Can Transnational Corporations Serve as Engines of Development?

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The role of the transnational corporation (TNC) in promoting or impeding the development of countries is an issue that has been the subject of intense study in international political economy. From the late 1960s until the early 1980s, much was written about the origins, impact, and efforts to regulate TNCs (Vernon, 1971; Moran 1974; Biersteker 1978). Since the 1980s, however, the turn of many developing countries toward a policy of export oriented industrialization from import substitution industrialization led to a new literature on modes of attracting the TNC and the role of production networks in the global economy (Ernst and Ravenhill 1999). In this sense, the renewed focus of Sergio Vacca and Gianni Cozzi (2002) on how TNCs might be drivers of development is a welcome addition. I do have some concerns about their arguments, which often mix normative and empirical arguments in a less than optimal manner. I also found that the arguments while provocative, do not fully take into account the extensive literature on the subject.

The basic argument of the Vacca and Cozzi paper is that TNCs can be drivers of economic development under certain conditions. Before turning to their arguments, let us first consider the most prominent approaches to this issue. The liberal perspective, drawing from neoclassical economics, has generally found the TNC to be an engine to promote the efficient allocation of resources (see, for example, Vernon 1971). This approach argues that in principle, TNCs can spread technology, bring capital, promote managerial skill, and provide a conduit for developing countries' products. Together, these assets can accelerate global growth rates, and may prove beneficial for individual countries in increasing their global competitiveness. By contrast, dependency theorists, who derived their analysis from Marxist arguments, are considerably less sanguine on the effects of TNCs. They argue that TNCs help to perpetuate an exploitative relationship between developed and developing countries (Barnet and Mueller 1974). These arguments have often been raised by organizations such as the United Nations Conference on Trade and Development (UNCTAD) as well as the current anti-globalization movement. Finally, the neomercantilist view, focusing on the role of states power, has argued that the key to securing benefits and avoiding the costs of interacting with TNCs is a strong state (Gilpin 1975; Weinstein 1976; Grieco 1984). From this perspective, states with well-organized bureaucracies and those that are more insulated from corruption can manage the relationship with TNCs to extract the maximum benefit from these corporations (Encarnation and Mason 1990). Summarizing

these three approaches, liberals love the TNC, dependistas want to get rid of them, and mercantilists would like to control them.

Where do Vacca and Cozzi fit into this long-standing debate on the effects of TNCs and efforts to regulate them? It would appear that Vacca and Cozzi would fit centrally into the well-developed analysis of the possibility of that states might control TNCs. Before turning to the overall evaluation of their argument, let me focus on a few key assertions in their paper.

First, the authors argue that TNCs should support the development of developing countries to become successful in the new global economy. They argue that TNCs must do so because the new growth paradigm is based on the development of human capital. Without access to such developed labor, TNCs will not be able to successfully benefit from the world economy. This, then, primarily in a normative argument but occasionally from an empirical perspective is used to suggest that a new convergence of the interests of TNCs and developing countries is emerging. Although I would strongly support their normative arguments about how TNCs should help developing countries, there is a sharp gap here between one's normative desires and the realities of TNC-developing country relations. This issue is a complex one relating to the possibilities of managing the relationship that depends, as I have noted above, on the strength of the state and its abilities in managing the process. Thus the arguments in the first part of their paper, while well meaning, do not provide sufficient insight into the process by which states and local bureaucracies might be *able* to develop sufficient capacity to allow them to successfully bargaining with well equipped TNCs. The notion that the TNCs themselves will encourage the emergence of strong state structures that will allow them to be regulated is provocative but needs considerable more theoretical and empirical analysis to be convincing. An obvious counterhypothesis is that TNCs would be quite happy to develop aspects of the local infrastructure and labor markets that are of specific interest to them—but will refrain from actually finding ways to help states regulate them.

