
**New Political Economy**
Publication details, including instructions for authors and subscription information:
http://www.informaworld.com/smpp/title~content=t713439457

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Online Publication Date: 01 July 1998

**To cite this Article** Walter, Andrew(1998)'Do they really rule the world?',New Political Economy,3:2,288 — 292
**To link to this Article: DOI:** 10.1080/13563469808406357
**URL:** http://dx.doi.org/10.1080/13563469808406357

*New Political Economy, Vol. 3, No. 2, 1998*

# Do They Really Rule The World?

ANDREW WALTER

A recent book by David Korten entitled *When Corporations Rule the World* captures the essence of much contemporary concern that global, mobile firms are increasingly able to impose their preferences upon relatively immobile governments, workers and citizens.[1] Much contemporary 'globalisation theory' sweeping through the halls of academia also suggests that states (and citizens) have largely lost the power to tax, manage the domestic business cycle and enact various kinds of regulatory constraints upon capital. In this short contribution, I argue that such broad claims are exaggerated, and I try to explain an anomaly. The anomaly is that 'global firms' often fail in their demands that important host states adopt inward investment rules or regimes allowing their full operational flexibility; yet they have apparently unleashed policy competition between sub-state or sub-regional authorities eager to attract or retain investments. As the first claim will attract more abuse than the second, more space is devoted to it.

## Structural power arguments and policy arbitrage

The core of the globalisation argument is that increasing capital mobility raises the bargaining power of firms *vis-à-vis* immobile states, citizens and factors (primarily labour). In this 'structural' version, by a process of regulatory arbitrage states are pushed into spontaneous or unilateral liberalisation, which coincides with the interest of capital agents. For example, Jan Art Scholte argues that '[global] firms can ... with relative ease relocate production facilities and sales outlets to other jurisdictions if they find a particular state's regulations overly burdensome. Usually this threat alone is sufficient to make a state amenable to, *inter alia*, privatization and liberalization.'[2] A direct implication of this argument is that domestic rules relating to the treatment of FDI will increasingly reflect the interests and preferences of mobile firms rather than those of host states. On the face of it, there is much supporting evidence. Indeed, the overwhelming trend in the developing countries has been in the direction of the liberalisation of rules relating to inward foreign direct investment.

But this trend masks important anomalies. While the broad trend in developing countries in recent decades was towards the liberalisation of *entry and exit* of foreign investors into a number of sectors, many also shifted towards heavy usage of what some have referred to as 'creeping', rather than outright, expropriation. Perhaps most importantly, various performance requirements have been aimed at enhancing the contribution of FDI to the host economy, thereby constraining the operational flexibility of TNCs.[3] In recent years, many countries have been more willing to liberalise entry and exit regulations (including the right to financial transfers) than such operational restraints. The most important host developing countries, in particular, remain heavy users of such instruments in spite of their growing share of global FDI flows since the 1980s. They often also retain non-transparent screening procedures for entry, widespread use of limits

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1356-3467/98/020288-05 

on foreign ownership and outright prohibitions in designated 'strategic' sectors.[4]

This is inconvenient for the structural power argument. The bulk of FDI in the 1990s to the developing world has flowed to a handful of countries, in the following order of importance: China, Mexico, Malaysia, Argentina, Brazil, Indonesia, Hungary, Thailand, Poland, Colombia, Nigeria and Taiwan. The paradigm case is China, which maintained an extremely illiberal FDI regime while it rocketed to first place in terms of FDI inflows. If the policy arbitrage effect to which Scholte refers was powerful, these countries should have *more* rather than less liberal FDI regimes than countries receiving little FDI. But, if anything, there is an inverse relationship between the liberality of a developing country's FDI regime and its importance as a location for FDI. There are important exceptions: NAFTA has bound Mexico to what the US Trade Representative's office calls a 'state of the art investment regime' and Argentina is one of the only major developing countries to sign a bilateral investment treaty (BIT) with the USA. The US 'model BIT' prohibits the use of such restrictive policy instruments (along with various other things). For East Asian countries, however, their desire to retain such policy instruments for development purposes has meant that the USA has so far been unable to negotiate BITs with any of these countries, and not for want of trying.[5]

## Collective action problems: the structural weakness of capital

The reason for this empirical anomaly in the broad trend towards liberalisation is obvious. The sheer attractiveness of East Asia as a location for international business means that these countries are in a much stronger bargaining position than sub-Saharan Africa. After considerable liberalisation of entry restrictions, the likes of Malaysia, Indonesia, China and Thailand have been able to retain often onerous operating restrictions upon TNCs because there is more capital (and there are more TNCs) in the world economy than Asian tiger economies. If one automobile company dislikes the terms of a deal offered by the Chinese authorities, a competitor will take its place. Although China (and much more restrictive India) may be an exception because of the size of its domestic market, the heavy use of restrictive measures by the ASEAN countries has not prevented them from receiving a growing share of FDI flows either. Mobile international firms suffer from a basic collective action problem: as a group they cannot avoid investing in China, Malaysia or Indonesia because they have nowhere else to go. *Ceteris paribus*, firms prefer countries with liberal investment rules, but all things are never close to equal.

