm’s length principle” to prevent transfer pricing that took advantage of tax havens—geographic zones with much lower than average tax levels—by shifting profits toward the tax haven. The arm’s length principle compared prices used in intrafirm transactions with
those that might be used between unrelated firms. If there was a major discrepancy, then the intrafirm prices violated the arm’s length principle. While this was by no means a perfect resolution of the problems posed by transfer pricing, it probably helped to prevent the most blatant abuses. In a report published in 1994, the OECD reaffirmed its commitment to the arm’s length principle.  

In 1986, the principle of the right of establishment became part of the OECD’s Code on the Liberalization of Current Invisible Operations. Under this principle, if the establishment of an office, branch, or subsidiary was a prerequisite for doing business abroad, then signatories to the Code agreed to grant the right to other signatories to establish such facilities on a nondiscriminatory basis.

The OECD convened a series of roundtables beginning in 2006 on Freedom of Investment, National Security, and “Strategic Industries.” The purpose was to discuss existing practices within the membership of the OECD and to arrive at a consensus on principles that could reduce “unnecessarily restrictive policies to achieve security objectives.”

### Governance in the United Nations

Another limited international solution was offered by the United Nations. Largely as a result of the pressures from the Third World countries, in 1974 and 1975 two new organizations were established within the United Nations system: the Center on Transnational Corporations (CTC), which gathered and generated information on multinational corporations, and also the intergovernmental United Nations Commission on Transnational Corporations (UNCTC), which acted as a forum for considering issues related to multinational corporations, for conducting inquiries, and for supervising the center. The commission’s activities focused on the development of an international code of conduct for multinational corporations. Because the commission was such a large, public governmental forum and because the positions of the member countries differed (thirty-three were developing countries, five were socialist, and ten were developed market economies), the bargaining process was tedious and often confrontational. After well over a decade, the negotiations on a code of conduct remained deadlocked on a number of issues. Most difficult were the definition of a transnational corporation—with the developed market countries wanting to include state-owned transnationals of the Eastern bloc and the socialist states not wanting to accept this definition—as well as the demand of the developed market economies for assurances on the treatment of MNCs by host governments in return for concessions governing the MNCs’ behavior. In the 1980s, as interest shifted from controlling to encouraging foreign investment, the code negotiations languished.

The CTC attempted to remedy the dearth of information on multinationals by studying their operations and effects, offering technical advice to member countries, and making policy recommendations to the commission. In the process, the center has commissioned and compiled information on multinationals and has made available services to countries whose lack of information could...
place them at a negotiating disadvantage with foreign corporations. When the United Nations was restructured in the early 1990s, the UNCTC was disbanded.

Other steps have been taken in the United Nations toward regulating various MNC activities. The United Nations Conference on Trade and Development (UNCTAD) formulated a code in 1980 on restrictive business practices that establishes principles and rules for controlling anticompetitive behavior, such as abuse of market power or restraint of competition. Other agreements were reached concerning consumer protection, and transborder data flows. Negotiations took place in various parts of the United Nations system on technology transfer and international patent agreements.

**Bilateral and Minilateral Governance**

One final form of international governance of multinational corporations involves not a unified and centralized order but, rather, a complex system of bilateral or multilateral negotiations among states, possibly leading to a series of agreements on specific matters or to methods for mediating conflicts. Conflicting national laws, in such areas as taxation, antitrust regulations, patents, export controls, and balance-of-payments controls, may be harmonized through such negotiation. In the area of taxation, for example, the OECD has written a draft convention containing proposals regarding many issues of taxation. Although never implemented, the treaty has guided subsequent bilateral negotiations and treaties among the developed market economies.

Another bilateral approach might be the establishment of arbitration, adjudication, or simply consultation procedures that would accompany regulations or take the place of regulations when rules cannot be agreed upon. The World Bank set up an organization to do this called the International Center for the Settlement of Investment Disputes (ICSID) in 1966. By 2007, 144 countries were members. As of November 2007, ICSID had 134 concluded cases and 125 pending cases.

It was also possible to create bilateral or minilateral institutions or processes to which countries or companies and countries desiring a solution could turn. Such commissions existed in the socialist states to manage state-corporate disputes, and NAFTA and the U.S.–Canada Free Trade Agreement included provisions for dispute settlement panels to resolve trade disputes and to continue reviewing each country’s trade remedy laws.

