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 Poli 160D Final
 TA: Max. Wed 3:30
 December 6, 2011

Final Exam

1. Are multinational corporations a force for development or mechanisms of impoverishment? Present your case with explicit reference to at least one of the various IPE perspectives. Use examples from the international political economy to illustrate your points.

Despite the existing opinion that Multinational corporations (MNC's) are beneficial, they are mechanisms of impoverishment for the developing nations that they do business with. They seek to minimize conditions and restrictions of the host government in order to create the best terms of profit including exploiting cheap labor and abundant natural resources. These corporations also reinforce dependency for development on decisions and actions of owners of multinational capital who remain in the wealthy world. First, I will explain what multinational corporations are and how they work. Then I will present the argument that MNC's are beneficial to developing nations. After doing this, I will disprove that argument and demonstrate all the ways that MNC's are mechanisms of impoverishment.

Multinational corporations are companies that have significant operations not just in the country in which it is headquartered, but also in other countries, and that pursues global strategies as a result of which it views the world as a single, integrated market.¹ These companies expand through foreign direct investment (FDI), which grew at three times the rate of world trade since 1992 demonstrating that MNC's play a huge role in the world economy.² MNC's main concern is about making a profit so FDI is an activity that occurs primarily between rich

¹ Joseph, Grieco and G. John Ikenberry, "Glossary," In *State Power and World Markets- International Political Economy*, (New York & London: W.W. Norton & Company, 2003), 348.

² Roger Schoenman, "Globalization & Integration Part 2," Class lecture, International Political Economy from UC Santa Cruz, Santa Cruz, November 21, 2011.

countries because for MNC's the concern is access to wealthy consumers and markets. Relatively little FDI originates in and little goes to the developing world. Although little investment goes to the developing world, many developing nations are still involved with MNC's, allowing MNC's to have access to their resources in order to try and improve their economy. The liberal argument for MNC's is that these companies provide a series of advantages to the host country including knowledge and transfer of technology, financial capital, managerial techniques that countries often lack.³ They also provide a fusion of resources to create new jobs, and teach locals to use the modern technology that they bring.

Although, it may appear that MNC's are beneficial to the host country in reality this is not the case. A major downside to engagement with MNC's is that host countries lose their sovereignty in a cycle of negotiations. From a realist perspective this is the worst thing that can happen for states. According to realists, once states lose their ability to make their own decisions, they are left with nothing. Multinational corporations possess the required capital, technology, managerial skills, access to world markets, and other resources that governments in the Third world need or wish to obtain for economic development.⁴ In addition to possessing these aspects most states possess out of date government structures and inadequate laws for collecting taxes and controlling foreign business. These institutional weaknesses impair the ability of host states in their negotiations with multinational corporations. Therefore, when these nations become involved with MNC's, MNC's can take

³ Ibid.

⁴ Shah M. Tarzi, "Third World Governments and Multinational Corporations: Dynamics of Host's Bargaining Power," In *International political economy*, 2nd ed, (London: Unwin Hyman, 1990), 169.

advantage of them in numerous ways because they do not have stable systems in place to balance out the MNC's power.

Also, once a host country becomes involved with a MNC it is very difficult to negotiate terms with these companies. MNC's have developed globally based systems of integrated production, marketing, and distribution networks in order to reduce costs and enhance their global outreach. A host country that engages in joint ventures with highly integrated and sophisticated foreign firms invariably becomes dependent on the multinationals controlled globally integrated networks.⁵ If a host country is not happy with the terms of agreement with an MNC, often times nations are unable to negotiate because of the fear that they will lose access to these global systems that they need to help their economies.

Another constraint on a host government's ability to exercise power arises from the use of political risk management strategies. In order to better diminish political risks, MNC's often establish transnational alliances that dramatically increase the cost to the host state of changing the foreign investment regime in their favor. Therefore the host countries are becoming trapped in these negotiations with multinationals.