Second, as I have suggested in discussing the trend in the literature on TNCs, the shift away from analysis of the effects of TNCs and efforts to regulate them is strongly tied to changing economic strategies in the developing countries. Although Vacca and Cozzi note that developing countries have increasingly shifted their strategy to attract investment, it is worth elaborating on the context of this new shift in terms of understanding the likely dynamics of the relationship between TNCs and developing countries.

In the post World War II period, and even earlier in the 1930s as a result of the collapsing global economy, developing countries pursued policies of import substitution industrialization (ISI). The logic of this approach, theoretically promoted by analysts such as Raul Prebisch, was that the developing countries faced deteriorating terms of trade in that the market for primary products as compared to manufactures was weaker. Prebisch and others in the 1950s thus advocated that countries attempt to build their domestic manufacturing industries behind temporary protective tariffs and quotas. In his view, such strategy would allow developing countries to compete with more developed countries. Most countries in Latin America, Africa, and some in Asia pursued ISI policies with initial success. Yet, these policies began to induce a whole set of inefficiencies. First, firms had little interest in

competing in world market given their protected home market, and thus were able to sell low quality products with inefficient production techniques. Second, countries found that they still needed to import essential technologies and still had to rely on rich countries for capital. Third, in some cases, TNCs were able to enter developing country markets behind these protective barriers and themselves developed an interest in the continuation of protection in the host market.

The policy of ISI thus began to be seen by many as increasingly inappropriate. In particular, the demonstration effect of the rapid growth of East Asian countries in the 1970s threw into question the benefits of an ISI policy as opposed to an export oriented industrialization (EOI). The problem many countries faced, however, was that shifting from an ISI to EOI strategy was no easy matter, given the strong vested interests that had developed for ongoing protection. Thus, despite some efforts, most Latin American failed to make the transition to EOI (Haggard 1990).

By the 1980s, however, the onset of the sovereign debt crisis fostered both a severe need to rethink development strategies as well as increasing pressure by international financial institutions on Latin American countries to open up their markets. For much of the 1980s, debt resolution efforts amounted to simply rolling over debt, and the economic performance of indebted countries failed to improve. With the reduction of their debt burdens in the early 1990s through the Brady Plan (Aggarwal 1996), countries finally were able to emerge from the severe burden of debt that had weighed down their economies. As many of these countries were under IMF adjustment programs, they began a process of economic reform and removed many protective barriers. In the case of countries, such as Mexico, this included a shift in trade strategy more generally, with its accession to the GATT in 1986 and signing of the NAFTA agreement in 1993.

The result of these economic reforms, led by both domestic interests in the context of external pressure from financial institutions, was a shift by developing countries to an EOI strategy. Such a strategy, however, required significant inflows of capital and technology because competing on global markets rather than only in protected domestic markets required a dramatic shift in the quality of goods. It is in this context that we must see the shift in developing countries attitudes toward the influx of direct foreign investment by TNCs.

The implications of the new focus on EOI points to the importance of trends in the global trading system, and new forms of trade measures that have developed recently. Two points are worth making in this context. First, the strategy of EOI is premised on access to rich countries' markets. If protectionist pressures increase with the multitude of countries clamoring to compete for market shares in developed countries, some countries may rethink their commitment to an EOI strategy and again begin to introduce elements of protection in their own market. Thus, the ongoing WTO Doha round of trade negotiation is likely to greatly affect the prospects for developing countries to continue with their strategy and their relatively recent encouragement of TNC investment.