**International Investment Agreements**

International investment agreements (IIAs) are mostly bilateral agreements of three types: bilateral investment treaties (BITs), double taxation treaties (DTTs), and agreements that deal with other economic activities (such as trade) but also contain investment provisions. The total number of IIAs by the end of 2006 was 5,500 (see Figure 4.9). BITs are designed to guarantee transparency in case of expropriation and to identify host countries who are willing to take measures
to avoid expropriation. The largest number of BITs to date have been concluded between developed and developing countries, although recently there has been growth in BITs between pairs of developed and developing countries. The main purpose of BITs, from the standpoint of host countries, is to generate more inward FDI.\textsuperscript{154} From the standpoint of home countries, the purpose is to reduce uncertainty connected with foreign investment sent abroad.\textsuperscript{155}

The Multilateral Agreement on Investment

In 1995, the 25 members of the OECD began negotiations on new rules for international investment called the Multilateral Agreement on Investment (MAI). The agreement was designed to increase investment flows by clarifying the rights of foreign investors, eliminating barriers to investment, and creating a venue for dispute settlement. The members of the OECD asked outsiders to consider joining the agreement.\textsuperscript{156}

In February 1997, the text of the draft MAI was leaked to Public Citizen, a Washington, D.C.–based organization headed by Ralph Nader that had opposed NAFTA, the Uruguay Round, and fast-track negotiating authority. Public Citizen posted the draft on the Internet, along with many arguments against the MAI.\textsuperscript{157} Soon a wide variety of antiglobalization groups had decided to oppose the MAI also. The reasons they gave were sometimes questionable. They claimed that the MAI would end affirmative action and other kinds of equal opportunity employment programs. They argued that the MAI would undermine environmental regulations and threaten national sovereignty, even in the United States. A diverse set of groups took anti-MAI positions including, among others, the AFL-CIO, the Sierra Club, the Western Governors Association, and the Women’s Division of the United Methodist Church. In April 1998, the
OECD announced that it would suspend negotiations of the MAI for six months, effectively killing it.  

More important than the anti-MAI demonstrations that occurred in Paris, however, were problems in the agreement itself. So many exceptions had been written into the agreement during negotiations that it was becoming merely a “codification of existing, law, policy, and practice among the negotiating countries.” In addition, some negotiators believed that measures added during the protracted negotiations actually detracted from the overall goal of promoting further liberalization of investment policies.

The defeat of the MAI in 1998 was often mentioned as the first in a chain of defeats for globalizing measures that occurred in the late 1990s. As in the case of the Battle in Seattle over the WTO (see Chapter 3), there was a tendency to overestimate the impact of the antiglobalization demonstrators and to underestimate other important factors such as the lack of agreement among the major industrialized countries. Nevertheless, there was clearly evidence of growing support for political movements that defined their goals in terms of stopping or at least slowing movement toward globalization of the world economy. One very important common theme in those diverse movements was suspicion of the motives of multinational corporations.

**CONCLUSIONS**

National, regional, and international governance of multinational corporations focused primarily on promoting rather than regulating foreign direct investment during the Bretton Woods period. Not until the 1970s were there any significant attempts to establish rules of conduct for MNCs, and even then the political impetus came largely from the developing countries. Despite some international tension and national uneasiness regarding multinational corporations during the period of interdependence, there was no dominant perception of a common interest in restricting the activities of MNCs in the industrialized countries, especially in the one country that might mobilize the system for common action—the United States. In the 1990s, during the period of globalization, resistance to institutionalizing some of the key global governance goals of MNCs—national treatment, right of establishment, guarantees against expropriation, and the creation of an international forum for the resolution of investment disputes—was effectively expressed by antiglobalization forces. The developing countries remained very suspicious of the efforts of high-technology firms to define a new regime for intellectual property protection within the WTO (again, see Chapter 3). But developing countries also were suspicious of the motives of antiglobalization NGOs, based as they were primarily in the industrialized countries. Until a change toward greater consensus on these matters was made, international governance of multinational corporations would remain limited. In the coming years, the politics of FDI would probably focus as a result on national, bilateral, and regional rather than international governance.
ENDNOTES

1. Multinational corporations (MNCs) are also referred to as multinational enterprises (MNEs), transnational corporations (TNCs), and transnational enterprises (TNEs).

2. John H. Dunning, *Multinational Enterprises and the Global Economy* (Reading, Mass.: Addison–Wesley, 1992), 3. Increasingly, a firm can come to resemble a multinational corporation by negotiating international cooperation agreements (ICAs) with firms in other countries, instead of engaging in foreign direct investment. So the most important prerequisite for calling a firm multinational is no longer the ownership of overseas assets but rather direct participation in overseas value-added activities. We are indebted to Stephen Kobrin for his comments on this point.