The collective action problem also applies to the financial markets. As with the debt crisis of the early 1980s, the recent financial crisis in Asia has necessitated IMF policy conditionality precisely because capital markets are so bad at imposing 'market conditionality'. Although some argue that the IMF simply does the bidding of global capital, it strains credibility to suggest that the markets consciously forced a regional currency crisis, with the massive losses this entailed, in order to push these countries into the loving arms of the IMF. The last thing markets expected was the bursting of the East Asian bubble. Similarly, while the latest IMF packages have entailed substantial easing of FDI restrictions, particularly in the financial sector, only the most paranoid conspiracy theorist could believe that this was part of a concerted TNC strategy. Hence, before the crisis, FDI inflows often strengthened rather than weakened the ability of states to resist the liberalisation preferences of TNCs. Once the crisis abates, and capital begins flowing back to the rapidly growing emerging market countries of Asia and Latin America, their ability to resist liberalisation pressures will grow again. Even the IMF may find that promises made in the heat of the crisis may not be carried out.

## Structural weakness and political lobbying

In the face of their structural weakness, TNCs have resorted to old-fashioned political lobbying, particularly of their parent (home) governments. In a brave new world in which mobile capital could simply compete away restrictive state policies it did not like, there would be no need for such corporate lobbying and diplomacy. In the USA, the result of vocal corporate demands for diplomatic pressure on the major host developing countries to liberalise their FDI policies has been a multi-track US strategy of bilateral, regional and multilateral initiatives. However, the results of such activities have so far been disappointing for US (and other) TNCs. In East Asia, the bilateral strategy has failed: the list of countries with which the USA has successfully negotiated BITs is striking for its relative unimportance for US business. Efforts to obtain anything more than a weak non-binding investment agreement within APEC have come to nothing. The target countries have had little incentive to change this stance while FDI has been flooding in, and the US business sector has not favoured a tough policy of unilateral sanctions to ensure compliance because of the fear that this would jeopardise the market access they already enjoy.

The various multilateral initiatives that the USA has largely initiated have also been disappointing for business (with the exception of the recent telecoms and financial services agreements within the WTO). The results of the Trade Related Investment Measures (TRIMs) agreement in the Uruguay Round in particular were especially disappointing, leading to pressure for a separate initiative in a more conducive forum, which resulted in the opening of talks on the Multilateral Agreement on Investment in 1995. While the OECD was chosen because it was dominated by major capital exporting countries, the ultimate objective of US business and government was to place additional pressure on recalcitrant developing countries by extending MAI (as a 'stand-alone' agreement) to 'like-minded' developing countries.

It is unlikely that MAI will answer the prayers of TNCs in this respect, in spite of a widespread view among opponents that it will provide unprecedented entry and operating flexibility for TNCs ('NAFTA on steroids', as North American NGOs refer to MAI). MAI opponents have been misled by the US-inspired negotiating approach, which first sets out general (liberal) rules and then turns to negotiating exceptions and reservations in the small print and the annexes. Even in the not-so-small print, OECD governments (including the US) fully intend to retain the right to regulate key aspects of TNC activity within their domestic jurisdictions, refusing key business demands such as the full inclusion of taxation in MAI. The USA has notably rejected the arguments of its own business community and everyone else that it should accept constraints upon the use of 'extra-territorial' measures for foreign policy purposes, as in the controversial Helms–Burton and Iran–Libya Sanctions acts. Other OECD governments have insisted on various exceptions to basic principles in areas such as privatisation, while Canada has demanded a blanket reservation for 'cultural' industries. In addition, US business lobbies dramatically underestimated the potential for the domestic politicisation of the MAI, and the mobilisation of labour and NGO groups has probably made the business insistence on no binding labour and environmental standards clauses in MAI untenable.

These factors have meant that an agreement was not reached by the original April 1998 deadline, and if the initiative does not collapse entirely, negotiations over the liberalisation or 'rollback' of country exceptions and reservations will be deferred. Moreover, even if a strong MAI were eventually to emerge, pressure on major host developing countries outside the OECD to accede will be limited (not only because they reject the labour and environmental clauses demanded by Northern

NGOs). First, developing country opposition will probably continue to keep MAI out of the WTO for the time being, where linkage politics might be possible. Second, despite recent concessions on investment entry provisions by East Asian countries undergoing IMF-led structural adjustment programmes, it is implausible to think that the IMF could force these countries to accept much more general MAI provisions. Third, the OECD strategy of isolating the recalcitrant developing countries is unlikely to put pressure on the major host states in East Asia as long as these countries continue to attract a large share of global FDI flows to developing countries. This strategy in the end depends upon the structural market power of capital to force policy convergence upon non-MAI members and, as we have seen, this effect is weak.