To comment on the liberal argument that MNC's are helpful because they transfer technology to the host country and help the host country prosper, this is simply not the case. Typically integration is found in companies having very complex technology.⁶ There is little that the host country can do to influence integration, and consequently the host country may be severely constrained in its bargaining position. The majority of research and development is

⁵ Ibid, 174.

⁶ Ibid, 177.

undertaken by highly integrated firms and is located in the industrialized home countries as a result technological developments are beyond the reach or control of developing host countries. Thus the developing host countries are not prospering from this new technology the MNC provides, in actuality the nations is seeing very little new technology at all.

Lastly, the argument that MNC's benefit a nation creating new jobs and opportunities is completely false. Multinational corporations in developing nations often times create a strong alliance between the foreign corporation and various powerful home state groups such as landowners, or other pro-business conservative groups.⁷ All these groups tend to share the multinationals distaste for radical social change. This alliance serves as a major constraint on the ability of host countries to spread economic success to the people of the nation. Instead power becomes concentrated in the hands of a few wealthy individuals, and the effect is a continuation of the status quo- keeping the developing nation poor.

Multinational corporations are mechanisms of impoverishments for the host country that they have contracts with. Often times the host country completely loses its sovereignty when it enters into negotiations with MNC's. From the realist perspective this is the worst thing that can happen to a nation because it has no way to protect itself from market influences. This is what happens to the host country when it is involved with MNC's. Nations become dependent on the integrated global networks that MNC's possess, therefore they are hesitant put restrictions on MNC's because it may drive them away. Nations become stuck in this cycle, unable to make changes in their contracts with MNC's. Lastly, MNC's do not benefit the standard of living of the

⁷ Ibid, 178

host nations they are involved in, rather they create strong a alliance with the powerful groups of the host country in order to keep the status quo and continue making a profit.

Part B: 5. What explains the trend towards freer trading markets since the end of World War II. Be sure to apply theoretical explanations and cite examples.

The trend towards freer markets began after World War II when the shift in ideological thinking went from protectionist to free trade, in other words from realism to liberalism. This trend has been continuing because of international bodies put in place to manage this trade such as the WTO. The trend towards freer markets is also coupled with the rise in globalization. Globalization has been making markets more integrated due to a change in technology and international political atmosphere. First, I will explain what the market was like before WWII with Pax Britannica as a hegemon. Then I will analyze Pax Americana's power and the creation of the WTO and how this has changed the markets, increasing the trend towards freer trade. Lastly, I will examine the large role that globalization has played in creating freer trading markets, and how this differs from the previous era of globalization.

Before WWII occurred, the mindset of nations was one of protectionism. The world enjoyed an initial Golden Era of economic integration from the 1870s to the outbreak of WWI in 1914. During this era, Pax Britannica was the hegemon and focused on regulating and maintaining an open international economy by providing the international trading infrastructure to the market. This Golden Era was followed by an attempt at reconstruction of world economic integration during the 1920s and sharp decay in such integration from the 1930s to the end of the 1940s.⁸ During this era states were applying a realist approach to the economy. States were trying

⁸ Joseph, Greico and John Ikenberry, "Economic Globalization and Political Backlash," In *State Power and World Markets- International Political Economy*, (New York and London: W.W. Norton&Company, 2003), 208.

to protect themselves by implementing protectionist measures in an attempt to make their domestic economies the greatest. Great powers were moving towards exclusive and antagonistic economic blocs. It can be argued that WWII was the result of a decade of economic fragmentation, trade protectionism, and regional conflict among great powers. This move towards protectionism completely shattered Pax Britannica as a hegemon because it was so invested in the system of free trade without regulations to protect it domestically. So when nations became scared and turned to protectionism, Britain lost all control and suffered economically.

