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**The Multinational Company:
Master Or Servant?**

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THE MULTINATIONAL COMPANY: MASTER OR SERVANT?

Introduction

As a rule, radical intellectuals don't lead debate, as they like to think they do, but are usually several steps behind. Take Ralph Nader, perhaps the world's most famous consumer activist. Writing about corporate welfare earlier this year, Nader concluded that:

We're supposed to have a government of, by and for the people. Instead we have a government of the Exxons, by the General Motors and for the DuPonts.¹

Much of his criticism of US corporate welfare was valid. But it doesn't follow that the global economy is the plaything of an international conspiracy of giant multinational corporations. Indeed, Nader's attack on corporate imperialism is beginning to sound dated. Twenty years ago, Raymond Vernon, a Harvard academic, could write plausibly in *Storm over the Multinationals* that "the multinational enterprise has come to be seen as the embodiment of almost anything disconcerting about modern industrial society". Today the United Nations - no less - is in the business of advising governments on how to benefit from the capital, technology and employment opportunities that multinational companies can bring to the countries that attract them.

This shift of opinion among policymakers is part of the counter-revolution in economic policy that has swept the world over the last two decades. Later on I shall spell out the ways in which investment by multinational companies can help generate growth and prosperity, and the conditions under which countries can obtain these benefits without loss of national sovereignty. The heart of the issue at stake is the policy regime that allows countries like New Zealand to capture most successfully the benefits of the activities of multinational companies. If, and only if, we get this right can we be confident in saying that such companies are our servants and not our masters.

First, however, I want to explore the background to the beliefs expressed by Ralph Nader, since they still find support among opponents of New Zealand's

¹ Ralph Nader, 'Corporations Dismantling Democracy', *The Evening Post*, 8 January 1997.

policy revolution of the last dozen years, and also among members of the public who believe that multinational investment is automatically a process of 'selling off the farm'.

The Fall and Rise of the International Economy

Multinational companies are hardly new. Before World War I, the international economy had achieved a degree of openness and integration that has been recovered only in recent years. After World War I, protectionism came into fashion, and faith in international capitalism was weakened by the Great Depression. Reflecting the influence of Marxist-Leninist ideas which were triumphant in the Soviet Union, foreign investment was widely disparaged as 'economic imperialism'.

Such ideas continued to evolve after World War II, and helped to keep capital markets under strict government control even as international trade was gradually liberalised under the GATT. In the 1950s and 1960s, some leading intellectuals produced a new version of the critique of capitalism that drew on the quasi-Marxist belief that competition was a self-defeating process that led spontaneously to the concentration of production into fewer and fewer hands and ultimately the replacement of competition and markets by monopoly. John K Galbraith, for example in *The New Industrial State*, argued that supply and demand were reconciled, not by entrepreneurs and markets, but by a technical-managerial class, or the 'technostructure'. Management had seized control of giant corporations, marginalised the shareholders, and replaced the profit motive with an expansion motive. This it could do because it effectively controlled demand as well as supply. In the 1950s Galbraith had already argued in *The Affluent Society*, as had Vance Packard in *The Hidden Persuaders*, that commercial exchanges were not expressions of consumer sovereignty that guided entrepreneurs' productive decisions, but rather were expressions of the masses' enslavement by advertising, which generated the artificial wants that it suited the corporations to supply.

In the West, these beliefs encouraged corporatism, whereby governments sought to work with the 'technostructure' to ensure that the latter's interests coincided with the national interest. Galbraith's assertion that the management and the ownership of corporations had become separated had the effect of downplaying the distinction between the public and the private sectors, and

sanctioned state ownership where it existed. In developing countries, Galbraith's analysis chimed well with the fashion of 'development economics', promoted internationally by organisations like UNCTAD, which encouraged governments to avoid multinational investment and instead to seek national self-sufficiency through import controls (to stimulate domestic industry) and commodity taxes (to fund investment).

