"Summary of article by James Crotty, Gerald Epstein, and Patricia Kelly: Multinational Corporations in the Neo-Liberal Regime" in Frontier Issues in Economic Thought, Volume 6: A Survey of Sustainable Development. Island Press: Washington DC, 2001. pp. 239-243

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A number of theories about the socio-economic effects of increased foreign direct investment (FDI) have emerged in recent decades. These include:

• "The race to the bottom" – increased mobility of MNC's allows them to play off workers, communities and nations against one another, hurting low-skilled workers and the unemployed while benefitting owners of capital and some professional workers.

• "The climb to the top" – competition for FDI will promote improved infrastructure, education, and economic growth. This is compatible with "neo-liberal convergence": the claim that capital and technology transfer will raise living standards in poorer countries and promote a lessening of international income gaps.

• "Uneven development" – some regions will benefit at the expense of others. In the theory of imperialism, the North exploits the South. More recently, there are fears that export-oriented growth in the South damages the North through competition with cheap Southern labor.

• "Much ado about nothing" – FDI is still a relatively small proportion of national GDP, and flows primarily among already developed nations and a handful of developing countries. It therefore has little effect on inequality, unemployment, or wages.

In this chapter, Crotty, Epstein and Kelly argue that within the current neo-liberal context, the "race to the bottom," is the most likely outcome of FDI. Their analysis focuses on aggregate demand for labor, domestic and international "rules of the game," and the nature of domestic and international competition. In particular, they examine the effects of these three factors on the relative bargaining power of firms and workers and on the ability of governments to capture benefits from FDI.

**Shift in Bargaining Power**

In the high-employment, high-growth era of the 1960's, outward flows of U.S. FDI were of about the same magnitude relative to GDP as they are today. But at that time, foreign investment often translated into increased exports for domestic companies. When companies did go abroad, the domestic demand for workers was high enough that the move did not increase the bargaining power of firms.

In contrast, the 1990's are characterized by a neo-liberal regime which is conducive to chronic unemployment, coercive competition, and destructive domestic and international rules of the game. The key components of this regime are: fiscal austerity; financial, trade and investment liberalization; privatization; and increased labor market flexibility.

In this context, the impact of FDI is much larger than its size as a proportion of GDP might suggest. The threat of mobility and its spillover effects transform labor markets to the detriment of workers and communities in both sending and receiving nations. Whether or not capital is actually transferred is not as important as the impacts of the bidding process, which creates a "magnification effect" of FDI.

Countries like the U.S. which have large inward and outward investment flows are vulnerable to these effects. "It is not only the *net* mobility of capital but also the problems associated with the possible destructive impact of *gross* mobility of capital in a particular setting," that affects wages, income equality and unemployment. (121) In addition, countries which receive little FDI may nonetheless suffer social losses as they engage in a bidding war to attempt to attract it.

**Trends in Direct Foreign Investment**

Global FDI flows have increased steadily since 1980 in gross and net terms, and as a proportion of GDP and capital formation in all major regions. While the distribution of FDI flows is uneven, with the bulk going to the most developed countries, the amount going to the developing world is also growing rapidly. MNC's also increasingly use licensing, joint ventures, and outsourcing, so that FDI flows understate the total global influence of MNC's. Technological change and computerization can partly account for the explosive growth of FDI. But equally important are changes in the "enforcement structure – the set of domestic and international institutions and rules that secure the property rights and enhance the prerogatives of multinational corporations." (122) Most of the changes in countries' regulatory regimes have been towards liberalization. New areas have been opened to FDI, approval processes streamlined, and firm's exit options strengthened. In addition, the collapse of communist economies, together with deliberate sabotage by the US and international organizations of alternative development models, has led to a widespread perception among governments that there is no alternative to integration into the global economy.