After WWII nations wanted to ensure that a war on that scale never occurred again. The U.S., who became the hegemonic power, and other allied nations wanted to implement an open world economy in order to make countries dependent on one another and all interdependent on trade so that another world war would occur. The previous idea was that trade policy was traditionally more concerned with protection of domestic import-competing industries than with export promotion.⁹ This had been unsuccessful for nations therefore they needed another solution which the U.S. believed was free trade. However, the U.S. also wanted to protect itself and ensure that it did not end up like Pax Britannica. So, the U.S. helped to create international regimes that various countries would support in order to create stability for free trade and the international market.

The first thing the U.S. did was meet with the U.K. and came up with a solution to effectively manage free trade. In 1941, the U.S. and the U.K. passed the Atlantic Charter, a declaration of intent to set up a future free trading zone, where every nation has a chance and equal common markets. Although this was an important step leading to free trade what really

⁹ James Brander, "Rationales for Strategic Trade and Industrial Policy," In Krugman, ed., *Strategic Trade Policy and the New International Economics*, MIT Press, 1987.

created a trend towards freer markets was the creation of the WTO, previously known as GATT. The WTO is meant to implement the GATT agreement and provide a regular forum where future debates can happen and negotiations would be addressed.¹⁰ The creation of the WTO represents a crucial difference in the trend towards free trade. International bodies now exist to manage the trade and protect individual domestic markets when problems arise, providing stability to the market.

Liberals believe that this was a critical shift from just bringing down barriers to actually setting up free and fair trading system. However, liberals are still skeptical of the ability of institutions to actually manage trade and would like trade to be completely free. The trend towards free trade is continuing with the importance of international bodies such as the WTO, which represents a neoliberal approach to free trade. The international political economy is not completely free because it has these intentional bodies that are meant to regulate the system, thus at the moment the international economy is emphasizing a neoliberal approach to trade.

This neoliberal trend toward free trade the world is experiencing is completely different from any other previous periods. For example, the world economy is more integrated than any prior time in history. By 1973 trade as a ratio of world GDP already exceeded the Golden Era's high and by the end of the 1990s it reached 17% and is still continuing to grow at a rapid rate.¹¹ Therefore, it is clear that trade is playing a larger role in the economy than ever before. Also, linkages with foreign markets are more complex than they have ever been because of the international trading system. Foreign exchange transactions for the purposes of investment now

¹⁰ Roger Schoenman, "The Post World War II International Trading System," Class lecture, International Political Economy from UC Santa Cruz, Santa Cruz, October 31, 2011.

¹¹ Joseph Greco and John Ikenberry, "Economic Globalization and Political Backlash," In *State Power and World Markets- International Political Economy*, 209.

dwarf transactions for the purposes of international trade in goods and services demonstrating that the period of free trade that the world is currently experiencing larger and more complex than it has been in any other period.¹²

The reason that free trade is higher than it has been in another period is because of the rise of globalization. This rise in globalization and trend towards free trade is increasing due to technology and changes in the international political conditions. Three types of technological change that encourage the trend towards free trade include: continuing improvements in transportation technology which reduce the cost of international exchanges of goods and services, advances in communications and computing technology which create new opportunities today for both trade and cross-national financial transactions and lastly multinational corporations becoming active in the world economy by using these previous methods.¹³ In addition to improved technology increasing the trend towards free trade international political conditions also have created an environment conducive to greater economic interconnections and freer trade. The international sphere has joined together to create the WTO and IMF in order to oversee the trading system, allowing nations to put their trust in trade. In addition to these international bodies, the international system has also come together to create international agreements facilitating trade and financial integration, limiting the risk involved in trading, spurring more nations to participate in international trade.

Overall, the trend towards freer trade is higher than it has ever been. This is due to the change in ideology and system from realist, protectionist system to a liberal, open system. The

¹² Ibid, 210.

¹³ Ibid, 220.

trend towards this liberal open system of free trade is also connected with the implementation of new international bodies such as the WTO, which facilitates the trading system. The combination of these international bodies and the rise in globalization is spurring the trend towards freer markets. Due to the increase in various technologies that come with globalization and the creation of an international sphere to manage this new system free trade will continue to prosper.

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