The failure of 'think big' corporatism and of development economics scarcely needs to be rehearsed here. Giant corporations became notorious for sloth and rigidity, and were shown up by entrepreneurial firms that could respond quickly to changing consumer tastes. American corporations found themselves challenged by nimbler Japanese competitors. Developing countries, led by the Asian tigers, showed that low taxes along with openness to trade and foreign investment were a surer path to prosperity than 'self-sufficiency', which led only to stagnation and aid-dependency. They learned the wisdom of the aphorism of Professor Joan Robinson, the Cambridge University economist, that "if there's one thing worse than being exploited, it's not being exploited at all". Nowadays, multinational corporations thrive not on planning partnerships with governments but on market opportunities provided by an internationalised economy. Falling transport and communications costs, along with policy changes like the removal of barriers to foreign investment and the liberalisation of capital markets, have made it easier and less risky for companies to invest on a world scale, while the privatisation of state enterprises in many countries has provided additional opportunities for them to do so.

One recent convert to multinational investment is none other than J K Galbraith himself. In his latest book *The Good Society*, Galbraith tells us that the multinational corporation is not an agent of private imperialism but rather an almost benign source of inward investment and technology transfer. Reviewing this book, Robert Skidelsky remarked that:

It has been Galbraith's fate to survive into an age when practically all his assumptions, projections and remedies have been made obsolete by history with a capital H.²

² Robert Skidelsky, 'Whatever Happened to the New Industrial State?', *The Times Literary Supplement*, 11 October 1996.

We should at least be grateful that Galbraith has been prepared to adjust his ideas to reality.

Still, it is important not to exaggerate the scale and significance of multinational enterprises. In the early 1980s, some observers thought that internationalisation would enable multinational corporations to take over the world, by enabling them to realise huge economies of scale. In practice, internationalisation has released entrepreneurial forces that are subjecting large multinationals themselves to competition, as technology erodes economies of scale and makes possible more customised goods and services. In 1993 *The Economist* estimated that the number of multinationals had grown at least fivefold during the two decades to 1993, and that the top 100 multinational companies accounted for between 40 percent and 50 percent of all cross-border assets.³ However, that represented only about 16 percent of the world's productive assets. And for all the talk of 'globalisation', almost every country funds the lion's share of its investment out of its own savings.

Similarly, there are very few multinational companies that are not deeply entrenched in their home countries: the idea of the pure multinational or non-national company floating in a kind of economic cyberspace remains something of a fantasy. So whereas Galbraith once believed that the free play of commercial forces favoured the concentration of economic power into ever fewer hands, experience suggests that the international economy accommodates a variety of processes - not just centralisation but decentralisation as well. If national sovereignty has appeared to become less effective, this reflects not so much the growing power of multinational companies as the increasing freedom of individuals, both as consumers and entrepreneurs.

The Benefits of Multinational Companies

According to Statistics New Zealand, in the year to 31 March 1995 the level of foreign investment in New Zealand rose by NZ\$4.6 billion to \$96.7 billion. Nearly all of this increase consisted of foreign direct investment, typically by multinational companies - purchases of real estate, acquisitions of existing firms, and the creation of new businesses. FDI rose to a level of \$40.3 billion.

³ 'Everybody's Favourite Monsters: A Survey of Multinationals', *The Economist*, 27 March 1993.

The remaining investment consisted mainly of private portfolio investment (i.e. equity participation in, and lending to, public and private enterprises).

New Zealand is a source of, as well as a host to, international investment, though on a much smaller scale. In the year to 31 March 1995, the stock of direct foreign investment originating in New Zealand rose by NZ\$1.8 billion to \$11.5 billion. Interestingly, given the debate over Asian investment, New Zealand has invested more in Asia over the last two years than Asians have invested in New Zealand. Yet New Zealand remains a net importer of capital by a wide margin, and about one-third of the workforce relies directly or indirectly for employment on firms that are at least partly foreign-owned. It is therefore vital that we understand, first, the very great actual and potential benefits that multinational companies can bestow on countries that attract their investments, and, second, how such countries can maximise and enjoy those benefits while remaining masters of their own fate.