Second, the dynamics of the trading system are strongly affecting both developing country and TNC strategies. Here, the new growth in regionalism and bilateralism is

likely to have a sharp impact on the prospects of growth in TNC investments in particular states. In the late 1980s, following on the debt crisis, as noted, Mexico began to pursue a host of trading arrangements. Following its accession to the GATT and negotiation of NAFTA, it has begun to pursue a host of bilateral accords with countries in Latin America, the European Union, and is now in negotiations with Japan. The result of this strategy (and one that has been pursued in similar measures by Singapore), has been to make Mexico a trade hub, which has served to attract very significant amounts of direct foreign investment. Indeed, what we now see is strong competition by TNCs to enter such favored countries. At the same time, however, other countries who might wish to pursue bilateral or others trade liberalizing agreements, but who have been unable to for one reason or the other, now find themselves increasingly marginalized. This has made it considerably more difficult for them to attract investment and they have often only been able to do so with extremely favorable terms for the investing TNCs. Thus, linking the trade strategy of states with their likely ability to regulate and interact successfully with TNCs must be an essential element in any analysis of likely trends in TNC-developing country behavior.

In the context of a country's ability to attract investment, it is worth investigating the experience of various countries. Vacca and Cozzi present a very brief analysis of China's successful ability to attract TNCs to its market. They argue that China has pursued a strategy that "exploits American capitalism without, however, adopting the underlying ideology which has characterized the American experience" (p. 10). There are several points worth considering with respect to China's experience. First, and foremost, the case of China is hardly a prototypical one, and thus it is extremely hard to generalize about the advantages or disadvantages from this case. The Chinese state is exceptionally strong and the Chinese market is a huge market that has hitherto remained protected.

It is in this context that we must understand China's ability to negotiate with TNCs on equal or advantageous footing. Indeed, it is precisely these advantages that neomercantilist arguments have pointed to in looking at the ability of countries to adequately negotiate with TNCs. These abilities have been extensively analyzed in a project that I directed that focused on European, American, and Japanese TNC market and nonmarket strategies in East Asia (Aggarwal 2001; Aggarwal and Urata 2002; Aggarwal 2003). Based on detailed empirical work that examines the strategies of TNCs from different home countries in the East Asian region, as well as the counter-strategies of countries such as China and others in the region, this work systematically shows how strong countries can secure significant advantages in their negotiations with TNCs. It also shows how weaker countries may find themselves played off by such companies. The clear lesson of this work and that of others focusing on bargaining strategies (Moran 1974; Weinstein 1976; Grieco 1984) is that one cannot really generalize from the relative success of China, Japan, Korea, and others in dealing with TNCs to weak and small countries in Africa, Latin America, and elsewhere. Thus at least in terms of case selection, Vacca and Cozzi's choice of China to discuss TNC-developing country relations is too limited and must be expanded to really understand their dynamics.

In terms of the case of China itself, the rather sanguine view that foreign direct investment entering China will benefit its economy has come under scrutiny.
For example, Samuel Ho and Ralph W. Huenemann (1984) emphasize the efficacy of Chinese politicians in the initial contact between Chinese reformers and MNCs, when the Chinese tactically played off eager foreign investors against each other and imposed arbitrary terms of negotiation and contracting. But Ho and Huenemann also point to the potential inefficiencies of the bureaucratic pursuit of technology via FDI. More recently, Yasheng Huang (2003) argues that the policy of attracting foreign investment in China reflects "substantial weaknesses in its economy" rather than strength. He suggests an "institutional" perspective that contains two components: 1) a "demand perspective," centered on explaining why the Chinese have sought FDI beyond what might be the threshold of sensible and efficient usage; 2) a focus on how domestic political and institutional distortions explain these patterns, rather than purely economic calculus. With respect to the latter, he identifies two basic distortions: a political "pecking order" for domestic firms in terms of their relative access to FDI vs. domestic sources of capital, and the serious fragmentation of the national economy. In short, the notion that even strong states will be able to secure optimal results in their negotiations with TNCs is thus brought into question.

In short, Sergio Vacca and Gianni Cozzi's article on how TNCs might be drivers of development is a good first step in reviving the debate on how TNCs interact with host governments. By rejecting simple minded ideas that TNCs are always a negative force or that they always bring positive rewards to all, they have pointed to the need to more fully understand the bargaining relationship between these companies and host states. This points to a need to further focus on the variation among types of states and types of companies to more fully understand the dynamics of this ongoing relationship.

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