## Sub-state FDI competition

Does all this suggest there is nothing to the claims of globalisation theory? Not entirely. There does seem to be considerable pressure on governments to liberalise entry to international firms, in part thanks to the debt crisis of the 1980s and the associated demise of heavy import-substitution development models. In addition, at the margin, there may well be structural pressure on governments to make improvements in the operating conditions of mobile firms, such as to reduce levels of corporate taxation. Yet much work needs to be done to investigate the extent of such effects; there are too many claims of the *post hoc, propter hoc* variety in the existing literature.

In fact, most of the existing evidence for policy arbitrage is at the sub-national or sub-regional integration agreement (RIA) levels rather than at the international level, and for good reason. Familiar anecdotes about Hoover moving production from France to Scotland to exploit lower labour costs and greater 'flexibility', or Mercedes Benz announcing a shortlist of 62 sites for a new US factory and unleashing an inglorious 30-state bidding war, suggest that mobility does matter. This is because, at lower levels of political jurisdiction, the collective action dilemma passes from international firms to sub-federal states, regions or local authorities.

To oversimplify, consider the following simple two-stage model of a Japanese automobile or electronics producer considering building the kind of foreign factory that has received large incentive packages from US states or European sub-regions in recent years. In stage I of its location decision, the firm decides that a combination of protectionist threat and commercial logic means that it has no choice but to locate inside the USA or the EU. In stage I, the mobile firm (and its competitors) has little bargaining power *vis-à-vis* the USA or the EU; all the cards are in the hands of the state/region. In stage II of the location decision, the firm finds that the number of site possibilities is very large. In fact, the possible number of sites will be many multiples of the available number of firms (in highly oligopolised industries) offering high-wage jobs in a technology-intensive industry. In stage II, the firm (and its competitors) can play off various sub-federal jurisdictions in the final location choice. Thus the federal government need offer no incentives for a firm to enter the US market, while Alabama and its various competitors feel they have no choice but to engage in an escalating incentives war. This resolves some of the conflicting evidence about the relative importance of incentive packages in firms' location decisions.[6]

Important issues follow from this which require further research. First, if countries with large internal markets do not suffer a loss of bargaining power (and need not compete either on rules or in terms of incentives) *vis-à-vis* domestic market-orientated FDI, will they do so when the FDI is export-orientated? Much may depend on the location's access to key export markets: Mexico's pulling power as a location for US-orientated exporters increased dramatically as a result of NAFTA. This leads to a second issue: RIAs mean that nationstates risk becoming 'sub-federal' competitors *vis-à-vis* highly mobile firms who simply need access to the broader regional market. If a semiconductor manufacturer is relatively indifferent between Ireland and Scotland as a production site from which it can access the whole European Economic Area (EEA) market, Ireland's special tax rate of 10 per cent for manufacturing FDI might be a considerable incentive. This helps explain the EU's recent concern about destructive 'tax competition'. However, in principle, regions (or the USA) can overcome such dilemmas through the harmonisation of policies and standards at agreed levels. (The EU has relatively successfully constrained the escalation of bidding wars in the past decade or so compared to the USA, in part because of the constraints imposed by EU competition law and regional policy, in part because of the lesser decentralisation of taxing power in most EU countries.)

Finally, there are two further qualifications to the extreme globalisation predictions. First, it is not clear that, if mobile firms are sensitive to policy rules at sub-federal levels within integrated regions, this will necessarily always lead to a 'race to the bottom'. Despite fears that mobile capital will arbitrage away high environmental standards in some countries, often we find US states or European regions advertising high environmental standards as part of their attractiveness as a location (similar 'race to the top' possibilities arise with public infrastructure and human capital). Second, it is important to remember that much FDI is considerably less 'footloose' than the oft-repeated anecdotes imply. In particular, FDI in services, which constitutes the bulk of global FDI flows, often needs to locate near its customer base, though this might not apply to wholesale banking services.

## Notes

1. David Korten, *When Corporations Rule the World* (Kumarian Press/Berrett-Koehler, 1995).
2. Jan Art Scholte, 'Global Capitalism and the State', *International Affairs*, Vol. 73, No. 3 (1997), p. 443.
3. For a general overview of this trend, see Charles Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (University of California Press, 1985); and Charles Oman, *New Forms of International Investing in Developing Countries* (OECD, 1989).
4. For annual compilations on a country-by-country basis of the various policy instruments by which countries continue to regulate the operations of TNCs, see the investment sections of US Department of State, *Country Commercial Guides*, and US Trade Representative, *National Trade Estimates*.
5. A number of European countries have agreed BITs with East Asian countries but, unlike the USA, European countries have agreed exceptions to key principles such as national treatment (non-discrimination) and prohibitions against performance requirements in the interest of obtaining agreement.
6. I am grateful to Charles Oman of the OECD for clarifying this point.

# The Limits of European Union Competition Policy

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EU competition policy has three main objectives. The first is common to any competition authority anywhere else: it is anti-trust, the maintenance of open mar-

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1356-3467/98/020292-04  