Investment from multinational companies is *prima facie* beneficial in that it adds to a country's total stock of capital and so facilitates increases in economic activity, productivity and growth that otherwise may not occur. This is most obviously true when direct investment takes the form of new 'greenfield' enterprises. But it is true also when it involves the takeover of existing domestically owned enterprises or the purchase of real estate by foreigners ('selling off the farm'). One commentator has summarised these benefits thus:

Economic benefits always accrue to the residents who choose to dispose of their assets to foreigners. ... Whenever domestic financial or real assets are purchased by non-residents, the amount of funds available to residents for additional spending is thereby supplemented. Moreover, when foreigners buy existing ... assets at higher prices than residents would be willing to pay, the ... sellers of those assets make capital gains that they otherwise would not have made. The proceeds of the sale of assets may then be used to create new domestic assets, to be spent on consumption, or even to acquire new foreign assets.⁴

There are two sides to every commercial transaction, and both sides benefit. If people sell off parts of the 'farm', it's because they see a net gain in so doing. Xenophobic restrictions on the level of foreign purchases of domestic assets

⁴ Tony Makin, 'Liberalising Australia's Foreign Investment Policy', *Agenda*, Volume 3, Number 2, 1996, p. 139.

impose costs in terms of forgone capital gains and, in the case of state assets, opportunities to further reduce public debt.

Another benefit that multinational companies can confer on their host countries is the promotion of trade. A large proportion of international trade occurs between multinational companies and between the different branches of such companies. This is especially true for trade in high technology products, which is growing fast and generates positive spillover effects. Commerce between multinational companies and domestic firms provides the latter with access to international trade networks and generally deepens a country's integration in the international economy, so helping it to discover and exploit more fully its comparative advantages.

A third benefit that multinational companies can bring is the strengthening of domestic competition. This is likely to be especially the case with small economies, many of whose markets may be dominated by one or a few suppliers. A striking example in New Zealand is the telecommunications market in which, before deregulation, Telecom Corporation enjoyed a virtual monopoly. Now several multinational telecommunications companies have entered the market. They are providing competition that would have been unlikely to emerge, at least in the short term, from New Zealand-owned companies because of a lack of financial muscle and technical expertise.

Of course, it is also possible for takeovers and mergers involving multinational companies to diminish domestic competition by reducing the number of producers in a market. However, in an open economy, mergers that reduce domestic competition may do little harm if the markets in which the companies concerned operate remain exposed to international competition. This, in turn, depends crucially on the prevailing policy regime. If it is sound, the benefits that multinational companies can offer are unlikely to be offset by any harmful effects.

Multinational companies can also be sources of technological expertise. It is well established that technological progress is an important factor in economic growth. Multinational companies are a major transmission mechanism of such progress. Some technology is costly and requires substantial investment that only large companies, like multinational ones, can afford. As well, foreign direct investment is often the only way that multinational companies can fully

exploit their investments in new technology, as they take advantage of, and bring together, various features of the global economy. The expertise that multinational companies transmit includes management techniques and work practices, which can be imitated by local firms and help them to increase their productivity.

Many of these benefits are evident in the activities of what is perhaps the world's best known multinational company: McDonald's. McDonald's is a leading symbol of what is often casually referred to as the 'Americanisation' of the world. But one of the most remarkable things about McDonald's is how deeply enmeshed it is in its host economies. Its burgers are produced from local ingredients: in Russia it actually owns and runs the agribusinesses that supply its wheat and beef. Its franchise system transfers its successful management techniques to local populations. Its famous system of employing and training local teenage labour creates lasting benefits for its employees. The competition it provides for local rivals has greatly improved the latter's quality of service. It's no wonder that countries are so eager to be invaded by McDonald's.