**An Alternative Framework for Analysis of FDI**

Some mainstream models of FDI allow for the possibility of uneven development or a race to the bottom. But almost all these models assume full employment. The model presented here does not assume full employment, and focuses on bargaining power and threat effects. In this model, MNCs will move to a new location as long as the benefits outweigh the fixed costs of moving. Communities trying to attract MNCs will "bid" by offering costs (measured in terms of wage and tax levels) which are sufficiently low to cover the fixed costs of moving. In response, communities that presently host MNCs must lower wages to a level equal to that of the community trying to attract the MNC minus the fixed cost of moving.

If the host communities cooperate with MNCs, the firms will not move, "but there will be a decline in wages induced by the threat of moving … the 'magnification effect'." (126) The effect is more pronounced when more than two countries are involved in the bidding process. Other bidders may receive little FDI, yet end up with reduced tax and wage rates, altering their distribution of income and reducing their level of public services.

Current global conditions are conducive to this model rather than to a mainstream full-employment model. Global competition has broken down the oligopolistic control, capital-labor cooperation, and high aggregate demand characteristic of the "Golden Age" of the 1950's and 60's. Thus firms have turned to conflictual rather than cooperative labor relations, and have initiated a coercive process of leveling-down. Stagnant wages and contractionary monetary policies keep aggregate demand low, increasing the need for communities to bid to attract employment. The liberalized "rules of the game" also reduce the bargaining powers of governments that subscribe to bilateral or multilateral investment agreements.

**Effects of FDI and MNC's on Wages, Employment, and Social Conditions**

There is considerable specific evidence supporting the hypothesis that FDI has negative effects on workers and communities. In the US, for example, manufacturing firms frequently threaten to close if workers unionize, and workers find these threats credible. Several studies indicate that increased FDI has reduced US employment by parent companies. Within the U.S., individual states commonly offer substantial increases in subsidies and tax breaks to attract investment. In developing nations, a review of empirical literature suggests that positive spillover effects from FDI on wage levels are small or nonexistent.

In East Asia, external forces pressured the state-led economies responsible for the "East Asian economic miracle" to adopt neo-liberal policies. Financial deregulation, open markets, and decontrol of capital flows created the conditions for a boom-and-bust cycle as massive inflows of speculative investment gave way to panic and equally massive outflows. The International Monetary Fund (IMF) further diffused neo-liberalism in Asia by conditioning the allocation of its rescue funds on the implementation of further liberalization policies and fiscal austerity. This allowed MNCs to use the IMF against labor unions and government to "win major labor concessions and to eliminate burdensome regulations." (131)

The successful "Swedish Model," characterized by a centralized bargaining structure, and a set of traditional relations and mutual obligations connecting business, labor and the state in the Golden Age, was also dismantled by the negative effects of FDI flows. A more free-market oriented position in the 1980's encouraged Swedish MNCs to locate a substantial amount of their resources outside Sweden and outsource high value-added, high-skilled segments of the production process. Thus high-growth industries with positive economic spillover effects were exchanged for low-skilled raw material processing and intermediate good production, and unemployment in Sweden rose to record levels.

**Policy Suggestions**

Measures which could be taken to reverse the negative impacts of the current neo-liberal regime include:

• To restore the faster global aggregate demand growth and lower unemployment levels that minimize the harmful effects of FDI, expansionary macroeconomic policies should be initiated by national governments and international institutions. Control of short-term capital flows may be required to assure that these policies are sustainable.

• A moratorium on all international agreements that liberalize FDI controls until an effective set of international rules governing FDI is implemented.

• An end to World Bank and IMF policies of pressuring developing countries to open their economies in exchange for credit.

• The establishment of international labor standards and corporate codes of conduct.

• Stronger national laws protecting union rights, improved social safety nets, and worker/community input into corporate governance.

• Stronger capital market regulation and Tobin taxes on short-term capital flows.

These and other measures to restrain coercive competition can alter the domestic and international context for FDI, and thus enable communities to capture more of the benefits of FDI flows. Globalization is not an irreversible juggernaut; its impacts can be steered by constructive policy action to change the “rules of the game”.