4. The 10-percent cutoff has been adopted by the Organization for Economic Cooperation and Development as a standard for measuring FDI. Unfortunately, only the United States and Japan abide by the OECD standard. See DeAnne Julius, *Global Companies and Public Policy: The Growing Challenge of Foreign Direct Investment* (London: Royal Institute of International Affairs, 1990), 16.


6. This chapter focuses on direct foreign investment in the developed market economies; see Chapter 8 for a discussion of investment problems in North–South relations.


10. Alan Rugman makes this argument in *The End of Globalization: Why Global Strategy is a Myth and How to Profit from the Realities of Regional Markets* (New York: AMACOM, 2000).


17. See Vernon, Sovereignty at Bay.

18. We are referring here to the Foreign Corrupt Practices Act of 1977.


20. World Investment Report 2007. Note that these figures are cited at book value, which means that they represent the historical value of the investments—that is, what they cost at the time of acquisition with no adjustment for inflation or changing market values since then. This means that the U.S. investments, which were generally made earlier, are undervalued. Although the increase in other countries’ foreign direct investment is significant, the contrast would not be as sharp if all investments were measured at current market value.
21. Calculated by the authors from data in the *World Investment Report*. Average annual growth in exports of goods and services was only around 6 percent during the same decades.


29. It should be noted that these figures include holdings of real estate and government bonds, and not just flows of FDI.


37. The reader should note the parallel with the rise of the mortgage-backed securities discussed in Chapter 2.


63. Dunning, *Multinational Enterprises and the Global Economy*, 386, 408–411. For a report on efforts to measure intrafirm trade by U.S. firms by the U.S. Department of

64. An example of this sort of work is Ann Harrison, “The Role of Multinationals in Economic Development: The Benefits of FDI,” *Columbia Journal of World Business*, 29 (Winter 1994): 7–11. The work reported was done in developing countries but could have been done as easily in industrialized countries.


68. A good summary can be found in Dunning, *Multinational Enterprises and the Global Economy*, chs. 10–16.


77. Peninou et al., *Who’s Afraid of the Multinationals?* 69–70.


90. See, for example, Richard Cupit, *Reluctant Champions: U.S. Presidential Policy and Strategic Export Controls* (New York: Routledge, 2000); Michael Mastanduno,


103. See Charles Lipson, Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries (Berkeley: University of California Press, 1985); Nathan M. Jensen, Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment (Princeton, N.J.: Princeton University Press, 2008); and


109. In July 1995, the United States and Japan concluded an investment agreement under which the Japanese government undertook to promote FDI inflows into Japan by giving foreign investors access to Japanese government finance and by promoting access zones and joint research facilities.


112. FIRA rejected only 10 percent of the proposals submitted for review between 1974 and 1985, but if one considers proposals that were withdrawn prior to review or firms that were deterred from going through the process at all, the rejection rate was probably closer to 25 percent. See Rod B. McNaughton, “U.S. Foreign Direct Investment in Canada, 1985–1989,” *The Canadian Geographer* 36 (Summer 1992): 181–189.


114. On the Investment Canada Act, see Investment Canada, *Annual Report 1986–87* (Minister of Supply and Services Canada, 1987); and Thorne, Ernst and Whinney,
Canada’s Investment Canada Act: An Executive Summary (Toronto: Thorne, Ernst and Whinney, 1986). FIRA was renamed Investment Canada.


121. An R&D consortium is an effort, usually jointly funded by a government together with a number of private firms who are members of the consortium, to share the costs of developing a new commercial technology. Japan pioneered this form of collaborative research and was particularly successful in the semiconductor industry with its VLSI (very large scale integrated [circuits]) program between 1976 and 1979.


137. See Lipson, *Standing Guard*, 132–133.

138. The International Civil Aviation Organization (ICAO), the International Labor Organization (ILO), and the World Health Organization (WHO) have all witnessed attempts to do this.


143. See http://www.oecd.org/document/6/0,3343,en_2649_34887_1838086_1_1-1_1,00.html.

144. See http://www.oecd.org/document/53/0,3343,en_2649_34887_1933109_1_1-1_1,00.html.


149. The CTC, which had been based in New York, was absorbed into the United Nations Conference on Trade and Development (UNCTAD) in Geneva. Fortunately, UNCTAD has continued to publish the data on FDI and MNC activities that were previously published by the CTC.


157. The OECD posted the draft on its website after the leak. See http://www1.oecd.org/daf/mai/htm/2.htm.