Indeed, the international success of McDonald's has made it possible to test the early 19th-century theory of international peace through trade. The modern version of the theory, propounded by Thomas Friedman of the *New York Times*, maintains that no country with a McDonald's has ever gone to war with another. So far, it has passed all tests. Friedman is reported to fear a backlash from poorer nations unable to benefit from the globalisation of the world economy: "They may feel that their traditional culture will be steamrolled by it and fear that they won't eat the Big Mac, the Big Mac will eat them." But for the present, the news is good: "Relations between Andorra and Hong Kong, Sweden and El Salvador, and Iceland and New Zealand have never been better".⁵

Multinational Companies and Public Policy

The appropriate policy stance towards multinational companies is one that removes unwarranted obstacles to foreign direct investment and creates an environment in which those investments are most likely to succeed. Of course,

⁵ James Langton, 'The Golden Arches Theory of Conflict Resolution', *The Press*, 31 December 1996.

such policies (competitive tax rates; adequate infrastructure, education and training; transparent, simple and competition-enhancing regulations; flexible labour markets; and a stable macroeconomy) remove unwarranted obstacles to, and enhance the prospects for, domestic investment as well. Like domestic investors, foreign investors should not have to demonstrate that their proposals are in the public interest: rather, the burden of proof should lie with those who argue that they aren't.

On the other hand, special treatment for multinational companies is likely to be inefficient and welfare-reducing. And it is under such policies that multinational companies can become our masters. Take the link between foreign investment and import tariffs. Some companies become multinational as a way of avoiding the trade-reducing effects of tariffs: unable to export their goods to countries with high tariff barriers, they shift their production to them instead. Some governments implicitly use tariffs as a way of attracting foreign investment. But, once inside the gates, multinational corporations acquire a special interest in the maintenance of protective barriers in perpetuity and can loudly threaten to liquidate their investments unless their favoured treatment continues. If their lobbying is successful, the economic distortions reduce potential national income and damage consumer interests.

Fortunately, multilateral trade organisations like the World Trade Organisation and APEC have drawn up common codes of practice that help countries resist attempts by protected multinational companies to play them off against one another by seeking to maximise special favours. International competition for foreign investment tends nowadays to be indirect and benign, as governments limit tax rates and commercial regulation and concentrate on public investment in education and infrastructure.

To summarise this point: if directly sought by concessions and favours, the patterns and levels of foreign investment could be inefficient and of little benefit to the receiving country. But where foreign investment is governed by a sound policy regime that applies in a neutral fashion across the whole economy, both foreign and domestic firms are disciplined by competition and resources tend to be used in ways that are of most value to the community.

National Sovereignty

These arguments may not impress people, including some politicians, who prefer to conceive of economic sovereignty as a game played by nation states in which any economic gain that accrues to one nation must come at the expense of others. To this way of thinking, the profit that a multinational company repatriates to its shareholders is self-evidently a loss to the host country. However, profit repatriated from New Zealand to, say, the United States, Taiwan, or Australia represents a loss to New Zealand only if it is inflated by protection or subsidy, or by special deals that exempt the company from the tax laws and other regulations that apply to domestic companies. Otherwise, repatriated profit is evidence that the investment has succeeded in generating wealth, of which the host country has obtained a share. Would anyone seriously argue that the country would be better off if foreign investors in it systematically made losses?

Economists emphasise the case for maximising the freedom of firms and individuals to promote their own welfare through voluntary decisions and exchanges. Barriers to international trade and investment are restraints on that freedom, and when exchanges are possible across international borders, everyone benefits. Economists see no contradiction in principle between such economic freedoms and national sovereignty: sound policies can enhance both, not one at the expense of the other.

The economic nationalist, on the other hand, views such economic freedoms as a threat to national sovereignty. What counts for such a person is the ability of the nation to implement political decisions about its preferred pattern of economic development. Individual economic sovereignty would be all too likely to disrupt such decisions, and so is likely to be suppressed in the name of national sovereignty. Economic nationalist regimes do not necessarily eschew foreign investment altogether. Although they are likely to try to avoid foreign involvement by funding more of their investment from national savings, they are typically willing to allow foreign investors in so long as they agree to conform with government-determined national priorities. In such cases, however, multinational companies may be put off from investing altogether, or become the beneficiaries of privileges organised by politicians. The trouble is that countries that go down this road are likely to end up poorer and weaker, and therefore to enjoy less true national sovereignty, than those that give priority to individual sovereignty and economic freedom.

We in New Zealand have learned from bitter experience that politically determined national priorities are all too likely to lead to projects that, by ignoring or suppressing market forces, reduce national wealth and increase national debt. Such countries lose international prestige, goodwill, and - by becoming indebted to foreign interests - control over their own destinies. New Zealand in 1984 was at the mercy of the international financial system: if the financial reforms had not been adopted as a matter of policy by the incoming Labour government, the adjustments would have been imposed brutally by the financial markets or the IMF. Today, New Zealand has regained the sovereignty it was at risk of losing. As an economy with one of the highest levels of economic freedom in the world, its attractiveness to overseas investors goes a long way to compensate for its small size and its vulnerability. It is an example of the way the free international market places nations on a truly equal footing by rendering irrelevant differences between them in terms of size and military might.

Globalisation of economic activity has done nothing to undermine national sovereignty - to reduce the power of individual countries to make their own decisions. New Zealand is just as free today to borrow extravagantly, debase our currency or prop up uncompetitive industries as we were prior to 1984. The difference is that the consequences of adopting misguided policies impact on a country almost instantaneously. As Lawrence Summers, deputy secretary of the US Treasury, has put it:

One of the most foolish things said about the international economy these days is that because capital moves so quickly and so freely, government policies have little influence. In reality, precisely because of greatly increased capital mobility, the difference between having the right and the wrong government policies has never been greater. ... And just as good policies are rewarded more richly than before, mistaken policies are punished more severely.⁶

Thus the control of governments over the decisions of multinational companies is as powerful as it ever was. However, one thing is new: because the consequences of decisions on how these controls are used are more immediate and transparent, voters have much more control over governments. Why

⁶ Lawrence Summers, 'Summers on Mexico: Ten Lessons to Learn', *The Economist*, 23 December 1995.

anyone would view this development as a threat to national sovereignty or democracy is difficult to understand.

Concluding Comments

The role and impact of multinational corporations, and the degree to which they can dictate outcomes to their advantage, have evolved with the changes that have occurred over the last 50 years in the prevailing economic policy regime. In the post-war decades, multinational companies enjoyed a profile and political significance that reflected policy-makers' belief that the future lay with big organisations - in both the private sector and the public sector - that had outgrown market forces and could control their own commercial environments. The disappointing outcomes of this approach have served to show that 'bigness' in itself confers no competitive advantage.

We have consequently moved away from misconceived policies of corporatism and dirigisme to an understanding of the causes of the wealth of nations which tells us that multinational companies are, broadly speaking, as subject to market forces (and also to political forces) as other producers. They are important players, but not necessarily more important, for good or ill, than other economic entities that evolve spontaneously. We have learned that big is not necessarily best: consumers' interests are served simply by efficient businesses, and these vary enormously in size. Equally, our present understanding of public policy shows us how governments can promote (or, if they insist, undermine) the potential benefits of the international activities of businesses.

Imposing special burdens on multinational companies would risk scaring off foreign investment along with its potential benefits. By generating hostility between us and our trading partners and the possibility of retaliation, it would also diminish our economic and political sovereignty. Similarly, chasing the benefits of foreign investment with concessions like tax breaks and import protection would be self-defeating, would transfer wealth from New Zealand citizens to the shareholders of multinational companies, and would weaken our national sovereignty by encouraging multinational companies to play different countries off against each other in their search for favours.

New Zealand's present policy regime, which combines an openness to foreign investment with a predominantly market economy, less regulation, and similar treatment of domestic and foreign investment, is ensuring that the activities of multinational companies in New Zealand generally deliver net benefits to New Zealanders. If we continue to follow these rules, multinational companies will be our servants and not our masters, and, in my view, we will have nothing to lose and everything to gain by welcoming them to New Zealand.